# TESCO PERSONAL FINANCE GROUP LTD

# PILLAR 3 DISCLOSURES

## FOR THE YEAR ENDED 29 FEBRUARY 2016

**CONTENTS:**

**Appendices:**



**Tables:**

## 1. Introduction and Basel Framework

This document presents the Pillar 3 disclosures on capital and risk management, together with comparatives, of the regulated group (the Group) for the year ended 29 February 2016. The Group represents Tesco Personal Finance Group Ltd and Tesco Personal Finance plc, but excludes the joint venture engaged in insurance (Tesco Underwriting Ltd) and the subsidiary engaged in non-financial activities (Tesco Personal Finance Compare Ltd). Tesco Personal Finance Compare Ltd ceased trading in the prior year and the subsidiary is currently in the process of being liquidated. The Group and its scope of consolidation are illustrated in section 3.

Pillar 3 disclosures have two principal purposes:

- to meet the regulatory disclosure requirements under Part Eight of the Capital Requirements Regulation (CRR), which along with the Capital Requirements Directive (CRD) is known as CRD IV, supplemented by any specific additional requirements of the Prudential Regulation Authority (PRA), and;
- to provide further useful information on the capital and risk profile of the Group.

The Group's capital was calculated for prudential regulatory reporting purposes for the year ended 29 February 2016, using the Basel III framework of the Basel Committee on Banking Supervision (BCBS), as implemented by the European Union in the amended CRD IV, and in the PRA's Rulebook for the UK banking industry.

The implementation of CRD IV is subject to transitional arrangements, with the full implementation date being 1 January 2019. As a result, the Group's capital position is reported in these disclosures by applying the CRD IV transitional arrangements, and also by applying the end point CRD IV (the 'fully loaded' basis). Appendix 7 details the various elements of the regulatory capital requirements that banks or other financial institutions are required to hold under the CRD IV fully loaded basis.

### Regulatory Framework for Disclosures

The Basel framework is structured around three pillars that are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes.

- Pillar 1 sets out the minimum capital requirements that firms are required to meet for credit, market and operational risk.
- The Pillar 2 supervisory review process requires firms and supervisors to take a view on whether a firm should hold additional capital against risks not taken into account or not fully covered in Pillar 1 (e.g. interest rate risk in the banking book and pension risk); and factors external to the firm (e.g. economic cycle effects). To comply, institutions are required to develop adequate arrangements, strategies, processes and mechanisms, to maintain sound management and coverage of their risks, including maintenance of the prescribed capital requirements.
- Pillar 3 aims to complement the capital requirements and supervisory review process by encouraging market discipline through developing a set of disclosure requirements that allow market participants to assess the scope of application, capital risk exposures, risk assessment process and capital adequacy of the firm.

## 2. Disclosure Policy

The Group has a formal, Board approved policy which details its approach in complying fully with the Pillar 3 disclosure requirements as laid out in Part Eight of the CRR.

### 2.1 Frequency of Disclosure

In accordance with that policy, the Group has assessed itself against the need to publish Pillar 3 disclosures more frequently than annually and has concluded that annual disclosures are sufficient:

- The Group does not operate in complex or diverse markets; and
- The Group does not meet the criteria requiring special assessment of the need to publish Pillar 3 disclosures more frequently than annually as outlined in the guidelines issued by the European Banking Authority on 23 December 2014 and adopted on 15 October 2015.

The frequency of disclosure will be reviewed at least annually against the criteria outlined in both the CRR and the guidelines issued by the European Banking Authority. A review of the frequency of disclosure will also be triggered should there be a material change in approach used for the calculation of capital, business structure or regulatory requirements.

### 2.2 Verification and Medium

The Pillar 3 disclosures have been verified and approved through internal governance procedures, including review and approval by the Disclosure Committee and the Board. The disclosures are not subject to audit except where they are the same as those prepared under accounting requirements and disclosed in the Annual Report and Financial Statements of both Tesco Personal Finance Group Ltd and Tesco Personal Finance plc (the Company).

The Pillar 3 disclosures are published on the Tesco Bank corporate website:

http://www.corporate.tescobank.com/48/accounts-and-disclosures

### 2.3 Use of Disclosure Waivers

The CRR allows institutions to omit one or more of the required disclosures if information provided by such disclosures is not regarded as material or if it would be regarded as proprietary or confidential (with the exception of disclosures relating to Own Funds, Remuneration and Diversity). The Group has not made use of any of the waivers available.

## 3. Scope of Consolidation

The Company, trading as Tesco Bank, provides a range of financial services and products primarily to personal customers under the Tesco Bank brand, mainly through telephony and on-line sales channels.

Products currently offered by the Company include unsecured personal loans, secured mortgages, savings accounts, credit cards, personal current accounts, travel money and general insurance products. The Company primarily trades in the UK but has limited international exposure through its Irish credit card business.

### 3.1 Statutory Accounting Consolidation

Tesco Personal Finance Group Ltd operates as a holding company with 100% ownership of the Company and Tesco Personal Finance Compare Ltd. Tesco Personal Finance Compare Ltd ceased trading in the prior year and the subsidiary is currently in the process of being liquidated.

The Company holds 49.9% of Tesco Underwriting Ltd which is a joint venture company (jointly held with Ageas UK Ltd) and is equity accounted in the Annual Report & Financial Statements. Tesco Underwriting Ltd underwrites household and motor insurance and provides claims management services for these products. The Delamare securitisation structured entities are fully consolidated in the statutory group.

Consolidated Annual Reports and Financial Statements for both Tesco Personal Finance Group Ltd and the Company are prepared in accordance with International Financial Reporting Standards (IFRS), the interpretations of the IFRS Interpretations Committee (IFRIC), the Disclosure and Transparency rules of the Financial Conduct Authority (FCA) and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

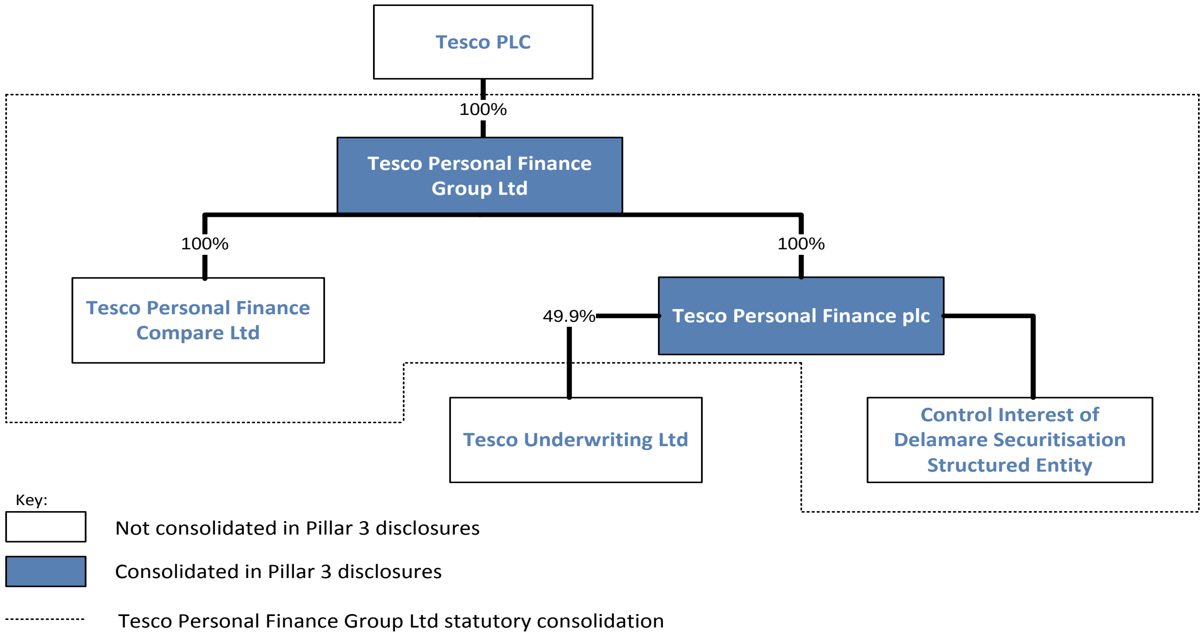
### 3.2 Regulatory Consolidation

The basis of consolidation for regulatory reporting purposes differs from the one used for statutory accounting (and therefore represented in the Annual Report & Financial Statements of Tesco Personal Finance Group Ltd).

The joint venture engaged in Insurance (Tesco Underwriting Ltd) and Tesco Personal Finance Compare Ltd (previously engaged in non financial activities) are not consolidated within the Group's Pillar 3 disclosures.

The securitisation undertaken via Delamare Securitisation structured entities does not meet the criteria for significant risk transfer, and accordingly the assets securitised are shown as assets of the Group within section 6, as part of Retail exposures. The securitisation is discussed in more detail in section 8.

The differences between the regulatory and statutory consolidation are illustrated in the following diagram:




The Group is regulated and supervised by the PRA and the FCA. The Company does not make use of the solo consolidation waiver provisions.

### 3.3 Comparability

The differences outlined above between the statutory and regulatory scope prevent direct comparison between the Annual Report & Financial Statements of Tesco Personal Finance Group Ltd and the Group's Pillar 3 disclosures in a number of areas.

To aid users, a statutory and regulatory scope balance sheet together with a reconciliation showing all items affecting regulatory own funds[1] is detailed in Table 1, as required by CRR Article 437(1) point (a). Table 2 shows the reconciliation of the regulatory scope balance sheet through to credit risk exposures, with the main differences being:

- Pillar 3 exposure values are derived from Balance Sheet values, net of provisions where appropriate, together with undrawn credit facilities which are assigned credit conversion factors based on prescribed regulatory values. As at 29 February 2016, the Group has circa £11.9bn of undrawn credit facilities of which £11.8bn relate to committed undrawn credit card facilities and £0.1bn relates to final offer mortgage agreements.
- The Group is required under the CRR to make certain adjustments to own funds, the most material being in relation to intangible assets and dated Tier 2 capital instruments.

### 3.4 Restrictions on the Transfer of Own Funds

There are restrictions on the ability of the Company to make distributions of cash or other assets to Tesco Personal Finance Group Ltd for the following reasons:

- Assets pledged as collateral: These assets are not available for transfer by the Company to Tesco Personal Finance Group Ltd.
- Regulatory capital requirements: As a regulated entity, the Company is subject to requirements to maintain minimum levels of capital, hence restricting the ability to make distributions of cash or other assets to Tesco Personal Finance Group Ltd.

[1] During transitional period to 31 December 2017, derogation has been provided and institutions are required to disclose specific items on own funds on a transitional basis, refer to Appendix 3 for the Group's disclosure.

## Table 1: Reported Balance Sheet under the Regulatory Scope of Consolidation

| | Appendix 3 | February 2016 Accounting Balance sheet (per financial statements) £m | Deconsolidation of Tesco Underwriting Ltd and Tesco Personal Finance Compare Ltd [1] £m | Regulatory Scope £m | February 2015 Accounting Balance sheet (per financial statements) £m | Deconsolidation of Tesco Underwriting Ltd and Tesco Personal Finance Compare Ltd [1] £m | Regulatory Scope £m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with central banks | | 567.3 | - | 567.3 | 628.7 | (2.4) | 626.3 |
| Loans and advances to banks | | - | - | - | - | - | - |
| Loans and advances to customers | | 8,545.7 | - | 8,545.7 | 7,725.3 | - | 7,725.3 |
| *of which: latent provisions* [2] | a | - | - | *(44.6)* | - | - | *(36.1)* |
| Derivative financial instruments | | 29.3 | - | 29.3 | 31.7 | - | 31.7 |
| Investment securities: | | | | | | | |
| - Available for sale | | 983.6 | - | 983.6 | 827.3 | - | 827.3 |
| *of which: non-significant investment below threshold* | b | - | - | *3.5* | - | - | - |
| - Loans and receivables | | 34.1 | - | 34.1 | 34.1 | - | 34.1 |
| *of which: loan to Tesco Underwriting Ltd deducted from Tier 1 pre-CRR* [2] | c | - | - | *6.8* | - | - | *10.2* |
| *of which: loan to Tesco Underwriting Ltd deducted from Tier 2 pre-CRR* [2] | d | - | - | *6.8* | - | - | *10.2* |
| *of which: loan to Tesco Underwriting Ltd deducted from Tier 2 CRR* [2] | e | - | - | *20.5* | - | - | *13.7* |
| Prepayments and accrued income | | 43.1 | (0.1) | 43.0 | 41.0 | - | 41.0 |
| Current income tax asset | | 1.7 | - | 1.7 | 4.5 | - | 4.5 |
| Other assets | | 277.1 | 0.3 | 277.4 | 200.5 | 4.0 | 204.5 |
| Investment in group undertakings | | - | - | - | - | 2.4 | 2.4 |
| Investment in joint venture | | 76.1 | (5.1) | 71.0 | 79.7 | (8.7) | 71.0 |
| *of which: significant investment in TU below threshold* [2] | f | - | - | *71.0* | - | - | *71.0* |
| Intangible assets | | 363.9 | - | 363.9 | 402.6 | - | 402.6 |
| *of which: other intangibles* [2] | g | - | - | *363.9* | - | - | *402.6* |
| Property, plant and equipment | | 78.9 | - | 78.9 | 86.4 | - | 86.4 |
| **Total assets** | | **11,000.8** | **(4.9)** | **10,995.9** | **10,061.8** | **(4.7)** | **10,057.1** |
| **Liabilities and Equity** | | | | | | | |
| Deposits from banks | | 82.0 | - | 82.0 | 106.5 | - | 106.5 |
| Deposits from customers | | 7,397.2 | - | 7,397.2 | 6,913.5 | - | 6,913.5 |
| Debt securities in issue | | 1,206.6 | - | 1,206.6 | 898.0 | - | 898.0 |
| Derivative financial instruments | | 150.5 | - | 150.5 | 86.9 | - | 86.9 |
| Provision for liabilities and charges | | 58.2 | - | 58.2 | 90.1 | - | 90.1 |
| Accruals and deferred income | | 128.2 | - | 128.2 | 120.0 | - | 120.0 |
| Current income tax liability | | - | - | - | - | - | - |
| Other liabilities | | 142.9 | 0.2 | 143.1 | 143.0 | 4.0 | 147.0 |
| *of which: debit valuation adjustment* [2] | h | - | - | *(0.8)* | - | - | *(0.1)* |
| Deferred income tax liability | | 31.0 | - | 31.0 | 39.8 | - | 39.8 |
| *of which: deferred tax liability - intangible assets* [2] | i | - | - | *26.5* | - | - | *37.8* |
| Subordinated liabilities | | 235.0 | - | 235.0 | 190.0 | - | 190.0 |
| *of which: allowable for Tier 2* [2] | j | - | - | *235.0* | - | - | *190.0* |
| **Total liabilities** | | **9,431.6** | **0.2** | **9,431.8** | **8,587.8** | **4.0** | **8,591.8** |
| **Equity** | | | | | | | |
| Shareholders funds | | | | | | | |
| Called up share capital | | 122.0 | - | 122.0 | 122.0 | - | 122.0 |
| *of which: amount eligible for CET1* [2] | k | - | - | *122.0* | - | - | *122.0* |
| Share premium account | | 1,098.2 | - | 1,098.2 | 1,098.2 | - | 1,098.2 |
| *of which: amount eligible for CET1* [2] | l | - | - | *1,098.2* | - | - | *1,098.2* |
| Retained earnings | | 321.9 | (5.3) | 316.6 | 186.2 | (7.9) | 178.3 |
| *of which: prior year retained profits* [2] | m | - | - | *178.3* | - | - | *98.9* |
| *of which: current year profit less dividend paid* [2] | n | - | - | *138.4* | - | - | *79.4* |
| Other reserves | o | 27.1 | 0.2 | 27.3 | 22.6 | (0.8) | 21.8 |
| *of which: other comprehensive income - gain on Available For Sale* [2] | | - | - | - | - | - | - |
| *of which: cash flow hedge reserve* [2] | p | - | - | *1.6* | - | - | *0.7* |
| Subordinated notes | | - | - | - | 45.0 | - | 45.0 |
| *of which: Tier 2* [2] | | - | - | - | - | - | *45.0* |
| **Total equity** | | **1,569.2** | **(5.1)** | **1,564.1** | **1,474.0** | **(8.7)** | **1,465.3** |
| **Total liabilities and equity** | | **11,000.8** | **(4.9)** | **10,995.9** | **10,061.8** | **(4.7)** | **10,057.1** |

## Notes:

[1] Insurance and non-financial undertakings are not consolidated within the Group's Pillar 3 disclosures, therefore the assets and liabilities of Tesco Personal Finance Compare Ltd require to be removed from the consolidated statutory accounting balance sheet of Tesco Personal Finance Group Ltd. Adjustments are also required to the assets and liabilities relating to Tesco Underwriting Ltd to remove the impact of equity accounting.

[2] Italicised values represent subsets of values directly above them, and also show the splits between Tier 1 and Tier 2 Capital subsequently detailed in Table 3: Capital Resources.

## Table 2: Regulatory Balance Sheet to Credit Risk Exposures

| February 2016 | Regulatory scope | Assets deducted from own Funds [1] | Provisions [2] | Off Balance Sheet [3] | Other adjustments [4] | Total credit risk exposures |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| **Regulatory balance sheet category** | | | | - | - | |
| Cash and balances with central banks | 567.3 | - | - | - | - | **567.3** |
| Loans and advances to banks | - | - | - | - | 20.4 | **20.4** |
| Loans and advances to customers | 8,545.7 | - | 44.6 | - | - | **8,590.3** |
| Derivative financial instruments | 29.3 | - | - | - | - | **29.3** |
| Investment securities: | | - | - | - | - | |
| - Available for sale | 983.6 | - | - | - | - | **983.6** |
| - Loans and receivables | 34.1 | (34.1) | - | - | - | **-** |
| Prepayments and accrued income | 43.0 | - | - | - | - | **43.0** |
| Current income tax asset | 1.7 | - | - | - | - | **1.7** |
| Other assets | 277.4 | - | - | - | - | **277.4** |
| Investment in group undertakings | - | - | - | - | - | **-** |
| Investment in joint venture | 71.0 | - | - | - | - | **71.0** |
| Intangible assets | 363.9 | (363.9) | - | - | - | **-** |
| Property, plant and equipment | 78.9 | - | - | - | - | **78.9** |
| **Total assets** | **10,995.9** | **(398.0)** | **44.6** | | **20.4** | **10,662.9** |
| **Credit converted balances and potential future credit exposure (PFCE)** | **-** | **-** | **-** | **48.2** | **-** | **48.2** |
| **Total** | **10,995.9** | **(398.0)** | **44.6** | **48.2** | **20.4** | **10,711.1** |

| February 2015 | Regulatory scope | Assets deducted from own Funds [1] | Provisions [2] | Off Balance Sheet [3] | Other adjustments [4] | Total credit risk exposures |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| **Regulatory balance sheet category** | | | | | | |
| Cash and balances with central banks | 626.3 | - | - | - | - | **626.3** |
| Loans and advances to banks | - | - | - | - | - | **-** |
| Loans and advances to customers | 7,725.3 | - | 36.1 | - | - | **7,761.4** |
| Derivative financial instruments | 31.7 | - | - | - | - | **31.7** |
| - Investment securities: | - | - | - | - | - | **-** |
| - Available for sale | 827.3 | - | - | - | - | **827.3** |
| Loans and receivables | 34.1 | (34.1) | - | - | - | **-** |
| Prepayments and accrued income | 41.0 | - | - | - | - | **41.0** |
| Current income tax asset | 4.5 | - | - | - | - | **4.5** |
| Other assets | 204.5 | - | - | - | - | **204.5** |
| Investment in group undertakings | 2.4 | - | - | - | - | **2.4** |
| Investment in joint venture | 71.0 | - | - | - | - | **71.0** |
| Intangible assets | 402.6 | (402.6) | - | - | - | **-** |
| Property, plant and equipment | 86.4 | - | - | - | - | **86.4** |
| **Total assets** | **10,057.1** | **(436.7)** | **36.1** | - | - | **9,656.5** |
| **Credit converted balances and potential future credit exposure (PFCE)** | - | - | - | **44.4** | - | **44.4** |
| **Total** | **10,057.1** | **(436.7)** | **36.1** | **44.4** | - | **9,700.9** |

### Notes:

[1] Assets that are ultimately deducted from own funds comprising material holding in Tesco Underwriting Ltd and intangible assets (relating to computer software in relation to the Group's operational platform). These are treated as a deduction from capital.

[2] Incurred but not reported provisions are added back in the calculation of credit risk exposures.

[3] Credit risk exposures reflect both drawn balances, as well as an allowance for undrawn commitments and contingent liabilities that are determined using a credit conversion factor to estimate the proportion expected to be drawn down at point of default.

[4] Other adjustments reflect a late settlement transaction which subsequently settled on 1 March 2016. Note, the risk weighted assets with regards to the settlement risk arising on the transaction is not material and has been included within Table 5, as part of counterparty credit risk.

## 4. Risk Management

There is a formal structure for reporting, monitoring and managing risks across the Group. This comprises, at its highest level, the Risk Appetite approved by the Board, which is supported by a detailed risk management framework (including policies and supporting documentation), independent governance and risk oversight.

The Enterprise Wide Risk Management Framework has been embedded across the business, and extends to all major risk categories affecting the Group. The framework is underpinned by governance, controls, processes, systems and policies within the first line business areas and those of the second line Risk Management function.

The Chief Risk Officer performs a strategic risk management role, and is responsible for managing and enhancing the Enterprise Wide Risk Management Framework. The Chief Risk Officer is independent from any commercial function, and reports directly to the Chief Executive Officer.

The Group is committed to embedding a strong risk culture throughout the business where everyone understands the risks they personally manage and is empowered and qualified to be accountable for them. The Group embraces a culture where each business area is encouraged to take risk–based decisions, whilst knowing when to escalate or seek advice. The Group also promotes a culture where there is no fear of escalating bad news or emerging risks through use of the Event Management Process. This process provides tools and techniques to identify, assess and manage events through to closure, which have an actual or potential negative impact on our customers, colleagues, operational capability, financial position or the reputation of the Group.

### 4.1 Risk Statement

The Group's strategic objective is to be the bank for Tesco customers – rewarding their loyalty and earning their trust. The Group operates with a strong customer focus and provides simple, transparent products which aim to deliver value for customers. The Group's strategy is pursued within a defined Risk Appetite.

The Board expresses the Risk Appetite through a number of key measures which define the level of risk acceptable. These are grouped into two main categories:

**Financial:** Capital, liquidity and credit risks.

**Reputational:** Operational, people, customer, regulatory and external reputational risks.

A suite of Risk Appetite measures is used by the Group to support the overarching objective to manage profit volatility within prescribed limits. The profit volatility limits seek to ensure that the Group remains profitable under severe market or economic stress conditions. The Group stayed within the limits throughout the year.

Risk Appetite measures are integrated into decision making, monitoring and reporting processes, with early warning trigger levels set to drive any required corrective action before overall tolerance levels are reached.

The Board maintains a Risk Appetite which is regularly monitored with formal reviews of the risk measures, in conjunction with the long term plan process.

The Risk Appetite and measures are discussed throughout the document.

### 4.2 Board Declaration - Adequacy of the Risk Management Arrangements

The Board of Directors is ultimately responsible for the Group's risk management framework. The Enterprise Wide Risk Management Framework is the combination of systems, structures, policies, processes and people within the Group that identify, assess, mitigate and monitor all internal and external sources of risk that could have a material impact on its operations.

The Board provides an annual declaration on the adequacy of the Group's risk management arrangements and provides assurances that the risk management systems in place are adequate and in line with Risk Appetite. This is provided in Appendix 1 of this document.

### 4.3 Risk Appetite

The Group maintains a Risk Appetite which defines the type and amount of risk that the Group is prepared to accept to achieve its objectives and forms a key link between the day to day risk management of the business, its strategic objectives, long term plan, capital planning and stress testing.

The Risk Appetite is formally reviewed and approved by the Board on an annual basis.

The Group's Risk Appetite comprises a suite of measures, covering financial and reputational (operational, people, customer, regulatory and external reputational) risks all of which are underpinned by corresponding measures with agreed triggers and limits.

The Board approves the Group's business plans, budget, long term plan, internal capital adequacy assessment process, individual liquidity adequacy assessment process and any material new product lines. The Board also monitors the Group's risk profile and capital adequacy position. The Group employs hedging and mitigation techniques defined within the Group's policies, to ensure risks are managed within Risk Appetite.

### 4.4 Approach to Risk Management

The Group has adopted the 'three lines of defence' model of governance with clearly defined roles and responsibilities to help drive effective risk management:

**First line of defence** – senior management within each business area are responsible for:

- establishing an effective control framework within their area of operation;
- identifying and controlling all risks so that they are operating within the defined Risk Appetite;
- ensuring that they are fully compliant with Group policies and, where appropriate, operating within defined thresholds; and
- devising, managing and reporting against appropriate key risk indicators, using management information and assurance processes to allow assessment of their control framework to manage key risks as they arise in their area of operation.

**Second line of defence** - the Risk Management function is responsible for:

- proposing to the Board appropriate objectives and measures to define the Group's Risk Appetite;
- devising the suite of policies necessary to control the business, including the overarching framework for independent monitoring of the risk profile; and
- providing oversight, challenge and additional assurance where required.

The Risk Management function uses expertise and provides frameworks, tools and techniques to assist management in meeting its responsibilities, as well as acting as a central co-ordinator to identify enterprise wide risks and make recommendations to address them.

**Third line of defence** – this comprises the Internal Audit function which is responsible for providing independent assurance to the Board and senior management on the adequacy of the design and operational effectiveness of internal control systems. The internal audit function has an independent reporting line to the Audit Committee.

### 4.5 Enterprise Wide Risk Management Framework Components

The scope of the Enterprise Wide Risk Management Framework extends to all major risk categories faced by the Group and is underpinned by governance, controls, processes, systems and policies within the second-line risk function and those of the first-line business areas. The key components to manage and control risks effectively are outlined below, with the risk governance structure detailed separately in section 4.4.

#### i) Policies

The Group has a framework of key policies in place which are approved at Board and Executive level committees. Each policy is owned by a specific individual who is responsible for maintenance and assurance of the policy. Each policy must be reviewed on at least an annual basis to ensure its continued effectiveness and applicability in line with changing risks.

The Risk Management function provides tracking and oversight of the policy framework and is responsible for undertaking assurance and providing reports to the Board on its effectiveness.

#### ii) Risk Identification

The risk identification process provides guidance on the sources to be investigated in order to identify new and emerging risks and sets out consistent principles which should be applied. New and emergent risks and the recommended response to them are reported by the Risk Management function to relevant governance bodies.

#### iii) Risk Assessment

The risk assessment process is the means by which the Group understands and estimates the effect of risk on the business, processes, systems and controls that mitigate those risks to an acceptable level. These assessments are reported to the Board on a regular basis.

### iv) Risk Management Function

The independent Risk Management function operates under the leadership of the Chief Risk Officer, who is a member of the Board. Risk teams reporting to the Chief Risk Officer, are the second line of defence within the Enterprise Wide Risk Management Framework, and are resourced by people with expertise in each of the principal risks faced by the Group. This enables appropriate analysis, challenge, understanding and oversight of each of the principal risks.

The Risk Management function has responsibility for integrated risk reporting, providing aggregation and consolidation to ensure that risk coverage is considered holistically and that there is clear ownership of the risks and issues.

The Group monitors and tracks current exposures against limits defined in the agreed Risk Appetite and by the regulators. Exceptions are reported on a monthly basis to the Asset and Liability Management Committee, Risk Management Committee (RMC), and to each meeting of the Board Risk Committee. Adherence to these limits is independently monitored, measured and reported using a suite of key risk indicators defined by the relevant risk team. Decisions made at subordinate risk committees and forums are reported up to senior committees as appropriate.

### v) Stress Testing

Stress testing is a key element of the Enterprise Wide Risk Management Framework. Key risks are subject to stress testing and scenario analysis with the Group's business plans being subjected to severe adverse impact scenarios to assess the potential impact on the business including projected capital and liquidity positions. The results of stress testing, along with proposed actions are reported to the RMC, Asset and Liability Management Committee and Board Risk Committee. These are captured in both the internal liquidity adequacy assessment process and the internal capital adequacy assessment process.

### vi) Integrated Risk Processes

The Group's integrated risk processes include the linking of Risk Appetite to business plans and associated capital and liquidity requirements.

The Group is required to submit internal capital adequacy assessment process reports which set out future business plans, the impact on capital availability, capital requirements and the risks to capital adequacy under stress scenarios, to the PRA.

The Group also maintains a Recovery and Resolution plan that provides the framework and a series of recovery options which could be deployed in the event of a severe stress that impacts capital or liquidity positions. The Recovery and Resolution plan is reviewed and approved by the Board on at least an annual basis.

## 4.6 Risk Governance Structure

The Group has established a governance structure which is appropriate for the business in terms of its level of complexity and risk profile. This structure is continually reviewed so that it remains suitable to support the business. The risk governance structure set out in these disclosures describes the structure that was in place for the year to 29 February 2016.

The Board is the key governance body and is responsible for overall strategy, performance of the business and ensuring appropriate and effective risk management, in line with the approved Risk Appetite.

The Board has delegated responsibility for the day to day running of the business to the Chief Executive who has in turn established the Executive Committee (ExCo) to assist in the management of the business and delivery of strategy in an effective and controlled way.

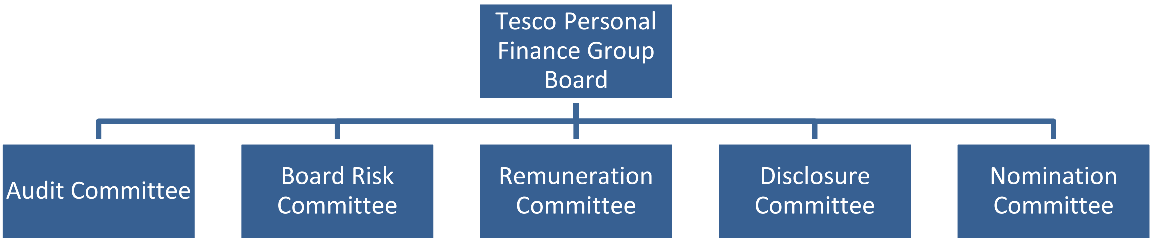
The Board has established Board Committees and senior management committees to:

- oversee the Enterprise Wide Risk Management Framework;
- identify the key risks facing the Group; and
- assess the effectiveness of risk management actions.

In order to consider high level matters which require cross functional oversight and engagement, the ExCo has established a series of sub-committees which report directly to it.

### 4.6.1 The Board

The Board has overall responsibility for the business. It sets the Risk Appetite and strategic aims for the business, in some circumstances subject to shareholder approval, within a control framework which is designed to enable risk to be assessed and managed. The Board satisfies itself that financial controls and systems of risk management are robust. In order to support effective governance and management of the wide range of responsibilities, the Board has established the following five sub-committees:




| Board Committee | Committee Purpose |
| --- | --- |
| Audit Committee | The key responsibilities of the Committee are to:<br>▪ review and recommend to the Board for approval the Financial Statements;<br>▪ monitor accounting policies and practices for compliance with relevant standards;<br>▪ review the scope and results of the annual external audit;<br>▪ consider the effectiveness of the external auditors and their independence;<br>▪ maintain a professional relationship with the external auditor;<br>▪ examine the arrangements in place to enable management to comply with requirements and standards under the regulatory system;<br>▪ oversee the internal audit function and the internal audit programme;<br>▪ work closely with the Board Risk Committee to avoid, as much as possible, any overlap or gap in the overall risk and assurance activities of the two committees;<br>▪ carry out such investigations or reviews as shall be referred to it by the Board;<br>▪ approve the annual plan of Risk Assurance activity within Tesco Bank;<br>▪ receive and review reports, findings and recommendations from Risk;<br>▪ review and consider the adequacy of any follow up action, and any relevant investigation work, carried out by or on behalf of Risk;<br>▪ review and monitor management's response to findings and recommendations following investigations carried out by Risk; and<br>▪ review the findings of external assurance reports provided by outsourced providers.<br><br>Further detail on the Audit Committee is included within the Directors' Report in the Annual Report and Financial Statements of both the Group and the Company.<br><br>The Audit Committee has met seven times during the year ended 29 February 2016. |
| Board Risk Committee | The role of the Board Risk Committee includes:<br>• the oversight and challenge of the Group's Risk Appetite and the recommendation to the Board of any changes to Risk Appetite;<br>• the assessment of future risks;<br>• the review and challenge, where appropriate, of the outputs from the Asset and Liability Management Committee and RMC; and<br>• to oversee that a supportive risk culture is appropriately embedded in the business.<br><br>The Board Risk Committee met six times during the year ended 29 February 2016. |

| | |
|---|---|
| Remuneration Committee | The role of the Remuneration Committee is:<br>• to determine and approve remuneration arrangements for all identified (Code) staff within the Group as defined in the FCA's Remuneration Code;<br>• to approve a remuneration framework for those employees of the Group below the leadership level;<br>• to align, where appropriate, remuneration in the Group with Tesco PLC Group Reward policy;<br>• to design the levels and structure of remuneration necessary to attract, retain, and motivate the management talent needed to run the Group's business in a way which is consistent with the Risk Appetite and ongoing sustainability of the business; and<br>• to confirm that remuneration policy in the Group is compliant with all applicable legislation, regulation and guidelines.<br>The Remuneration Committee met five times during the year ended 29 February 2016. |
| Disclosure Committee | The Disclosure Committee is responsible for ensuring compliance with relevant legal and regulatory obligations in relation to the timing, accurate disclosure and announcement of information.<br>The Disclosure Committee also reviews, on behalf of the Board, certain legal or regulatory disclosures ahead of publication and makes recommendations to the Board as appropriate.<br>The Disclosure Committee has met twice during the year ended 29 February 2016. |
| Nomination Committee | The role of the Nomination Committee includes:<br>• reviewing the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and making recommendations to the Board with regard to any changes;<br>• reviewing the leadership needs of the organisation, both executive and non-executive, with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace;<br>• formulating plans for succession for both executive and non-executive directors and in particular for the key roles of chairman and chief executive; and<br>• identifying and nominating for the approval of the Board, candidates to fill board vacancies as and when they arise.<br>The Nomination Committee has met three times during the year ended 29 February 2016. |

#### 4.6.2 Executive Committee (ExCo)

The Group's Board has delegated the day to day running of the business to the Chief Executive who has in turn established the ExCo to assist in the management of the business and delivery of strategy in an effective and controlled way.

The ExCo has the following principal roles and responsibilities:

- to authorise certain levels of spend;
- to provide general executive management of the Group and to monitor performance including financial performance, in accordance with the approved strategic plan and risk appetite as approved by the Board;
- to oversee risks and controls across the business;
- to promote a culture of fairness and to actively promote and encourage the Values;
- to strive for the successful execution of strategy;
- to set out a framework of reporting to the Board that is sufficient to enable the Board to fulfil its responsibilities;

- to review strategic plans, budgets and all other matters to be referred to the Board, with regard to the interests of its shareholder, employees, customers and other stakeholders, prior to submission to the Board for approval;
- to review, challenge and provide direction relating to the delivery of fair outcomes for customers through regular updates on Conduct Risk that are challenged and reviewed by the Conduct Committee;
- to determine whether to launch the Group's Recovery Plan in the event of a breach of a recovery trigger and to manage the crisis thereafter (with the exception of a liquidity crisis that would be managed by the Liquidity Event Management Committee); and
- to oversee Procurement and Supplier Management, with particular focus on ensuring that the key risks associated with outsourcing and third party supplier management are assessed and mitigated.

Each ExCo member is accountable to the Chief Executive and to the Board, for managing performance in line with the Group's long term plan, strategy, annual budget and Risk Appetite.

In order to support the ExCo, the following six sub-committees have been established:


| **ExCo Sub Committee** | **Committee Purpose (Summary)** |
|---|---|
| Conduct Committee | The principal role of the Conduct Committee is to provide review and challenge relating to the delivery of fair outcomes for customers by each business area. |
| Asset & Liability Management Committee | The principal role of the Asset and Liability Management Committee is:<br>• to optimise the Group's balance sheet structure within boundaries and Risk Appetite set by the Board and regulation; and<br>• to identify, manage and control the Group's balance sheet risks in the execution of its chosen business strategy.<br>The Asset and Liability Committee has three sub-committees; the Liquidity Management Forum, Market Risk Forum and Capital Management Forum. |
| Risk Management Committee (RMC) | The principal role of the RMC is to ensure that there is effective management and control of all key risks and issues facing the Group.<br>The following seven sub-committees support the RMC in discharging its duties:<br>• Financial Crime, Operational and Regulatory Risk Committee;<br>• Credit Risk Management Committee;<br>• Wholesale Credit Risk Forum;<br>• Operational Resilience Steering Committee;<br>• Supplier Management Group;<br>• Banking Price Models Committee; and<br>• Policy Framework Committee.<br>The RMC met ten times during the year ended 29 February 2016. |
| People Matters Group | The principal role of People Matters Group is to lead the People Agenda to ensure it meets the needs of customers and employees. |

| | |
|---|---|
| Insurance Executive Committee | The principal role of the Insurance Executive Committee is to monitor the performance of the Group's Insurance business against strategy and goals.<br>The Insurance Management Committee helps the Insurance Executive Committee to discharge its responsibilities. |
| Banking Executive Committee | The principal role of the Banking Executive Committee is to monitor the performance of the Group's Banking business against strategy and goals. |

### 4.7 Risk Assurance

Risk assurance is undertaken by way of a co-ordinated risk assurance plan devised by the second and third lines of defence, paying particular attention to the key risks and issues facing the business. Both the second and third lines of defence report their findings and track actions via the Audit Committee.

The Audit Committee obtains assurance of the internal control and risk management environment through an agreed programme of audits carried out by the Internal Audit function and risk assurance work carried out by the Risk Management function.

The plan of Risk Assurance activity is supplemented by a series of quarterly Risk and Control Self Assessments carried out by the first line of defence teams.

### Internal Audit

The primary role of Internal Audit is to help the Board and ExCo to protect the assets, reputation and sustainability of the Group by:

- assessing whether all significant risks are identified and appropriately reported by business management, and the Risk Management function, to the Board and ExCo;
- assessing whether they are adequately controlled; and
- challenging the ExCo on the effectiveness of governance, risk management and internal controls.

The Internal Audit function achieves this through the following core responsibilities:

- to propose an annual audit plan based on its understanding (after discussion with management) of the significant potential risks to which the organisation could be exposed;
- to carry out audits of functions and processes in accordance with the annual audit plan and any additional special investigations requested by management, the Board, the Audit Committee or the regulators;
- to assess the adequacy and effectiveness of the controls in the functions and processes audited, and to issue recommendations for improvement based on the results of work carried out;
- to verify compliance with those recommendations; and
- to report to the Audit Committee in relation to Internal Audit matters.

In addition to the above, Internal Audit also provide feedback and challenge on the effectiveness of the Group's control framework through attendance at relevant governance committees and through stakeholder management meetings.

## 5 Capital Management

The Board has ultimate responsibility for capital management and capital allocation. Day to day responsibility for capital planning and other aspects of capital management are delegated to the Treasury Director. Stress testing and preparation of the internal capital adequacy assessment process is delegated to the Risk Management function.

The Group undertakes the annual internal capital adequacy assessment process, capital planning and long term plan processes, which are all approved by the Board. The Group's capital plan and management actions seek to ensure that there is an adequate capital base to support the business and strategic objectives. Capital adequacy and performance against capital plan is monitored on a daily basis by Treasury with monthly reporting provided to the Board, the Asset and Liability Management Committee and the Capital Management Forum. The Asset and Liability Management Committee is the main body responsible for monitoring all aspects of capital planning, including the review and recommendation of capital injections into subsidiaries of the Group, prior to submission to the Board for approval.

The internal capital adequacy assessment process considers all of the known risks faced by the Group, the probability of these risks occurring and how these are mitigated to derive the amount of Pillar 2 capital that is deemed appropriate to hold to absorb losses in a normal environment and in a stress scenario.

The Chief Financial Officer is responsible for the financial governance of the Group and its financial, management, statutory, regulatory and treasury reporting. Risks inherent in these processes and the effectiveness of the controls are assessed and managed in line with the Risk and Control Self Assessment framework. These are designed to comply with:

- statutory and regulatory disclosure requirements;
- the Group's policies; and
- the responsibilities of the first line of defence.

The PRA in its capacity as supervisor of the UK banking industry sets targets for, and monitors, the capital adequacy of the Group. Capital adequacy returns are submitted for the Group and the Company on a quarterly basis to the regulator. During the 12 month accounting period to 29 February 2016, the Group and Company fully complied with all capital requirements and operated well within the regulatory requirements determined by the regulator.

### 5.1 Pillar 1 – application within the Group

Pillar 1 covers the capital resource requirements for credit risk, market risk and operational risk.

The regulatory minimum amount of total capital is determined as 8% of the aggregate risk weighted assets and the Pillar 1 capital requirements referenced in this document are calculated using this regulatory minimum value.

The Group has adopted the standardised approach for calculating Pillar 1 minimum capital requirements for credit risk, operational risk and market risk as detailed below. The standardised approach uses standard industry-wide risk weightings, prescribed by the regulator, based on a detailed classification of asset types. It requires banks to use external credit ratings to determine the risk weightings for rated counterparties. Other counterparties are grouped into categories with set risk weightings applied to each.

- Calculation of capital for credit risk (Section 6): Credit risk is the potential that a borrower or counterparty fails to repay the interest or capital on a loan or other financial instrument. Principal sources of exposures include; loans and advances, debt securities, commitments and contingent liabilities.

  The risk weighted assets calculation for credit risk exposures is based on an estimate of the exposures at default (EAD). In determining EAD amounts, credit conversion factors are applied to undrawn commitments.

- Calculation of capital for Counterparty Credit Risk (CCR) (Section 7): CCR is 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-dated settlement transactions. As at 29 February 2016, the Group has circa £82m security financing transactions in the form of repo transactions and has no long-dated settlement transactions.

  The Group uses the CCR mark-to-market method to measure exposure value calculated as: market value plus an add-on for potential future exposure, prior to being risk weighted under the standardised approach.

- Calculation of the Credit Valuation Adjustment capital charge**:** The credit valuation adjustment amends the fair value of derivative assets to reflect the creditworthiness of the counterparty. It represents the capital charge for potential mark-to-market losses due to the credit quality deterioration of a counterparty that does not necessarily end with a default.

  The Group adopts the standardised approach that takes account of the external credit rating of the counterparty, incorporating the effective maturity and EAD from the CCR calculation.

- Calculation of capital for equity: all equity exposures are calculated under the standardised approach.
- Calculation of capital for securitisation and covered bond exposures (Section 8): A separate regulatory framework exists for the calculation of risk weighted assets relating to securitisation exposures. The Group enters into securitisation transactions in which it assigns credit card receivables to a structured entity (Delamare Cards Receivables Trustee Ltd). The securitisation does not meet the criteria for a significant risk transfer, and accordingly the assets securitized are shown as assets of the Group within Section 6 as part of Retail Credit Risk exposures. The securitisation is discussed in more detail in Section 8.
- Calculation of capital for operational risk (Section 9): Operational Risk is defined as 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.

  The Group calculates Pillar 1 Operational Risk capital using the standardised approach. The standardised calculation is derived from a percentage of income, averaged over the last three years.
- Calculation of capital for market risk (Section 10): Market risk is defined as 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, credit spreads and equities. Risk weighted asset calculations for market risk assess the losses from price volatility of financial assets and liabilities. The Group uses the standardised approach to calculate the market risk capital requirements. The Group's only exposure to market risk is in relation to foreign exchange exposure. The Group is below the de minimus limit for CRD IV and as such the Group has no Pillar 1 market risk requirement.

### 5.2 Pillar 2 – other principal risks

Pillar 2 covers the capital requirements of other principal risks including Liquidity and Funding Risk, Legal and Regulatory Compliance and Conduct Risk and Investment Risk relating to Pension Obligations. These risks are discussed in section 11.

## 5.3 Capital Resources

The following table presents the Group's own funds (Capital Resources) as at 29 February 2016.

Own funds for the Company, being the main subsidiary, is disclosed in Appendix 2 and the disclosure of own funds on a transitional basis is detailed in Appendix 3, as required by the CRR.

### Table 3: Capital Resources

| | February 2016 End Point £m | February 2016 Transitional £m | February 2015 End Point £m | February 2015 Transitional £m |
|---|---|---|---|---|
| **Common Equity Tier 1 capital** | | | | |
| Shareholders equity | 1,564.2 | 1,564.2 | 1,465.3 | 1,465.3 |
| Subordinated notes | - | - | (45.0) | (45.0) |
| | **1,564.2** | **1,564.2** | **1,420.3** | **1,420.3** |
| **Regulatory Deductions** | | | | |
| Intangible assets | (363.9) | (363.9) | (402.6) | (402.6) |
| Deferred tax liabilities: related to intangible assets | 26.5 | 26.5 | 37.8 | 37.8 |
| Unrealised losses on Available For Sale debt securities | - | - | - | - |
| Unrealised losses on Cash Flow Hedge Reserve | 1.6 | 1.6 | (0.7) | (0.7) |
| Adjustment to own credit standing | (1.9) | (1.9) | (0.1) | (0.1) |
| Material holdings | - | (6.8) | - | (10.2) |
| | **(337.7)** | **(344.5)** | **(365.6)** | **(375.8)** |
| **Total Common Equity Tier 1 capital** | **1,226.5** | **1,219.7** | **1,054.7** | **1,044.5** |
| **Tier 2** | | | | |
| 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 | 44.6 | 44.6 | 36.1 | 36.1 |
| | **279.6** | **279.6** | **271.1** | **271.1** |
| **Regulatory Adjustments** | | | | |
| Material holdings | (34.1) | (27.3) | (34.1) | (23.9) |
| | **(34.1)** | **(27.3)** | **(34.1)** | **(23.9)** |
| **Total Tier 2** | **245.5** | **252.3** | **237.0** | **247.2** |
| **Total capital resources** | **1,472.0** | **1,472.0** | **1,291.7** | **1,291.7** |
| **Risk weighted assets** | **7,366.4** | **7,366.4** | **6,846.5** | **6,846.5** |
| **Common Equity Tier 1 ratio (%)** | **16.6%** | **16.6%** | **15.4%** | **15.3%** |
| **Total capital ratio (%)** | **20.0%** | **20.0%** | **18.9%** | **18.9%** |

### Notes:

### i) Common Equity Tier 1 Capital

Tier 1 capital is a component of regulatory capital defined by the PRA, comprising Common Equity Tier 1 capital and Additional Tier 1 capital.

Common Equity Tier 1 capital is the highest form of regulatory capital under Basel III that comprises shares issued and related share premium, retained earnings and other reserves net of regulatory adjustments.

The Group's Tier 1 capital is wholly comprised of Common Equity Tier 1. The following table shows the movement in Tier 1 capital over the year.

### Table 4: Movement in Common Equity Tier 1

| | February 2016 £m | February 2015 £m |
|---|---|---|
| **Common Equity Tier 1 at the beginning of the year** | 1,044.5 | 917.8 |
| Ordinary Shares issued | - | - |
| Profit attributable to Shareholders | 188.4 | 130.5 |
| Gains and losses on liabilities arising from own credit risk | (1.9) | (0.1) |
| Other reserves | 7.8 | 13.5 |
| Ordinary dividends | (50.0) | (51.2) |
| Movement in intangible assets | 38.7 | 25.1 |
| Movement in material holdings in financial sector entities | 3.4 | 3.3 |
| **CRD IV adjustments:** | | |
| Deferred tax liabilities related to intangible assets | (11.2) | 5.6 |
| Material holdings in financial sector entities | - | - |
| **Common Equity Tier 1 at the end of the year** | **1,219.7** | **1,044.5** |

CRR Article 437 requires disclosure of the key features of the Group's capital instruments (Common Equity Tier 1, Additional Tier 1 and Tier 2 instruments). The full disclosures are shown in Appendix 4 and include for each instrument:

- the governing law of the instruments;
- the regulatory treatment on a transitional and post transitional basis;
- the instrument type, issue dates, nominal amounts, accounting classification and call option dates; and
- write-down features and sub-ordination for each instrument.

### ii) Regulatory Deductions from Tier 1 Capital

The intangible assets deduction relates to computer software in relation to the Group's operational platform.

The material holdings deduction represents the transitional adjustment for the Company's subordinated loan investment in Tesco Underwriting Ltd.

### iii) Tier 2 Capital

Tier 2 capital is a component of regulatory capital mainly comprising qualifying subordinated loan capital.

All dated and undated subordinated debt held is issued by the Company to Tesco Personal Finance Group Ltd which, in turn, has issued similar debt to Tesco PLC. Details of subordinated liabilities are provided in Appendix 4.

The undated and dated subordinated debt instruments comply with CRD IV requirements. 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 and/or Tesco Personal Finance Group Ltd. 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. The earliest options call date is 31 March 2025, but the debt may be repaid on any date if a regulatory or legislative change occurs that would result in the instrument no longer being eligible as Tier 2 capital.

Redemption can be in whole, or in part, at par value plus accrued interest. Interest payable is based on 3 month LIBOR plus margin of 60 to 225 basis points.

### iv) Regulatory Adjustments to Tier 2 Capital

The material holdings deduction represents the transitional adjustment for the Company subordinated loan investment in Tesco Underwriting Ltd.

### 5.4 Capital Requirements

The following table shows the overall Pillar 1[2] minimum capital requirements and risk weighted assets for the Group under the standardised approach. The Company, being the main subsidiary is also disclosed in Appendix 2.

### Table 5: Capital Requirements

| | February 2016 | | February 2015 | |
|---|---|---|---|---|
| | 8% Own Funds Capital Requirement £m | Risk Weighted Assets £m | 8% Own Funds Capital Requirement £m | Risk Weighted Assets £m |
| **Exposure class** | | | | |
| Central government or central banks | - | - | - | - |
| Multilateral development banks | - | - | - | - |
| Institutions | 6.0 | 75.3 | 5.2 | 64.8 |
| Corporates | 3.4 | 42.6 | 2.0 | 25.2 |
| Retail | 410.8 | 5,134.7 | 389.7 | 4,871.0 |
| Secured by mortgages on immovable property | 46.9 | 585.9 | 33.8 | 422.8 |
| Exposures in default | 3.7 | 46.6 | 3.5 | 44.2 |
| Covered bonds | 1.0 | 13.0 | 0.5 | 6.4 |
| Equity exposures | 14.5 | 181.2 | 14.4 | 179.9 |
| Other items | 13.9 | 173.8 | 14.5 | 180.6 |
| **Total credit and counterparty credit risk** | **500.2** | **6,253.1** | **463.6** | **5,794.9** |
| **Total market risk** | - | - | - | - |
| **Total operational risk** | **87.6** | **1,094.8** | **81.3** | **1,016.5** |
| **Total credit valuation adjustment** | **1.5** | **18.5** | **2.8** | **35.1** |
| **Total Pillar 1 capital requirements** | **589.3** | **7,366.4** | **547.7** | **6,846.5** |

### Notes:

Settlement risk arises where certain transactions are unsettled after their due delivery date and is required to be disclosed separately. The Group had exposure to a late settlement transaction on 29 February 2016. The risk weighted assets arising from the late settlement transaction are immaterial and therefore, have not been disclosed separately and instead included within counterparty credit risk, in line with CRD IV.

### 5.5 Countercyclical Capital Buffer (CCB)

The countercyclical capital buffer aims to ensure that banking sector capital requirements take account of the macro-economic environment in which banks operate. Its primary objective is to use a buffer of capital to achieve the broader macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth that have often been associated with the build-up of system-wide risk. The buffer can be drawn down to absorb losses during stressed periods.

The Basel III countercyclical capital buffer is calculated as the weighted average of the buffers in effect in the jurisdictions to which banks have a credit exposure.

The Financial Policy Committee of the Bank of England is responsible for setting the UK CCB rate i.e. the CCB rate that applies to UK exposures of banks, building societies and large investment firms incorporated in the UK. The Financial Policy Committee has maintained a UK CCB rate of 0% during the period to February 2016.

CCB consists entirely of Common Equity Tier 1 capital and, if the minimum buffer requirements are breached, capital distribution constraints will be imposed on the Group. Consistent with the capital conservation buffer, the constraints imposed relate only to capital distributions (dividends, share buy backs and limits on Directors' remuneration).

[2] Pillar 1 capital does not include foreign exchange exposure as this is de-minimis under CRR minimum threshold and includes credit valuation adjustment risk which is required in line with CRR Article 381.

### 5.5.1 Regulatory Developments

The CCB disclosure requirements, set out within the European Banking Authority's final regulatory technical standard, came into force as at 1 January 2016.

The regulatory technical standard requires banks to use uniform templates for the disclosure of CCB and to ensure the countercyclical buffer requirements are calculated and publically disclosed with at least the same frequency as the minimum capital requirements. In addition, when disclosing the buffer requirement, banks must also disclose the geographical breakdown of the relevant credit exposures used in the CCB calculation.

### 5.5.2 The Group's CCB Disclosure

The Group's foreign exposures as at 29 February 2016, total 0.40% of total exposures. In line with the regulatory technical standard, the Group has chosen to simplify the identification of foreign exposures and allocate them to the place of the institution (UK) on the basis that the Group's foreign exposures are less than 2% of the aggregate of credit, trading and securitisation exposures.

The Group has adopted the uniform templates for the disclosure of CCB for the year ended 29 February 2016, as detailed in the following tables.

**Table 6: Geographical Distribution of Credit Exposures Relevant for the Calculation of the Countercyclical Capital Buffer**

Level of Application: Consolidated

| | | February 2016 | | | | | |
|---|---|---|---|---|---|---|---|
| | | General credit exposures | | Trading book exposures | | Securitisation Exposure | |
| | | Exposure value for Standardised Approach | Exposure value for Internal Ratings Basis | Sum of long and short positions of trading book | Value of trading book exposures for internal models | Exposure value for Standardised Approach | Exposure value for Internal Ratings Basis |
| | | 010 | 020 | 030 | 040 | 050 | 060 |
| 010 | **Breakdown by country:** | | | | | | |
| | UK | 9,038,853,232 | | | | | |
| 020 | **Total** | 9,038,853,232 | | | | | |

| | | February 2016 | | | | | |
|---|---|---|---|---|---|---|---|
| | | Own funds requirements | | | | | |
| | | of which: General credit exposures | of which: Trading book exposures | of which: securitisation exposures | Total | **Own funds requirements weights** | **Countercyclical capital buffer rate** |
| | | 070 | 080 | 090 | 100 | 110 | 120 |
| 010 | **Breakdown by country:** | | | | | | |
| | UK | 494,217,033 | | | 494,217,033 | 1.00 | 0.00% |
| 020 | **Total** | 494,217,033 | | | 494,217,033 | 1.00 | |

**Table 7: Amount of Institution Specific Countercyclical Capital Buffer**

| | | **February 2016** |
|---|---|---|
| | | 010 |
| **010** | Total risk exposure amount | 7,366,350,150 |
| **020** | Institution specific countercyclical capital buffer rate | 0.00% |
| **030** | Institution specific countercyclical capital buffer requirement | 0 |

## 5.6 Capital Conservation Buffer

The capital conservation buffer is designed to enable banks to absorb losses in stressed periods. All banks will be expected to hold a capital conservation buffer of 2.5% of risk weighted assets, comprising Common Equity Tier 1 capital by 1 January 2019.

### 5.6.1 Regulatory Developments

The capital conservation buffer came into effect on 1 January 2016 and is being phased in until 1 January 2019, starting at 0.625% from 2016 and increasing each subsequent year by an additional 0.625% to reach its final level of 2.5% by 1 January 2019.

### 5.6.2 The Group's Capital Conservation Buffer

Based on the above requirements, at 1 January 2016, the capital conservation buffer applicable to the Group is 0.625%.

## 5.7 Leverage Ratio

The leverage ratio was introduced under the Basel III reforms as a simple, transparent, non-risk based ratio intended to restrict the build-up of leverage in the banking sector to avoid distressed deleveraging processes that can damage the broader financial system and the economy.

It is defined as the ratio of Tier 1 capital to the total exposure measure and applies an equal weighting to all assets regardless of their risk.

The leverage framework is emerging in the UK, with a preliminary target level set by the BCBS that banks should hold a minimum leverage ratio of 3%. In addition, a supplementary counter-cyclical leverage buffer would apply to other systemically important institutions and major UK banks and building societies, requiring them to hold an additional 35% of this 3% (4.05% in total). The Group is not expected to be identified by the PRA in their list of other systemically important institutions since its distress or failure would not have a systemic impact on the UK or the EU economy or financial system.

### 5.7.1 Regulatory Developments

To harmonise the disclosure of the leverage ratio across EU institutions, the European Banking Authority published final implementing technical standards on 15 June 2015, which follows the BCBS uniform disclosure templates and instructions.

The BCBS intends to make any final adjustments to the definition and calibration of the leverage ratio in the first half of 2017, with a view to migrating to a binding requirement on 1 January 2018.

### 5.7.2 The Group's Leverage Ratio Disclosure

The Group ratio of 10.3% as at 29 February 2016 (2015: 9.6%), demonstrates a low appetite for excessive leverage.

The Group has adopted the uniform templates for the disclosure of the leverage ratio for the year ended 29 February 2016, as detailed in the following tables. Note, row numbers in the following tables relate to the EBA row reference number used within the standardised templates, where rows contain a nil value these have been excluded for the purpose of these disclosures.

The Leverage ratio disclosures of the Company are reported within Appendix 2.

#### Table 8: Summary Reconciliation of Accounting Assets and Leverage Ratio Exposures

| | | **February 2016 Applicable Amounts £m** |
|---|---|---|
| 1 | Total assets as per published financial statements | 11,000.8 |
| 2 | Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation | (4.9) |
| 4 | Adjustments for derivative financial instruments | 30.1 |
| 6 | Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures) | 1,195.8 |
| 7 | Other adjustments | (370.7) |
| **8** | **Total leverage ratio exposure** | **11,851.1** |

### Table 9: Leverage Ratio Common Disclosure

| | | February 2016 CRR leverage ratio exposures £m |
|---|---|---|
| **On-balance sheet exposures (excluding derivatives and securities financing transactions "SFTs")** | | |
| 1 | On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) | 10,968.1 |
| 2 | Asset amounts deducted in determining Tier 1 capital | (370.7) |
| **3** | **Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)** | **10,597.4** |
| **Derivative exposures** | | |
| 4 | Replacement cost associated with *all* derivatives transactions (i.e. net of eligible cash variation margin) | 27.8 |
| 5 | Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method) | 30.1 |
| **11** | **Total derivative exposures (sum of lines 4 to 10)** | **57.9** |
| **Other off-balance sheet exposures** | | |
| 17 | Off-balance sheet exposures at gross notional amount | 11,866.8 |
| 18 | Adjustments for conversion to credit equivalent amounts | (10,671.0) |
| **19** | **Other off-balance sheet exposures (sum of lines 17 to 18)** | **1,195.8** |
| **Capital and total exposures** | | |
| **20** | **Tier 1 capital** | **1,219.7** |
| **21** | **Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)** | **11,851.1** |
| **Leverage ratio** | | |
| **22** | **Leverage ratio** | **10.3%** |

### Table 10: Leverage Ratio: Split-Up of On-Balance Sheet Exposures (Excluding Derivatives, Securities Financing Transactions and Exempted Exposures)

| | | February 2016 CRR leverage ratio exposures £m |
|---|---|---|
| EU-1 | Total on-balance sheet exposures (excluding derivatives, securities financing transactions, and exempted exposures), of which: | 10,968.1 |
| EU-3 | Banking book exposures, of which: | 10,968.1 |
| EU-4 | Covered bonds | 77.7 |
| EU-5 | Exposures treated as sovereigns | 1,352.0 |
| EU-7 | Institutions | 241.9 |
| EU-8 | Secured by mortgages of immovable properties | 1,655.8 |
| EU-9 | Retail exposures | 6,846.7 |
| EU-10 | Corporate | 43.2 |
| EU-11 | Exposures in default | 46.6 |
| EU-12 | Other exposures (e.g. equity, securitisations, and other non-credit obligation assets) | 704.2 |

### Table 11: Disclosure on Leverage Ratio Qualitative Items

1 **Description of the processes used to manage the risk of excessive leverage:**
Leverage exposure and management is embedded as part of the Group's capital planning process and considered in line with the Common Equity Tier 1 capital and risk-based asset ratios as part of the long term plan. The Capital Management Forum tracks compliance monitoring of leverage and performance to plan on a monthly basis. Management actions are recommended by the Capital Management Forum to the Asset and Liability Committee to prevent the Group from being excessively leveraged and to seek to ensure that capital ratios remain in excess of minimum capital requirements in normal circumstances and in stress.

2 **Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers:**
The Group's leverage ratio has increased in the year from 9.6% to 10.3% on a transitional basis, which is primarily driven from a higher increase in the Common Equity Tier 1 capital, as a result of retained earnings, than exposures.

## 5.8 Encumbered and Unencumbered Assets

The Group has adopted the definition of encumbered and unencumbered contained in the EBA's final guidelines on disclosure of June 2014.

Asset Encumbrance represents a claim to an asset by another party usually in the form of a security interest such as a pledge. Encumbrance reduces the assets available in the event of default by a bank and therefore, the recovery rate of its depositors and other unsecured bank creditors.

### 5.8.1 Regulatory Developments

More extensive guidelines around the disclosure of encumbered and unencumbered assets are expected to be issued by the European Banking Authority at a later date, which will be transformed into a binding technical standard. The aim of the guidelines is to enable the market to obtain relevant and transparent information on encumbered and unencumbered assets that is clear and easy to compare across the industry, thereby enhancing the information available to investors.

### 5.8.2 The Group's Asset Encumbrance Disclosure

The Group maintains limits for total encumbrance and product encumbrance for Credit Cards, Personal Loans and Mortgages as part of the Risk Appetite process. Assigning and/or pledging assets as part of secured funding and repo markets activity give rise to encumbrance.

The Group's total encumbrance ratio is 24% as at 29 February 2016. The asset encumbrance ratio is calculated as the (total encumbered assets + total collateral received reused) divided by (total assets + total collateral received).

The Group's disclosure of encumbered and unencumbered assets as at 29 February 2016 are detailed in Appendix 5 and has been prepared based on the draft guidelines issued by the European Banking Authority in June 2014. This is in line with the Pillar 3 disclosures made in the prior year.

## 6 Credit Risk

Credit risk is the risk that a borrower or counterparty fails to repay the interest or capital on a loan or other financial instrument. The Group's aim in relation to credit risk is to seek to lend responsibly, ensuring that the credit risk profile remains within agreed volatility parameters as articulated in the Risk Appetite.

All lending is subject to robust underwriting processes and the performance of all loans is monitored closely. Regular management reports are submitted to the Board and appropriate Committees.

Credit risk arises principally from 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 Group 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 Group's holding of that entity's financial instrument.

The Chief Risk Officer together with the Director of Credit Risk and the Financial Risk Director, are responsible for:

- development and oversight of the credit risk management framework;
- developing credit risk policies, tools and frameworks across the business;
- managing effective credit risk strategies;
- providing oversight of credit risk activities undertaken by the first line; and
- monitoring credit performance.

The Credit Risk function maintains a suite of policies defining the minimum requirements for the management of credit activities, including the Credit Risk policy and Minimum Standards, Wholesale Credit Risk policy, Model Development, Collections and Recoveries, and Provisioning policies. All credit risk policies are subject to annual review and approval by the RMC, with the Level 1 Credit Risk policy being reviewed by the Board Risk Committee and approved by the Board.

Credit risk policies are supported by a range of processes and procedures that cover the activities undertaken throughout the credit life cycle. Management information is produced for different audiences within the governance framework to allow monitoring of policy compliance. The key risk indicators are of significant importance, with supporting limits and tolerances that allow the Group to track performance. Trends are also identified that could act as an early warning that performance may move outside Risk Appetite in the future.

### Retail Credit Risk

Retail credit risk is the risk that a borrower or counterparty fails to pay the interest or to repay the capital on borrowing. All lending is carefully underwritten and the performance of all loans is monitored closely. Regular management reports are submitted to the Board and appropriate Committees.

### Controls and risk mitigants

To minimise the potential for the Group to be exposed to levels of bad debt that are outside risk appetite, a robust infrastructure of processes and systems has been established that cover the end to end retail credit risk customer life cycle, the key components of which are outlined below:

Credit scoring: The quality of new lending is tightly controlled using appropriate credit scoring and associated rules. Judgemental analysis is used for more complex cases.

Affordability: In being a responsible lender, the Group employs affordability models including minimum free income thresholds based on a customer's income and outgoings to confirm that they have the ability to repay the debt they are seeking.

Valuations: Independent property valuations are undertaken at mortgage inception. The Group's mortgage assets are revalued quarterly using a regional house price valuation index model.

Credit policies and guides: A suite of retail credit risk policies and guides are maintained, or overseen, by the Credit Risk function. These policies define the minimum requirements for the management of credit activities across the credit life cycle. The guides comprise specific product and customer related thresholds that in turn seek to ensure the Group is operating within agreed retail credit risk appetite.

Monitoring and reporting: Management information is produced covering all lending portfolios which are tailored to meet the requirements of different audiences within the overall governance framework. Key risk indicators with supporting limits and tolerances allow the Group to track performance against risk appetite and identify any emerging trends that could act as an early warning that performance could move outside approved risk appetite thresholds, thereby allowing mitigating actions to be taken.

## Wholesale Credit Risk

The Group does not operate in the mainstream commercial or corporate lending market. However the Group is exposed to Wholesale Credit Risk within its liquid asset portfolio with the inherent risk that these counterparties could fail to meet their obligations.

### Controls and risk mitigants

Control Framework: The Group maintains a ratings-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, with the limits contained therein approved by RMC or Board as appropriate. The Treasury Director is responsible for ensuring that Treasury complies with CCR limits, with the Market & Liquidity Risk team, reporting to the Financial Risk Director, providing independent oversight that these limits are adhered to.

The Group's approach to depositing funds focuses on counterparties with strong capacity to meet financial commitments and requires approved counterparties to have 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, interest rate and foreign exchange derivatives. Ratings issued by external credit assessment institutions are taken into account as part of the process to set limits.

The framework sets limits on the amounts that can be placed based on counterparty credit-worthiness by country, instrument type and remaining tenor. As part of the credit assessment process for wholesale credit risk exposures, the Group uses the external credit ratings issued by Fitch (as the nominated external credit assessment institution) to help determine the appropriate risk weighting to apply under the standardised approach to credit risk exposures. The Group has a Wholesale Credit Risk Forum where current ratings and exposures are discussed on a monthly basis by members from Treasury and the Risk Management function. Counterparty credit reviews and proposals for new limits are also discussed at the Wholesale Credit Risk Forum as well as current market events and their possible impact on the Group. All material limits are approved by the RMC within parameters set by the Board and any exceptions or overrides to the policy must be explicitly agreed by this committee, or the Board as appropriate.

Risk mitigation techniques: The Wholesale Credit Risk policy also provides that credit risk mitigation techniques are applied to reduce credit risk exposure. All financial derivative transactions are governed by the International Swaps and Derivatives Association (ISDA). ISDA master agreements are in place with all derivative counterparties, Global Master Repurchase Agreements are in place for all repurchase counterparties and ISDA Credit Support Annexes have been executed with all of the Group's derivative counterparties. Use is also made of Delivery Versus Payment arrangements when settling transactions. As at 29 February 2016, no additional credit risk mitigation was deemed necessary.

Monitoring and reporting: Daily monitoring of exposures is undertaken by Market & Liquidity Risk with monthly reporting of key risk indicators provided to the RMC. Escalation processes are in place for the reporting of any breached limits directly to the RMC.

As at 29 February 2016 the Group has not experienced any impairment in connection with these financial assets. There is therefore no requirement to establish credit reserves for wholesale credit risk exposures.

### Concentration risk

The Group is potentially exposed to this risk by becoming concentrated in certain geographic areas or product profiles e.g. a disproportionate level of high loan to value mortgages. Such concentrations could produce unacceptable bad debts in some adverse but plausible situations.

#### Controls and risk mitigants

The Group mitigates these potential concentration risks by establishing appropriate limits and trigger thresholds that are regularly monitored and reported to the appropriate senior management team and risk committees.

### Wrong Way Risk

Wrong way risk is defined, by the ISDA, as the risk that occurs when exposure to counterparties is adversely correlated with the credit quality of that counterparty. In short it arises when default risk and credit exposure increase together.

The Group's Wholesale Credit Risk policy prohibits a repurchase counterparty and the issuer of the collateral from being the same, or related, entities. The exceptions to this are repurchase agreements transacted with the UK government where UK government debt is provided as collateral. Other than this, the Group has no exposure to wrong way risk.

### Third Party Credit Exposures

The Group has a number of contracts with third parties that involve the receipt of fees or commissions. Third party credit exposure arises through the risk that these payments may not be received. 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 Wholesale Credit Risk Manager is responsible for reporting these exposures and any limit breaches to the RMC.

### 6.1 Analysis of Credit Risk Exposures

This section of the disclosures set out the details of the Group's credit risk exposures by exposure class (Table 12), geographical location (Table 13), industrial sector (Table 14) and residual maturity (Table 15).

### i) Analysis by Exposure Class

The following table shows the credit risk exposure at the end of the financial year, together with average credit risk exposure for the financial year[3,4].

This disclosure includes amounts where the customer has a contractual right to draw down further balances, converted using regulatory credit conversion factors. The exposure is shown on a guarantor basis and is reported net of appropriate impairment provisions.

[3] The exposure shown in Table 12 includes the prevailing market value of the available for sale assets at the relevant reporting date.
[4] CRR Article 112 requires exposures to be assigned to specific exposure classes. Where an exposure class is nil, the exposure class is not reported in the credit risk tables.

### Table 12: Credit Risk Exposure by Exposure Class

| | Exposure Value | | Average Exposure Value | |
|---|---|---|---|---|
| | February 2016 | February 2015 | February 2016 | February 2015 |
| **Exposure class** | **£m** | **£m** | **£m** | **£m** |
| Central governments or central banks | 1,167.9 | 1,096.7 | 1,038.4 | 1,129.2 |
| Multilateral development banks | 184.1 | 202.7 | 178.0 | 247.9 |
| Institutions | 320.3 | 243.5 | 253.3 | 225.6 |
| Corporates | 43.2 | 25.5 | 36.5 | 27.3 |
| Retail | 6,846.7 | 6,495.1 | 6,745.0 | 6,449.8 |
| Secured by mortgages on immovable property | 1,673.9 | 1,208.1 | 1,488.8 | 1,037.9 |
| Exposures in default | 46.6 | 44.2 | 41.5 | 34.9 |
| Covered bonds | 77.7 | 37.9 | 66.2 | 42.2 |
| Equity exposures | 74.6 | 73.4 | 73.5 | 73.6 |
| Other items | 276.1 | 273.8 | 268.5 | 289.6 |
| **Total credit risk exposure** | **10,711.1** | **9,700.9** | **10,189.7** | **9,558.0** |

### ii) Analysis by Geographical Location

The Group's retail lending is primarily focussed on providing credit cards, personal loans, mortgages and current account overdrafts to UK personal customers, although there is limited exposure in the Republic of Ireland through the Irish credit card portfolio. The Group sells credit cards in 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. The following table provides the geographic distribution of the Group's credit risk exposure.

### Table 13: Credit Risk Exposure by Geographical Location

| | February 2016 | | | |
|---|---|---|---|---|
| | Geographic location | | | |
| | UK | Europe (ex. UK) | Other | Total |
| **Exposure class** | **£m** | **£m** | **£m** | **£m** |
| Central governments or central banks | 1,091.8 | 76.1 | - | 1,167.9 |
| Multilateral development banks | - | 138.5 | 45.6 | 184.1 |
| Institutions | 320.3 | - | - | 320.3 |
| Corporates | 33.4 | 9.8 | - | 43.2 |
| Retail | 6,814.8 | 31.9 | - | 6,846.7 |
| Secured by mortgages on immovable property | 1,673.9 | - | - | 1,673.9 |
| Exposures in default | 45.9 | 0.7 | - | 46.6 |
| Covered bonds | 77.7 | - | - | 77.7 |
| Equity exposures | 74.6 | - | - | 74.6 |
| Other items | 276.1 | - | - | 276.1 |
| **Total credit risk exposure** | **10,408.5** | **257.0** | **45.6** | **10,711.1** |

| | February 2015 | | | |
|---|---|---|---|---|
| | Geographic location | | | |
| | UK | Europe (ex. UK) | Other | Total |
| **Exposure class** | **£m** | **£m** | **£m** | **£m** |
| Central governments or central banks | 1,015.3 | 81.4 | - | 1,096.7 |
| Multilateral development banks | - | 146.6 | 56.1 | 202.7 |
| Institutions | 243.5 | - | - | 243.5 |
| Corporates | 24.1 | 1.4 | - | 25.5 |
| Retail | 6,465.1 | 30.0 | - | 6,495.1 |
| Secured by mortgages on immovable property | 1,208.1 | - | - | 1,208.1 |
| Exposures in default | 43.5 | 0.7 | - | 44.2 |
| Covered bonds | 37.9 | - | - | 37.9 |
| Equity exposures | 73.4 | - | - | 73.4 |
| Other items | 273.8 | - | - | 273.8 |
| **Total credit risk exposure** | **9,384.7** | **260.1** | **56.1** | **9,700.9** |

### iii) Analysis by Industrial Sector

The distribution of credit risk exposure by industry sector is provided in the following table. The Group is primarily focussed on providing financial services and products to UK personal customers although it also has exposure to wholesale counterparties. Other items are not assigned to Industry type.

**Table 14: Credit Risk Exposure by Industrial Sector**

| | February 2016 | | | | |
|---|---|---|---|---|---|
| | Industry type | | | | |
| **Exposure class** | **Financial Institutions £m** | **Government £m** | **Individuals £m** | **Wholesale, retail and other £m** | **Total £m** |
| Central governments or central banks | - | 1,167.9 | - | - | 1,167.9 |
| Multilateral development banks | 184.1 | - | - | - | 184.1 |
| Institutions | 320.3 | - | - | - | 320.3 |
| Corporates | - | - | - | 43.2 | 43.2 |
| *of which: Small and Medium Enterprises* | - | - | - | *1.0* | *1.0* |
| Retail | - | - | 6,845.0 | 1.7 | 6,846.7 |
| *of which: Small and Medium Enterprises* | - | - | - | *1.7* | *1.7* |
| Secured by mortgages on immovable property | - | - | 1,673.9 | - | 1,673.9 |
| Exposures in default | - | - | 45.4 | 1.2 | 46.6 |
| *of which: Small and Medium Enterprises* | - | - | - | *1.2* | *1.2* |
| Covered bonds | 77.7 | - | - | - | 77.7 |
| Equity exposures | 3.6 | - | - | 71.0 | 74.6 |
| **Total** | **585.7** | **1,167.9** | **8,564.3** | **117.1** | **10,435.0** |
| | | | | | |
| **Other items** | | | | | **276.1** |
| | | | | | |
| **Total credit risk exposure** | | | | | **10,711.1** |

| | February 2015 | | | | |
|---|---|---|---|---|---|
| | Industry type | | | | |
| **Exposure Class** | **Financial Institutions £m** | **Government £m** | **Individuals £m** | **Wholesale, retail and other £m** | **Total £m** |
| Central governments or central banks | - | 1,096.7 | - | - | 1,096.7 |
| Multilateral development banks | 202.7 | - | - | - | 202.7 |
| Institutions | 243.5 | - | - | - | 243.5 |
| Corporates | - | - | - | 25.5 | 25.5 |
| *of which: Small and Medium Enterprises* | - | - | - | *1.6* | *1.6* |
| Retail | - | - | 6,493.2 | 1.9 | 6,495.1 |
| *of which: Small and Medium Enterprises* | - | - | - | *1.9* | *1.9* |
| Secured by mortgages on immovable property | - | - | 1,208.1 | - | 1,208.1 |
| Exposures in default | - | - | 43.8 | 0.4 | 44.2 |
| *of which: Small and Medium Enterprises* | - | - | - | *0.4* | *0.4* |
| Covered bonds | 37.9 | - | - | - | 37.9 |
| Equity exposures | - | - | - | 73.4 | 73.4 |
| **Total** | **484.1** | **1,096.7** | **7,745.1** | **101.2** | **9,427.1** |
| | | | | | |
| **Other items** | | | | | **273.8** |
| | | | | | |
| **Total credit risk exposure** | | | | | **9,700.9** |

### iv) Analysis by Residual Maturity

The following table provides a maturity analysis of credit exposures on a contractual repayment basis.

### Table 15: Credit Risk Exposure by Residual Maturity

| | February 2016 Residual Maturity (Contractual) | | | | | | |
|---|---|---|---|---|---|---|---|
| Exposure class | On Demand £m | Repayable in 3 months or less £m | Repayable between 3 months and 1 year £m | Repayable between 1 and 5 years £m | Repayable over 5 years £m | Undated £m | Total £m |
| Central governments or central banks | 436.7 | - | 33.0 | 112.6 | 572.6 | 13.0 | 1,167.9 |
| Multilateral development banks | - | 20.0 | - | 125.5 | 38.6 | - | 184.1 |
| Institutions | 129.0 | 133.7 | 0.7 | 48.3 | 8.6 | - | 320.3 |
| Corporates | - | 40.4 | 2.4 | 0.4 | - | - | 43.2 |
| Retail | 3.1 | 3,846.8 | 725.4 | 1,955.3 | 316.1 | - | 6,846.7 |
| Secured by mortgages on immovable property | - | 16.8 | 51.1 | 286.4 | 1,319.6 | - | 1,673.9 |
| Exposures in default | - | 46.6 | - | - | - | - | 46.6 |
| Covered bonds | - | 0.7 | 0.1 | 55.5 | 21.4 | - | 77.7 |
| Equity exposures | - | - | - | - | - | 74.6 | 74.6 |
| Other items | - | - | - | - | - | 276.1 | 276.1 |
| **Total credit risk exposure** | **568.8** | **4,105.0** | **812.7** | **2,584.0** | **2,276.9** | **363.7** | **10,711.1** |

| | February 2015 Residual Maturity (Contractual) | | | | | | |
|---|---|---|---|---|---|---|---|
| | On Demand £m | Repayable in 3 months or less £m | Repayable between 3 months and 1 year £m | Repayable between 1 and 5 years £m | Repayable over 5 years £m | Undated £m | Total £m |
| Central Governments or Central Banks | 496.8 | 7.0 | 0.5 | 207.7 | 371.7 | 13.0 | 1,096.7 |
| Multilateral Development Banks | - | 0.5 | 1.8 | 138.5 | 61.9 | - | 202.7 |
| Institutions | - | 188.6 | 0.1 | 39.6 | 15.2 | - | 243.5 |
| Corporates | - | 25.1 | 0.4 | - | - | - | 25.5 |
| Retail | 2.7 | 3,843.2 | 728.4 | 1,686.5 | 234.3 | - | 6,495.1 |
| Secured by Mortgages on Immovable Property | - | 12.0 | 36.5 | 206.6 | 953.0 | - | 1,208.1 |
| Exposures in Default | - | 44.2 | - | - | - | - | 44.2 |
| Covered Bonds | - | 0.2 | 0.6 | 15.4 | 21.7 | - | 37.9 |
| Equity Exposures | - | - | - | - | - | 73.4 | 73.4 |
| Other Items | - | - | - | - | - | 273.8 | 273.8 |
| **Total** | **499.5** | **4,120.8** | **768.3** | **2,294.3** | **1,657.8** | **360.2** | **9,700.9** |

## 6.2 Credit Risk: Use of External Credit Assessment Institutions' Assessments

The following table shows the credit risk exposure by Credit Quality Step. The Group complies with the credit quality assessment scale with the appropriate issue or issuer rating used to determine the risk weightings applied under the standardised approach to credit risk.

The exposure amounts and the external credit ratings issued by Fitch have been included for corporates, institutions and covered bonds as required by CRR. For completeness the ratings of central governments and banks have also been included, in line with the defined risk weightings set out in the CRR.

### Table 16: Credit Risk Exposure by Credit Quality Step

| | February 2016 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Credit Quality Step 1 | Credit Quality Step 2 | Credit Quality Step 3 | Credit Quality Step 4 | Credit Quality Step 5 | Credit Quality Step 6 | Unrated or Defined Risk | |
| Fitch | AAA to AA- | A+ to A- | BBB+ to BBB- | BB+ to BB- | B+ to B- | CCC+ and below | Weight in CRR | Total |
| Exposure class | £m | £m | £m | £m | £m | £m | £m | £m |
| Central governments or central banks | - | - | - | - | - | - | 1,167.9 | 1,167.9 |
| Multilateral development banks | - | - | - | - | - | - | 184.1 | 184.1 |
| Institutions | 154.6 | 142.4 | 23.3 | - | - | - | - | 320.3 |
| Corporates | - | - | 24.5 | - | - | - | 18.7 | 43.2 |
| Retail | - | - | - | - | - | - | 6,846.7 | 6,846.7 |
| Secured by mortgages on immovable property | - | - | - | - | - | - | 1,673.9 | 1,673.9 |
| Exposures in default | - | - | - | - | - | - | 46.6 | 46.6 |
| Covered bonds | 25.1 | 52.6 | - | - | - | - | - | 77.7 |
| Equity exposures | - | - | - | - | - | - | 74.6 | 74.6 |
| Other items | - | - | - | - | - | - | 276.1 | 276.1 |
| **Total credit risk exposures pre and post mitigation** | **179.7** | **195.0** | **47.8** | **-** | **-** | **-** | **10,288.6** | **10,711.1** |

| | February 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Credit Quality Step 1 | Credit Quality Step 2 | Credit Quality Step 3 | Credit Quality Step 4 | Credit Quality Step 5 | Credit Quality Step 6 | Unrated or Defined Risk | |
| **Fitch** | **AAA to AA-** | **A+ to A-** | **BBB+ to BBB-** | **BB+ to BB-** | **B+ to B-** | **CCC+ and below** | **Weight in CRR** | **Total** |
| **Exposure class** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| Central governments or central banks | - | - | - | - | - | - | 1,096.7 | 1,096.7 |
| Multilateral development banks | | - | - | - | - | - | 202.7 | 202.7 |
| Institutions | 100.3 | 143.2 | | - | - | - | | 243.5 |
| Corporates | - | - | 21.4 | - | - | - | 4.1 | 25.5 |
| Retail | - | - | - | - | - | - | 6,495.1 | 6,495.1 |
| Secured by mortgages on immovable property | - | - | - | - | - | - | 1,208.1 | 1,208.1 |
| Exposures in default | - | - | - | - | - | - | 44.2 | 44.2 |
| Covered bonds | 12.3 | 25.6 | - | - | - | - | | 37.9 |
| Equity exposures | - | - | - | - | - | - | 73.4 | 73.4 |
| Other items | - | - | - | - | - | - | 273.8 | 273.8 |
| **Total credit risk exposures pre and post mitigation** | **112.6** | **168.8** | **21.4** | **-** | **-** | **-** | **9,398.1** | **9,700.9** |

## 6.3 Credit Risk: Asset Quality

Ineffective management and controls over the emerging asset quality of the Group’s lending portfolios could expose the Group to unacceptable levels of bad debt.

### Controls and risk mitigants

The Group’s asset quality is reflected through the level of its impairment by lending type. Asset quality profiles are regularly monitored and reported to the appropriate senior management team and risk committees.

## 6.3.1 Past Due, Impaired Assets and Provisions

### Past Due and Impaired Definitions

The Group considers exposures to be past due where a customer does not make the minimum contractual monthly payment of principal, interest or fee. For personal current accounts, past due status can also arise when the account is in excess. Accounts remain as past due but not impaired until the point where a loss trigger has occurred.

An asset will be recognised as impaired in response to the following loss triggers:

- where the customer makes a declaration of significant financial difficulty;
- where the customer has deceased;
- where the customer or third party agency communicates that it is probable that the customer will enter bankruptcy or another form of financial re-structure, e.g. insolvency or repossession;
- where the account has been transferred to recoveries and the relationship is terminated; or
- when the customer is:
  - more than 90 days past due (the equivalent of four payments down) for loans or credit card products;
  - greater than 6 months in arrears for mortgage products; and
  - 121 days or more in excess for overdrafts on personal current accounts.

In managing credit risk provisioning and impairment the Group applies International Financial Reporting Standards (IFRS), specifically International Accounting Standard (IAS) 39, Financial Instruments: Recognition and Measurement, which has been supplemented by IFRS 13, Fair Value Measurement, and 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 the amount or timing of 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 discounted at the loan’s original effective interest rate.

### Provisioning models

The Group also applies a collective impairment provisioning model that segments provisions into the incurred but not reported book and the impaired book based upon the approved definition of default operated on the credit card, loan, mortgage and current account portfolios.

Incurred but not reported provisions are held against accounts that do not meet any impairment triggers, based on the collective likelihood that a loss event has occurred.

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 factor in establishing these provisions are the anticipated loss rates.

### Table 17: Impaired and Past Due Exposures by Geographical Location

The Group's lending is primarily UK based, providing products to UK personal customers. There is limited exposure in the Republic of Ireland through the sale of credit cards.

| | February 2016 | | | February 2015 | | |
|---|---|---|---|---|---|---|
| | UK | Republic of Ireland | Total | UK | Republic of Ireland | Total |
| | £m | £m | £m | £m | £m | £m |
| **Past due but not impaired** | | | | | | |
| 0-29 days | 39.2 | 1.3 | 40.5 | 33.8 | 1.4 | 35.2 |
| 30-59 days | 11.9 | 0.3 | 12.2 | 8.9 | 0.3 | 9.2 |
| 60-89 days | 8.9 | 0.1 | 9.0 | 5.8 | 0.2 | 6.0 |
| **Total past due but not impaired exposures** | **60.0** | **1.7** | **61.7** | **48.5** | **1.9** | **50.4** |
| **Impaired exposures** | **151.7** | **1.4** | **153.1** | **139.6** | **2.0** | **141.6** |
| Impaired provision | 108.5 | 0.8 | 109.3 | 102.1 | 1.3 | 103.4 |
| Incurred but not reported provision | 44.2 | 0.4 | 44.6 | 35.9 | 0.2 | 36.1 |
| **Total provisions** | **152.7** | **1.2** | **153.9** | **138.0** | **1.5** | **139.5** |
| **Net impairment charge** | **63.5** | **0.7** | **64.2** | **48.0** | **0.4** | **48.4** |

### Table 18: Impaired and Past Due Exposures by Industrial Sector

The Group is primarily focussed on providing financial services and products to UK personal customers. The only collateral held by the Group relates to the mortgages portfolio where all mortgages are secured by a first charge over the property.

| | February 2016 | | | February 2015 | | |
|---|---|---|---|---|---|---|
| | Retail | Secured on Real-Estate Property | Total | Retail | Secured on Real-Estate Property | Total |
| | £m | £m | £m | £m | £m | £m |
| **Past due but not impaired** | | | | | | |
| 0-29 days | 39.7 | 0.8 | 40.5 | 33.4 | 1.8 | 35.2 |
| 30-59 days | 12.2 | - | 12.2 | 9.2 | - | 9.2 |
| 60-89 days | 9.0 | - | 9.0 | 6.0 | - | 6.0 |
| **Total past due but not impaired exposures** | **60.9** | **0.8** | **61.7** | **48.6** | **1.8** | **50.4** |
| **Impaired exposures** | **153.1** | **-** | **153.1** | **141.6** | **-** | **141.6** |
| Impaired provision | 109.3 | - | 109.3 | 103.4 | - | 103.4 |
| Incurred but not reported provision | 43.4 | 1.2 | 44.6 | 35.5 | 0.6 | 36.1 |
| **Total provisions** | **152.7** | **1.2** | **153.9** | **138.9** | **0.6** | **139.5** |
| **Net impairment charge** | **63.6** | **0.6** | **64.2** | **48.0** | **0.4** | **48.4** |

### Table 19: Analysis of Impairment Provisions for Loans and Advances

The following table shows the reconciliation of changes in provisions for loans and advances.

| | February 2016 £m | February 2015 £m |
|---|---|---|
| At beginning of year | 139.5 | 156.9 |
| Amounts written off | (47.3) | (63.2) |
| Increase in allowance, net of recoveries, charged to the income statement | 64.2 | 48.4 |
| Foreign currency translation | 0.2 | (0.1) |
| Unwind of discount | (2.7) | (2.5) |
| **At end of year** | **153.9** | **139.5** |

The provision held above covers both the incurred but not reported and impaired cohorts. Provisions for non-impaired loans and advances at 29 February 2016 were £44.6m (2015: £36.1m). Provisions for impaired loans and advances at 29 February 2016 were £109.3m (2015: £103.4m).

There are no further value adjustments in relation to credit risk. Non-credit risk value adjustments are disclosed in the Annual Report and Financial Statements of both Tesco Personal Finance Group Ltd and Tesco Personal Finance plc.

### 6.3.2 Forbearance

The Group could be exposed to unacceptable levels of bad debt and also suffer reputational damage if it did not provide adequate support to customers experiencing financial difficulties.

#### Controls and risk mitigants

The Group has well defined forbearance policies and processes. Forbearance is relief granted by a lender to assist customers in financial difficulty, through arrangements which temporarily allow the customer to pay an amount other than the contractual amount due. These temporary arrangements may be initiated by the customer or the Group where financial distress would prevent repayment within the original terms and conditions of the contract. The main aim of forbearance is to support customers in returning to a position where they are able to meet their contractual obligations.

A number of forbearance options are made available to customers by the Group. These routinely, but not exclusively, include the following:

- Arrangements to repay arrears over a period of time by making payments above the original contractual amount, that seek to ensure that the loan is repaid within the original repayment term.
- Short term concessions, where the borrower is allowed to make reduced repayments (or in exceptional circumstances, no repayments) on a temporary basis to assist with short term financial hardship.
- For secured products, it may also be acceptable to allow the customer to clear the arrears over an extended period of time, provided the payments remain affordable.

The Group has adopted the definition of forbearance as published in the European Banking Authority's final implementing technical standards of July 2014. The Group reports all accounts meeting this definition, providing for them appropriately. The value of secured and unsecured loans and advances that are subject to forbearance programmes is disclosed in the Annual Report & Financial Statements of both Tesco Personal Finance Group Ltd and Tesco Personal Finance plc.

### 6.4 Credit Risk: Collateral

The Group is exposed to potential bad debts as a result of mortgage lending, with the inherent risk that customers default on their obligation.

#### Controls and risk mitigants:

To mitigate this risk, all mortgages are secured by a first charge over the property being purchased or remortgaged, to safeguard the Group's proceeds in the event of a forced property sale situation. Valuation of the property is assessed as part of the application process by a Royal Institute of Chartered Surveyors certified valuer from the Group’s approved panel of valuers.

The Group revises the valuation of its collateral on a quarterly basis using a regional property price index. It is not normal practice to obtain additional third party revaluation of collateral unless further lending is being considered or the property has been repossessed.

The following table details the value of property collateral held against the Group’s mortgage portfolio as at 29 February 2016.

### Table 20: Value of Property Collateral held against the Group’s Mortgage Portfolio

| | **February 2016** £m | February 2015 £m |
|---|---|---|
| Exposure[1] | 1,669.7 | 1,196.8 |
| Collateral | 3,289.7 | 2,340.9 |
| Cover (%) | 197.0% | 195.6% |

### Notes:

[1] The mortgage balances above represent the credit risk inherent in the mortgage products and excludes accrued interest and fair value adjustment.

Policies are in place which allow the use of credit risk mitigation to reduce counterparty credit risk. As at 29 February 2016 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.

### 6.5 Non Trading Book Exposures in Equities

The Group’s non trading exposure in equities relates to the investment in Tesco Underwriting Ltd and the Group’s interest in Visa Europe.

Tesco Underwriting Ltd underwrites home and motor insurance contracts under the Tesco Bank brand. Tesco Underwriting Ltd is a joint venture which is equity accounted in the Annual Report & Financial Statements of both Tesco Personal Finance Group Ltd and the Company. This equity position in the non-trading book is held as a strategic shareholding.

The investment in Tesco Underwriting Ltd is valued at cost less any provision for impairment. At 29 February 2016 this investment was valued at £71.0m (2015: £71.0m).

The fair value of the Group’s interest in Visa Europe amounts to £3.5m (2015: nil), which has been assessed against the expected cash consideration to be received from the proposed sale to Visa Inc. The proposed sale is expected to complete during the second calendar quarter of 2016. The Group will also receive preferred stock as part of this transaction, which may be convertible into class A Common Stock of Visa Inc at certain future dates. Conversion is contingent on future events, principally related to the outcome of interchange litigation against Visa. Due to the inherent uncertainty relating to the outcome of this litigation, no value has been attributed to the preferred stock in these disclosures, in line with the Annual Report and Financial Statements of both Tesco Personal Finance Group Ltd and Tesco Personal Finance plc.

The carrying values on the balance sheet of both Tesco Underwriting Ltd and Visa Europe represent the fair value and there has been no sale or liquidation in the year, or any other unrealised gains or losses included in Common Equity Tier 1 capital.

## 7 Exposure to Counterparty Credit Risk (CCR)

CCR is 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-dated settlement transactions. As at 29 February 2016, the Group has circa £82m security financing transactions in the form of repo transactions and has no long-dated settlement transactions.

All financial derivative transactions are governed by industry standard ISDA Master Agreements, supplemented by ISDA Credit Support Annexes for a number of counterparties. Information relating to policies used in the management of Wholesale Credit Risk, Counterparty Credit Risk and Wrong Way Risk, is provided in section 6.

The Group in its ordinary course of business uses over the counter 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 the exposure value calculated as market value plus an add-on for potential future exposure, prior to being risk weighted under the standardised approach. As at 29 February 2016, the Group's total CCR exposures under the mark-to-market method amounted to £57.9m, comprising; £50.2m in interest rate contracts and £7.7m in foreign currency contracts (2015 total CCR exposures: £60.1m, comprising; interest rate contracts £54.8m and foreign currency £5.3m).

The Group's CCR capital calculations do not incorporate netting benefits and there is no use of collateral in calculating net derivatives credit exposure. The gross positive fair value of derivative contracts as at 29 February 2016 amounted to £27.8m (2015: £29.2m).

As at 29 February 2016, the Group had no public credit rating and no exposure to credit derivative transactions.

### Table 21: Counterparty credit risk exposures: Mark-to-market method

| | February 2016 £m | February 2015 £m |
|---|---|---|
| Interest-rate contracts | 50.2 | 54.8 |
| Contracts concerning foreign currency rates and gold | 7.7 | 5.3 |
| Contracts concerning equities | - | - |
| Contracts concerning precious metals except gold | - | - |
| Contracts concerning commodities other than precious metals | - | - |
| **Total counterparty credit risk exposures** | **57.9** | **60.1** |

#### Net derivative credit exposure

| | February 2016 £m | February 2015 £m |
|---|---|---|
| Gross positive fair value of contracts (excluding add on for potential future exposure) | 27.8 | 29.2 |
| Less: netting benefits | - | - |
| **Net current credit exposure** | **27.8** | **29.2** |
| Less: collateral held | - | - |
| **Net derivatives credit exposure** | **27.8** | **29.2** |

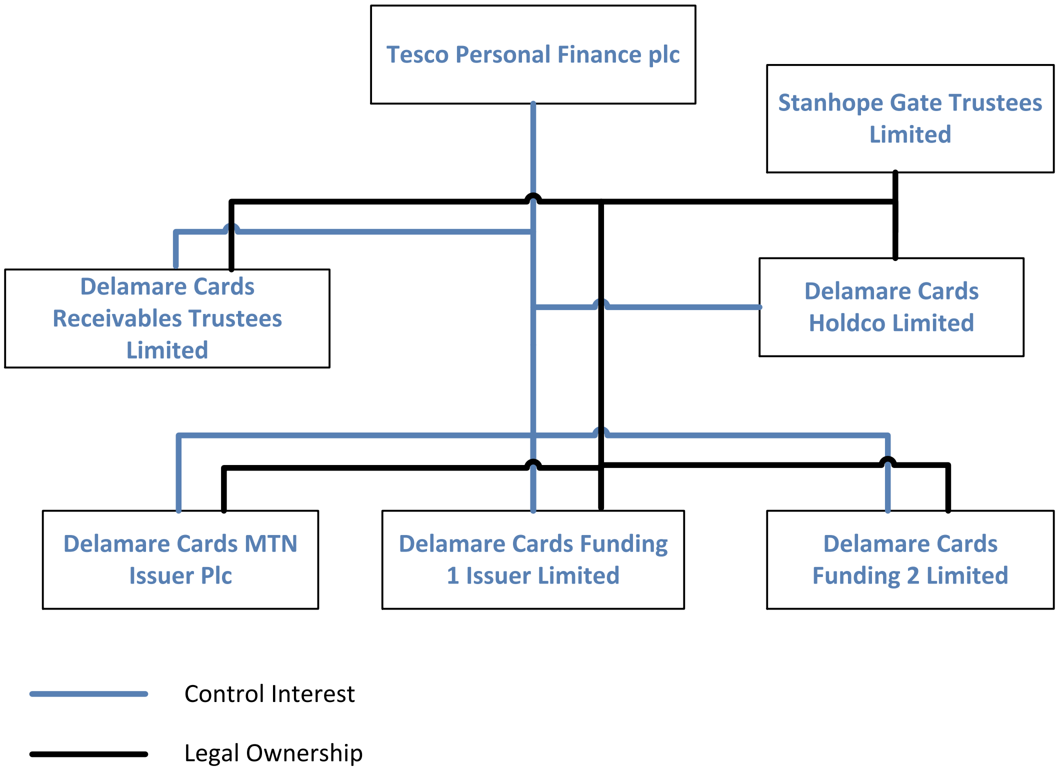
## 8 Securitisation and Covered Bond Exposures

For regulatory disclosure purposes, a securitisation is defined as a transaction where the payments are dependent upon the performance of a single exposure or pool of exposures and where the subordination of tranches determines the distribution of losses during the life of the transaction.

The principle objective of securitisation is to provide funding diversification, giving access to a wide range of investors in different geographical areas.

The Group enters into securitisation transactions in which it assigns credit card receivables to a structured entity (Delamare Cards Receivables Trustees Ltd) which supports the issuance of securities backed by the cash flows from the securitised pool of credit cards. Although none of the equity of the securitisation structured entity is owned by the Group, the nature of these entities, which are in substance controlled by the Group, mean that it retains substantially all of the risks and rewards of ownership of the securitised credit card receivables.

The following diagram details the securitisation structured entities:




Securitisation is used to provide secured term funding to the Group. The underlying assets are retained at amortised cost on the balance sheet and the securitisation bonds issued are held at amortised cost. For accounting purposes, the securitisation structured entity is consolidated in the Group as the substance of the relationship and retention of risk and rewards indicates control is retained. As at 29 February 2016, there were £1,800.0m (2015: £2,000.0m) notes in issue in relation to securitisation transactions, of which £800.0m (2015: £500.0m) relates to externally held notes. At the year end the Group had pledged £2,629.5m (2015: £3,011.3m) of credit card assets in Delamare structured entities. The beneficial interest of these assets has been assigned to Delamare Cards Receivables Trustee Limited.

The Group operates within the securitisation and covered bond markets as an investor, purchasing certain securitisation and covered bonds for the purposes of diversifying its wholesale assets as part of managing its overall liquidity assets buffer. The Group invests in covered bond securities where preferential capital treatment is permitted, and in AAA rated asset backed securities recognising the due diligence required per CRR Article 406. Bonds acquired are held as available for sale assets on the balance sheet. At 29 February 2016, the Group's exposure in covered bonds amounted to £77.7m (2015: £37.9m).

The Group does not hold any re-securitisation positions and is not active in synthetic securitisations. The Group 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.

### 8.1 Risks Inherent in Securitised and Covered Bond Assets

There are a number of inherent risks in purchasing securitised notes including:

- the performance of the underlying assets;
- the explicit support of the issuer and its financial stability;
- volatility in the market value of securitised notes; and
- liquidity risk that the structured entity issuing the securitisation notes has insufficient income on the underlying assets (and via interest rate or total return swaps) to meet its obligations.

The Group 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. Interest rate risk arising from fixed rate purchases of securitisation notes is hedged in line with the Group's interest rate risk policy.

The risks inherent in covered bonds relate primarily to the financial strength of the issuer and to the underlying assets used as collateral for the bonds. A pre-purchase credit assessment of the issuer's financial strength is undertaken together with a due diligence 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 also undertaken.

### 8.2 Approach to Calculating Risk Weighted Exposure Amounts

The Group adopts the standardised approach in relation to all types of securitisation and covered bond exposures. For invested positions, the Company calculates risk weighted exposure amounts using the credit quality steps prescribed in CRR for securitisations and covered bond exposures.

## 9 Operational Risk

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. The Group aims to effectively manage operational risks within defined Risk Appetite limits. The Group calculates Pillar 1 Operational Risk capital using the standardised approach.

### Controls and risk mitigants

The Group's risks are assessed utilising a risk management framework which is aligned to the three lines of defence model.

The Chief Risk Officer and the Operational Risk Director, together with a dedicated Operational Risk team, are responsible for:

- developing and maintaining the operational risk framework;
- working with relevant business areas to make sure that first line responsibilities are understood and that those responsibilities are executed within the framework;
- supporting relevant business areas to embed policies, frameworks and to instil a positive risk management culture; and
- independent monitoring, assessment and reporting on operational risk profiles and losses.

The Operational Risk function maintains policies defining the minimum requirements for the management of Operational Risk, Financial Crime and Information Security.

Business units and functions assess operational risks on an ongoing basis via a prescribed risk control self assessment process and operational risk scenario analysis. The risk control self assessment process is reviewed and updated to reflect changes to the risk and control environment arising from changes in products, processes and systems. The outputs are reported to relevant governance bodies. This is supplemented further by an event management process and monthly reporting of the Operational Risk profile to the RMC.

The operational risk scenario analysis builds on the risk control self assessment process and event management process to identify the forward looking risk profile and the results are used to inform the Board's decision on any additional requirement for Operational Risk Capital under Pillar 2.

The Financial Crime, Operational and Regulatory Risk Committee provides oversight of the Group's operational risk profile and provides regular reports and recommendations to the appropriate governance bodies.

## 10 Market Risk

Market risk is defined as 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, credit spreads and equities.

Market risk arises in the following ways:

- Interest rate risk in the Group's retail portfolios, certain income streams 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; and
- Investment risk relating to the Group's pension obligations.

The Group has no trading book exposures.

### Control and risk mitigants

Control of market risk is managed by the Asset and Liability Management Committee and the Market Risk Forum. These bodies provide oversight of the Group's market risk position at a detailed level, providing regular reports and recommendations to Board Committees.

Market & Liquidity Risk, as part of the Risk Management function, also reviews and challenges policies and procedures relating to market risk and provide oversight for the Asset & Liability Management and Transaction Management teams within Treasury.

### 10.1 Interest Rate Risk in the Banking Book (IRRBB)

Interest rate risk is the risk to earnings and capital arising from timing differences on the re-pricing of the Group's loans and deposits and unexpected changes to the slope and shape of the yield curve. The Group is exposed to interest rate risk through its dealings with retail customers as well as through lending to and borrowing from the wholesale market.

The Company offers lending and savings products with varying interest rate features and maturities which create potential interest rate exposures. IRRBB is the main market risk that could affect the Group's net interest income and arises where there is potential for changes in benchmark interest rates, which results in a movement in the banking book net interest income.

### Control and risk mitigants

The Group has established limits for 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.

IRRBB management information is monitored by the Asset and Liability Management team and regularly reviewed by the Asset and Liability Management Committee. IRRBB primarily arises from the consumer lending portfolios (including the mortgage pipeline) and retail deposits. Hedging strategies are implemented as required to ensure that the Group remains within its stated Risk Appetite.

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

- **Capital at Risk** – the capital at risk approach assesses the sensitivity of a reduction in the Group's capital to movements in interest rates. The scenarios considered include both parallel and non-parallel movements of the yield curve and have been designed to assess impacts across a suitable range of severe but plausible movements in interest rates. The capital at risk measure is an aggregate measure of four separate components, each being a distinct form of interest rate risk (Repricing Risk, Basis Risk, Pipeline Risk and Prepayment Risk). This approach has replaced the economic value of equity reporting used in 2014/15.
- **Net Interest Income Sensitivity** – this measures the effect of a +1.0%; -0.5% parallel interest rate shock on the next 12 months net interest income, based on the re-pricing gaps in the existing portfolio.

**Table 22: Capital at Risk and Net Interest Income Sensitivity Measures**

| Capital at Risk Sensitivity | February 2016 £m | February 2015 £m |
|---|---|---|
| Repricing risk | (4.4) | (4.4) |
| Basis risk | (3.9) | (4.4) |
| Pipeline risk | 0.1 | (0.0) |
| Prepayment risk | - | (1.2) |
| **Total** | **(8.2)** | **(10.0)** |
| **Net interest income sensitivity** | (0.48%) | (0.09%) |

The sensitivity analyses presented represent, in accordance with the requirements of IFRS 7 Financial Instruments Disclosure, management's assessment of a reasonably possible sensitivity, rather than worst case scenario positions.

### 10.2 Foreign Exchange Risk

The Group invests in non-GBP denominated bonds, and may raise funding from the wholesale markets in currencies other than GBP. Foreign exchange exposure arises if these exposures are not hedged. Foreign exchange exposure may also arise through the Group's Euro-denominated Irish credit card exposure and through invoices received which are denominated in foreign currencies.

#### Control and risk mitigants

Substantially all foreign currency exposure is hedged to reduce exposure to a minimum level, within Board approved limits. The residual exposure is not material and as such, no sensitivity analysis is disclosed.

## 11 Other Principal Risks

In addition to the risks identified above, there are a number of other risks to which the Group is exposed as detailed below, and where appropriate, Pillar 2 capital is held to support these risks.

### 11.1 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 sufficient stable and diverse sources of funding.

#### Controls and risk mitigants

Liquidity and funding risk is assessed through the internal liquidity adequacy assessment process on at least an annual basis. This process involves detailed consideration of the following:

- Identification of sources of liquidity risk;
- Quantification of those risks through stress testing;
- Consideration of management processes and controls to minimise the risk;
- Assessment of the type and quality of liquid asset holdings to mitigate the risk; and
- Consideration of the levels of contingent funding required to mitigate the risk.

The Group sets formal limits within the Liquidity Risk Management Policy to maintain liquidity risk exposures within the Liquidity Risk Appetite set by the Board. The key liquidity measures monitored on a daily basis are:

- the internal liquidity requirement;
- liquidity coverage ratio;
- the net stable funding ratio;
- the loan to deposit ratio;
- asset encumbrance; and
- wholesale funding ratio.

The Group measures and manages liquidity adequacy in line with the above metrics on a regular basis and maintains a conservative liquidity and funding profile to ensure that it is able to meet its financial obligations under normal, and stressed, conditions. The internal liquidity requirement seeks to ensure that the Group maintains adequate liquid assets to survive a defined stress scenario for a sufficient period as defined by Risk Appetite. The regulatory liquidity coverage ratio requires the Group to maintain a sufficient portfolio of high quality liquid assets to meet liquidity requirements during periods of market dislocation and stress over a 30 day period.

The Group monitors and reports on the composition of its funding base against defined thresholds to avoid funding source and maturity concentration risks.

The Group prepares both short term and long term forecasts to assess liquidity requirements and takes into account factors such as credit card payment cycles, investment maturities, customer deposit patterns, and wholesale funding (including Funding for Lending Scheme) maturities. These reports support daily liquidity management and are reviewed daily by senior management along with early warning indicators.

Stress testing of current and forecast financial positions is conducted to inform the Group of required liquidity resources. Reverse stress testing is conducted to inform the Group of the circumstances that would result in liquidity resources being exhausted. Liquidity stress tests are presented to the Liquidity Management Forum and the Asset and Liability Management Committee on a regular basis to provide evidence that sufficient liquidity is held to meet financial obligations in a stress.

The Treasury Director is responsible for formulating, and obtaining Board approval for, an annual funding plan as part of the overall business planning process. The Group is predominantly funded by its retail deposit base which reduces reliance on wholesale funding and, in particular, results in minimal short-term wholesale funding. A significant part of these retail deposits are repayable on demand on a contractual basis. The Group continuously monitors retail deposit activity so that it can reasonably predict expected maturity flows. These instruments form a stable funding base for the Group's operations because of the broad customer base and the historical behaviours exhibited.

During the year the Group accessed the Bank of England's Funding for Lending Scheme to support lending growth in a cost effective manner.

### 11.2 Legal, Regulatory Compliance and Conduct Risk

Legal and Regulatory Compliance Risk is the risk of consequences arising as a result of non-compliance with laws and regulatory requirements.

The risk of business conduct leading to poor outcomes for customers can arise as a result of an over aggressive sales strategy, poor management of sales processes, credit assessments and processes or failure to comply with other regulatory requirements.

The Group's aim is to always avoid breaches of laws and requirements. Where legal or regulatory requirements are not met, effective remediation plans will be put in place.

#### Controls and mitigants

As part of the policy framework, a dedicated Regulatory Advice and Compliance team is responsible for the Compliance Policy which is approved by the Board, as well as for monitoring, challenge and oversight of regulatory risk and compliance across the business. Guidance and advice to enable the business to operate in a compliant manner is provided by the Regulatory Advice and Compliance and Regulatory Legal teams.

Regulatory Advice and Compliance are also responsible for the detailed regulatory policies which underpin the Compliance policy (e.g. Data Protection and Regulatory Contact). These are further supported by Operational and Product Guides that provide relevant practical guidance to business and operational areas to enable them to comply with the regulatory policies.

The Group's Legal function has responsibility for commercial legal work (for Banking and Insurance), litigation/dispute resolution matters, providing guidance on mortgages regulatory compliance, advising on competition law and supporting the Group's Treasury activity. The Legal team also comprises the Company Secretarial function which, in addition to its role supporting the Board and maintaining statutory books, ensures the company complies with all applicable governance codes.

Conduct risk is monitored by the relevant business area and the second line Risk Management function. Business areas manage Conduct risk within the design of new products and use a range of management information to monitor the fair treatment of existing customers and to assess the fairness of existing products. A framework of product-led Conduct management information has been developed and is reviewed by senior management in the business lines. The Conduct Committee and the Board review and challenge delivery of fair outcomes for customers and are provided with management information. The Group has established organisational capacity to deal with customer complaints and to deal appropriately with the root causes. Customer research and insight supports the understanding of customer outcomes.

### 11.3 Investment Risk relating to Pension Obligations

Pension risk may be defined as the risk to a company 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 Group is a participating employer in the Tesco PLC Pension Scheme and is exposed to Pension risk through its obligation to the Tesco PLC Pension Scheme.

Tesco PLC is the sponsoring employer and has recognised the appropriate net liability of the Tesco PLC Pension Scheme.

## 12 Remuneration

### Approach to remuneration

The Group's Remuneration policy is designed to comply with the FCA's Remuneration Code.

The Group structures its approach to reward based on that used across the wider Tesco 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.

The Group externally benchmarks its reward framework annually to confirm it is aligned to the market and is adequate to recruit and retain qualified and experienced staff. Reward is structured to incentivise people to meet business goals, whilst ensuring actual awards are based on business and individual performance, promoting an environment of sound risk management.

The Group has identified (Code) staff as; 'senior management' which is defined as Directors of the Company including executive directors, non-executive directors and the Chairman of the Company. Other identified (Code) staff include other senior managers whose actions have a material impact on the risk profile of the Company. The list of identified (Code) staff is reviewed annually by the Remuneration Committee.

### Remuneration Committee

The Group has established a Remuneration Committee to oversee the Remuneration policy and decisions on reward for all identified (Code) staff.

The Remuneration policy is reviewed on a regular basis by the Committee. No significant changes have been made to the policy since the prior year.

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 on-going sustainability of the business and to be compliant with the applicable legislation and regulation.

The Remuneration Committee is appointed by the Board and during the year, consisted of the Chairman and other non-Executive Directors. Additionally, the Committee Chairman provides an annual update to the Remuneration Committee of Tesco PLC.

Members of the Remuneration Committee are members of either, or both of, the Group's Audit and Risk Committees, which ensures that they are regularly updated on key risk and control issues relating to the Group.

The Remuneration Committee is supported by the Chief People Officer of the Group and a representative from the Tesco PLC Group Reward team. In addition, the Group's Chief Executive attends meetings at the request of the Committee.

Where appropriate, the Committee also draws on external consultants to provide advice and guidance. During the year, the Committee received independent external advice from PricewaterhouseCoopers.

### Link between pay and performance

The Remuneration policy requires the following when determining individual remuneration arrangements to enforce the link between pay and performance:

- A combination of financial and non-financial performance measures of Tesco PLC is used, ensuring that decisions are not taken for short-term financial gain to the detriment of other aspects of the business;
- An appropriate combination of fixed and variable pay, benchmarked annually, ensuring the Group's fixed-variable ratios on remuneration are controlled and do not encourage inappropriate risk taking behaviour;
- The basis of assessment for the short-term bonus is adjusted for colleagues in control functions, so greater emphasis is placed on control objectives;
- Annual incentives reflect both individual performance and business performance. Senior people also have an element of their annual incentive based on Tesco Group performance; and
- Maximum award levels are determined as percentages of salary, which are pre-set for the Group, based on work level. Rewards are established within this framework, and therefore there is no opportunity for an individual to benefit from increased rewards outside of this core structure.

Where underperformance is identified it is managed through the performance management process and may result in reduced or zero awards.

### Design characteristics of the remuneration system

The Group delivers its reward via a combination of fixed pay, variable pay and other benefits. All identified (Code) staff participate in the variable reward schemes.

Long term incentive pay is based on the outcome of Group measures including; total shareholder return and cash flow.

A share based element to the variable reward supports long-term commitment, with all identified (Code) staff subject to levels of deferral. Shares awarded are those of Tesco PLC. Variable pay deferral levels are set at the time of award and in line with regulatory requirements, with at least 50% of variable pay being paid in shares

All incentive awards include provisions for adjustment for either malus or claw-back at the discretion of the Remuneration Committee. The following non-exhaustive list outlines the circumstances in which malus and/or clawback measures can be triggered:

- where performance has been materially misstated;
- where a participant has contributed to serious reputational damage of the Group; or
- failure to comply with our Code of Business Conduct through individual behaviour which has led to serious misconduct, fraud or misstatement.

### Board diversity policy

The Board recognises that successful businesses flourish by embracing intellectual, experiential, geographical and skills diversity as well as other factors such as gender, marital status, race, age, sexual preference and orientation, colour, creed, ethnic origin, religion or belief, disability and trade union affiliation. The Board is committed to promoting an inclusive culture across all levels that is reflective of the communities in which the Group operates.

### Recruitment policy for the selection of members of the management body

The Nomination Committee reviews annually the structure, size and composition of the Board, by evaluating the balance of skills, knowledge, experience and diversity currently in place, and makes recommendations to the Board with regard to any changes.

Information on the skills and experience of the Board is set out in their biographies on the Tesco Bank corporate website (refer to link contained in Appendix 6). This appendix also details the number of directorships held by members of the Board.

## Remuneration for Code Staff

Under CRR, the Group is required to make certain aggregate quantitative disclosures regarding the remuneration of identified (Code) staff. The tables below represent the Group's disclosure for the year ended 29 February 2016.

The level of remuneration for the financial year, split between fixed and variable remuneration, along with the number of identified (Code) staff:

| | February 2016 | | |
|---|---|---|---|
| | **Senior Management** | **Other Code Staff** | **Total** |
| Number of identified (Code) staff | 11 | 30 | 41 |
| Fixed reward (£m) [1] | 3.7 | 5.4 | 9.1 |
| Variable reward (£m) [2] | 3.0 | 3.8 | 6.8 |
| Total remuneration (£m) | **6.7** | **9.2** | **15.9** |

**Notes:**

[1] Values noted include; base salary (or fees in the case of non-executive directors), benefits in kind and any other benefits earned in the year.
[2] Where payable other than in cash, the variable remuneration has been valued for the purposes of this table using the fair value of shares accruing over the financial year.

The amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;

| | February 2016 | | |
|---|---|---|---|
| | **Senior Management** | **Other Code Staff** | **Total** |
| | **£m** | **£m** | **£m** |
| Cash | 1.5 | 1.9 | 3.4 |
| Compulsory deferred shares | 1.0 | 1.4 | 2.4 |
| Performance share awards | 0.5 | 0.5 | 1.0 |
| Total remuneration | **3.0** | **3.8** | **6.8** |

The amounts of outstanding deferred remuneration, split between vested and unvested portions;

| | February 2016 | | |
|---|---|---|---|
| | **Senior Management** | **Other Code Staff** | **Total** |
| | **£m** | **£m** | **£m** |
| Vested | 0.0 | 0.0 | 0.0 |
| Unvested | 1.5 | 1.9 | 3.4 |
| Total remuneration | **1.5** | **1.9** | **3.4** |

Of the above deferred remuneration awarded during the financial year, none has paid out and none has been reduced through performance adjustments.

One beneficiary received severance payments during the year totalling £30k. These payments were in line with the individual's contract of employment. No joining awards were made during the period.

Two individuals have received remuneration for the financial year between EUR 1.0 million and EUR 1.5 million and one individual received remuneration for the financial year between EUR 2.5 million and EUR 3.0 million.

## Appendix 1 - Declaration

### Board Risk Management Declaration

The Board is responsible for reviewing the effectiveness of the Group's risk management arrangements and systems of financial and internal controls. These are designed to manage rather than eliminate the risks of not achieving business objectives, and, as such, offer reasonable but not absolute assurance against fraud, material misstatement and loss.

The Board considers that the Group is properly resourced and skilled and has in place adequate systems and controls with regard to the Group's profile and strategy and an appropriate array of assurance mechanisms to avoid or minimise loss.

## Appendix 2: Tesco Personal Finance plc Capital Resources, Capital Requirements and Leverage Ratio

In accordance with Article 13 of the CRR, this Appendix sets out the reduced Pillar 3 disclosures of Tesco Pesonal Finance plc (the Company), the significant subsidiary of the Group.

| Capital resources: | February 2016 End Point £m | February 2016 Transitional £m | February 2015 End Point £m | February 2015 Transitional £m |
|---|---|---|---|---|
| **Common equity tier 1 capital** | | | | |
| Shareholders equity | 1,562.1 | 1,562.1 | 1,461.9 | 1,461.9 |
| **Regulatory Deductions** | | | | |
| Subordinated notes not qualifying as tier 1 | - | - | (45.0) | (45.0) |
| Intangible assets | (363.9) | (363.9) | (402.6) | (402.6) |
| Deferred tax liabilities: related to intangible assets | 26.5 | 26.5 | 37.7 | 37.7 |
| Unrealised losses on Cash Flow Hedge Reserve | 1.6 | 1.6 | (0.7) | (0.7) |
| Adjustment to own credit standing | (1.9) | (1.9) | - | - |
| Material holdings | - | (6.8) | - | (10.2) |
| | **(337.7)** | **(344.5)** | **(410.6)** | **(420.8)** |
| **Total Common Equity Tier 1 capital** | **1,224.4** | **1,217.6** | **1,051.3** | **1,041.1** |
| | | | | |
| **Tier 2** | | | | |
| 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 | 44.6 | 44.6 | 36.1 | 36.1 |
| | **279.6** | **279.6** | **271.1** | **271.1** |
| **Regulatory Adjustments** | | | | |
| Material Holdings | (34.1) | (27.3) | (34.1) | (23.9) |
| | **(34.1)** | **(27.3)** | **(34.1)** | **(23.9)** |
| **Total tier 2** | **245.5** | **252.3** | **237.0** | **247.2** |
| **Total capital resources** | **1,469.9** | **1,469.9** | **1,288.3** | **1,288.3** |
| **Risk weighted assets** | **7,345.9** | **7,345.9** | **6,844.2** | **6,844.2** |
| | | | | |
| **Common equity tier 1 ratio (%)** | **16.7%** | **16.6%** | **15.4%** | **15.2%** |
| **Total capital ratio (%)** | **20.0%** | **20.0%** | **18.8%** | **18.8%** |

| | February 2016 | | February 2015 | |
|---|---|---|---|---|
| **Pillar 1 capital requirements:** | 8% Capital Requirement £m | Risk Weighted Assets £m | 8% Capital Requirement £m | Risk Weighted Assets £m |
| Central government or central banks | - | - | - | - |
| Multilateral development banks | - | - | - | - |
| Institutions | 6.0 | 74.9 | 5.2 | 64.8 |
| Corporates | 3.4 | 42.6 | 2.0 | 25.2 |
| Retail | 410.8 | 5,134.7 | 389.7 | 4871.0 |
| Secured by mortgages on immovable property | 46.9 | 585.9 | 33.8 | 422.8 |
| Exposures in default | 3.7 | 46.6 | 3.5 | 44.2 |
| Covered bonds | 1.0 | 13.0 | 0.5 | 6.4 |
| Equity exposures | 14.5 | 181.2 | 14.2 | 177.6 |
| Other items | 12.3 | 153.6 | 14.5 | 180.6 |
| **Total credit and counterparty credit risk** | **498.6** | **6,232.5** | **463.4** | **5,792.6** |
| **Total market risk** | **-** | **-** | - | - |
| **Total operational risk** | **87.6** | **1,094.9** | **81.3** | 1016.5 |
| **Total credit valuation adjustment** | **1.5** | **18.5** | **2.8** | 35.1 |
| **Total Pillar 1 capital requirements** | **587.7** | **7,345.9** | **547.5** | **6,844.2** |

| Movement in Common Equity Tier 1 Capital: | February 2016 £m | February 2015 £m |
|---|---|---|
| **Common Equity Tier 1 at the beginning of the year** | 1,041.1 | 913.6 |
| Ordinary Shares issued | - | - |
| Profit attributable to Shareholders | 189.7 | 131.3 |
| Gains and losses on liabilities arising from own credit | (1.9) | (0.1) |
| Other Reserves | 7.8 | 13.5 |
| Ordinary dividends | (50.0) | (50.0) |
| Dividends to holders of other equity | - | (1.2) |
| Movement in intangible assets | 38.7 | 25.1 |
| Movement in material holdings in financial sector entities | 3.4 | 3.3 |
| **CRD IV adjustments:** | | |
| Deferred Tax laibilities related to intangible assets | (11.2) | 5.6 |
| Material holdings in financial sector entities | - | - |
| **Common Equity Tier 1 at the end of the year** | **1,217.6** | **1,041.1** |

### Summary reconciliation of accounting assets and leverage ratio exposures

| | | February 2016 Applicable Amounts £m |
|---|---|---|
| 1 | Total assets as per published financial statements | 10,973.4 |
| 4 | Adjustments for derivative financial instruments | 30.1 |
| 6 | Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures) | 1,195.8 |
| 7 | Other adjustments | (370.7) |
| **8** | **Total leverage ratio exposure** | **11,828.6** |

### Leverage ratio common disclosure

| | | February 2016 CRR leverage ratio exposures £m |
|---|---|---|
| **On-balance sheet exposures (excluding derivatives and securities financing transactions "SFTs")** | | |
| 1 | On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral) | 10,945.6 |
| 2 | Asset amounts deducted in determining Tier 1 capital | (370.7) |
| **3** | **Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)** | **10,574.9** |
| **Derivative exposures** | | |
| 4 | Replacement cost associated with *all* derivatives transactions (i.e. net of eligible cash variation margin) | 27.8 |
| 5 | Add-on amounts for PFE associated with *all* derivatives transactions (mark-to-market method) | 30.1 |
| **11** | **Total derivative exposures (sum of lines 4 to 10)** | **57.9** |
| **Other off-balance sheet exposures** | | |
| 17 | Off-balance sheet exposures at gross notional amount | 11,866.8 |
| 18 | Adjustments for conversion to credit equivalent amounts | (10,671.0) |
| **19** | **Other off-balance sheet exposures (sum of lines 17 to 18)** | **1,195.8** |
| **Capital and total exposures** | | |
| **20** | **Tier 1 capital** | **1,217.6** |
| **21** | **Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)** | **11,828.6** |
| **Leverage ratio** | | |
| **22** | **Leverage ratio** | **10.3%** |

### Leverage Ratio: Split-up of on-balance sheet exposures (excluding derivatives, SFT's and exempted exposures)

| | | February 2016 CRR leverage ratio exposures £m |
|---|---|---|
| EU-1 | Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which: | 10,945.6 |
| EU-3 | Banking book exposures, of which: | 10,945.6 |
| EU-4 | Covered bonds | 77.7 |
| EU-5 | Exposures treated as sovereigns | 1,352.0 |
| EU-7 | Institutions | 239.5 |
| EU-8 | Secured by mortgages of immovable properties | 1,655.8 |
| EU-9 | Retail exposures | 6,846.7 |
| EU-1( | Corporate | 43.2 |
| EU-1: | Exposures in default | 46.6 |
| EU-1: | Other exposures (e.g. equity, securitisations, and other non-credit obligation assets) | 684.2 |

### Disclosure on qualitative items

1 **Description of the processes used to manage the risk of excessive leverage:**
Leverage exposure and management is embedded as part of the Group's capital planning process and considered in line with the Common Equity Tier 1 capital and risk-based asset ratios as part of the long term plan. The Capital Management Forum tracks compliance monitoring of leverage and performance to plan on a monthly basis. Management actions are recommended by the Capital Management Forum to the Asset and Liability Committee to prevent the Group from being excessively leveraged and to seek to ensure that capital ratios remain in excess of minimum capital requirements in normal circumstances and in stress.

2 **Description of the factors that had an impact on the leverage ratio during the period to which the disclosed leverage ratio refers:**
The Group's leverage ratio has increased in the year from 9.6% to 10.3% on a transitional basis, which is primarily driven from a higher increase in the Common Equity Tier 1 capital, as a result of retained earnings, than exposures.

## Appendix 3: Transitional Own Funds Disclosure

In order to meet the requirements for disclosure of the specific items on own funds described in points (d) and (e) of Article 437 (1) of CRR No 575/2013, institutions are required to disclose transitional own funds by way of derogation to 31 December 2017. The following details the Group's disclosure:

| | | Reference to Table 1 | February 2016 Transitional Rules £m | February 2015 Transitional Rules £m |
|---|---|---|---|---|
| | **Common equity tier 1 capital: instruments and reserves** | | | |
| 1 | Capital instruments and the related share premium accounts | | **1,220.2** | **1,220.2** |
| | of which: ordinary share capital | *k,l* | 1,220.2 | 1,220.2 |
| | of which: instrument type 2 | | - | - |
| | of which: instrument type 3 | | - | - |
| 2 | Retained earnings | *m* | 178.3 | 98.9 |
| 3 | Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards) | *o* | 27.3 | 21.8 |
| 3a | Funds for general banking risk | | - | - |
| 4 | Amount of qualifying items referred to in Article 484(3) and the related share premium accounts subject to phase out from Common Equity Tier 1 | | - | - |
| 5 | Minority interests (amount allowed in consolidated Common Equity Tier 1) | | - | - |
| 5a | Independently reviewed interim profits net of any foreseeable charge or dividend | *n* | 138.4 | 79.4 |
| 6 | Common Equity Tier 1 capital before regulatory adjustments | | **1,564.2** | **1,420.3** |
| | **Common Equity Tier 1 capital: regulatory adjustments** | | | |
| 7 | Additional value adjustments (negative amount) | | (1.1) | - |
| 8 | Intangible assets (net of related tax liability) (negative amount) | *g,i* | (337.4) | (364.8) |
| 9 | Empty set in the EU | | - | - |
| 10 | Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38(3) are met) (negative amount) | | - | - |
| 11 | Fair value reserves related to gains or losses on cash flow hedges | *p* | 1.6 | (0.7) |
| 12 | Negative amounts resulting from the calculation of expected loss amounts | | - | - |
| 13 | Any increase in equity that results from securitised assets (negative amount) | | - | - |
| 14 | Gains or losses on liabilities valued at fair value resulting form changes in own credit standing | *h* | (0.8) | (0.1) |
| 15 | Defined-benefit pension fund assets (negative amount) | | | - |
| 16 | Direct and indirect holdings by an institution of own Common Equity Tier 1 instruments (negative amount) | | - | - |
| 17 | Holdings of the Common Equity Tier 1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount) | | - | - |
| 18 | Direct and indirect holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | | - | - |
| 19 | Direct, indirect and synthetic holdings by the institution of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | | - | - |
| 20 | Empty set in the EU | | - | - |
| 20a | Exposure amount of the following items which qualify for a risk weight of 1250%, where the institution opts for the deduction alternative | | - | - |
| 20b | of which: qualifying holdings outside the financial sector (negative amount) | | - | - |
| 20c | of which: securitisation positions (negative amount) | | - | - |
| 20d | of which: free deliveries (negative amount) | | - | - |
| 21 | Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38(3) are met) (negative amount) | | - | - |
| 22 | Amount exceeding the 15% threshold (negative amount) | | - | - |
| 23 | entities where the institution has a significant investment in those entities | | - | - |
| 24 | Empty set in the EU | | - | |
| 25 | of which: deferred tax assets arising from temporary differences | | - | - |
| 25a | Losses for the current financial year (negative amount) | | - | - |
| 25b | Foreseeable tax charges relating to Common Equity Tier 1 items (negative amount) | | - | - |
| 26 | Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment | | - | - |
| 26a | Regulatory adjustments relating to unrealised gains and losses pursuant to Article 467 and 468 | | - | - |
| | of which: Filter for Unrealised Loss 1 | | - | - |
| | of which: Filter for Unrealised Loss 2 | | - | - |
| | of which: Filter for unrealised gains on Available For Sale Debt instruments | | - | - |
| | of which: Filter for unrealised gain 2 | | - | - |
| 26b | Amount to be deducted from or added to common equity Tier 1 Capital with regard to additional filters and deductions required pre CRR | | - | - |
| 27 | Qualifying Additional Tier 1 deductions that exceed the Additional Tier 1 capital of the institution (negative amount) | *c* | (6.8) | (10.2) |
| 28 | Total regulatory adjustments to Common Equity Tier 1 | | **(344.5)** | **(375.8)** |
| 29 | Common Equity Tier 1 capital | | **1,219.7** | **1,044.5** |

| | | Reference to Table 1 | February 2016 Transitional Rules £m | February 2015 Transitional Rules £m |
|---|---|---|---|---|
| | **Additional Tier 1 Capital: instruments** | | | |
| 30 | Capital instruments and the related share premium accounts | | - | - |
| 31 | of which: classified as equity under applicable accounting standards | | - | - |
| 32 | of which: classified as liabilities under applicable accounting standards | | - | - |
| 33 | Amount of qualifying items referred to in Article 484(4) and the related share premium accounts subject to phase out from Additional Tier 1 | | - | - |
| | Public sector capital injections grandfathered until 1 January 2018 | | - | - |
| 34 | Qualifying Tier 1 capital included in consolidated Additional Tier 1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties | | - | - |
| 35 | of which: instruments issued by subsidiaries subject to phase out | | - | - |
| **36** | Additional Tier 1 capital before regulatory adjustments | | **-** | - |
| | **Additional Tier 1 (AT1) capital: regulatory adjustments** | | | |
| 37 | Direct and indirect holdings by an institution of own Additional Tier 1 instruments (negative amount) | | - | - |
| 38 | Holdings of the Additional Tier 1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount) | | - | - |
| 39 | Direct and indirect holdings of the Additional Tier 1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | | - | - |
| 40 | Direct and indirect holdings by the institution of the Additional Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | | - | - |
| 41 | Regulatory adjustments applied to Additional Tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts) | | - | - |
| 41a | Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to Article 472 of Regulation (EU) No 575/2013 | | - | - |
| | of which: items to be detailed line by line e.g., material net interim losses, intangibles, shortfall of provisions to expected losses etc. | | - | - |
| 41b | Residual amounts deducted form Additional Tier 1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to Article 475 of Regulation (EU) 575/2013 | | - | - |
| | of which: items to be detailed line by line e.g., reciprocal cross holdings in Tier 2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc. | | - | - |
| 41c | Amount to be deducted from or added to Additional Tier 1 capital with regard to additional filters and deductions required pre-CRR | | - | - |
| | of which: possible filter for unrealised losses | | - | - |
| | of which: possible filter for unrealised gains | | - | - |
| 42 | Qualifying Tier 2 deductions that exceed the Tier 2 capital of the institution (negative amount) | | - | - |
| 43 | Total regulatory adjustments to Additional Tier 1 capital | | - | - |
| 44 | Additional Tier 1 capital | | - | - |
| 45 | Tier 1 capital (Tier 1=Common Equity Tier 1+Additional Tier 1) | | **1,219.7** | **1,044.5** |
| | **Tier 2 capital: instruments and provisions** | | | |
| 46 | Capital instruments and the related share premium accounts | *j* | 235.0 | 235.0 |
| 47 | Amount of qualifying items referred to in Article 484(5) and the related share premium accounts subject to phase out from Tier 2 | | - | - |
| 48 | Qualifying own funds instruments included in consolidated Tier 2 capital (including minority interests and Additional Tier 1 instruments not included in rows 5 or 34), issued by subsidiaries and held by | | - | - |
| 49 | of which: instruments issued by subsidiaries subject to phase out | | - | - |
| 50 | Credit risk adjustments | *a* | 44.6 | 36.1 |
| 51 | Tier 2 capital before regulatory adjustments | | **279.6** | **271.1** |
| | **Tier 2 capital: regulatory adjustments** | | | |
| 52 | Direct and indirect holdings by an institution of own Tier 2 instruments and subordinated loans (negative amount) | | - | - |
| 53 | Holdings of Tier 2 instruments and subordinated loans of financial sector entities where those entities have reciprocal holdings with the institution designed to inflate artificially the own funds requirement of the institution (negative amount) | | - | - |
| 54 | Direct and indirect holdings of the Tier 2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount) | | - | - |
| 54a | of which: new holdings not subject to transitional arrangements | | - | - |
| 54b | of which: holdings existing before 1 January 2013 and subject to transitional arrangements | | - | - |
| 55 | Direct and indirect holdings by the institution of the Tier 2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount) | *d,e* | (27.3) | (23.9) |
| 56 | Regulatory adjustments applied to Tier 2 in respect of amounts subject to Pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) N0 575/2013 (i.e.CRR residual amounts) | | - | - |
| 56a | Residual amounts deducted from Tier 2 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to Article 472 of Regulation (EU) 575/2013 | | - | - |
| | of which: items to be detailed line by line e.g., material net interim losses, intangibles, shortfall of provisions to expected losses etc. | | - | - |
| 56b | Residual amounts deducted from Tier 2 capital with regard to deduction from Additional Tier 1 capital during the transitional period pursuant to Article 475 of Regulation (EU) 575/2013 | | - | - |
| | of which: items to be detailed line by line e.g., reciprocal cross holdings in Additional Tier 1 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc. | | - | - |

| | | Reference to Table 1 | February 2016 Transitional Rules £m | February 2015 Transitional Rules £m |
|---|---|---|---|---|
| 56c | Amount to be deducted from or added to Additional tier 2 capital with regard to additional filters and deductions required pre CRR | | - | - |
| | of which: possible filter for unrealised losses | | - | - |
| | of which: possible filter for unrealised gains | | - | - |
| 57 | Total regulatory adjustments to Tier 2 capital | | **(27.3)** | **(23.9)** |
| 58 | Tier 2 capital | | **252.3** | **247.2** |
| 59 | Total capital (Total Capital=Tier 1+Tier 2) | | **1,472.0** | **1,291.7** |
| 59a | Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts) | | - | - |
| | of which: items not deducted from Common Equity Tier 1 (Regulation (EU) 575/2013 residual amounts) (items to be detailed line by line e.g. deferred tax assets that rely on future profitability net of related tax liability, indirect holdings of own Common Equity Tier 1 etc.) | | - | - |
| | of which: items not deducted from Additional Tier 1 items (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line e.g., reciprocal cross holdings in Tier 2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc.) | | - | - |
| | of which: items not deducted from Tier 2 items (Regulation (EU) 575/2013 residual amounts) (items to be detailed line by line e.g., indirect holdings of own Tier 2 instruments, indirect holdings of non significant investments in the capital of other financial sector entities, indirect holdings of significant investments in the capital of other financial sector entities etc.) | | - | - |
| 60 | Total Risk Weighted Assets | | **7,366.4** | **6,846.5** |
| | **Capital ratios and buffers** | | | |
| 61 | Common equity tier 1 (as a % of risk exposure amount) | | **16.6%** | **15.3%** |
| 62 | Tier 1 (as a % of risk exposure amount) | | **16.6%** | **15.3%** |
| 63 | Total capital (as a % of risk exposure amount) | | **20.0%** | **18.9%** |
| 64 | Institution specific buffer requirements (Common Equity Tier 1 requirement in accordance with Article 92(1) a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (Global or Other systemically important buffer) expressed as a % of risk exposure amount) | | 5.1% | 0.0% |
| 65 | of which: capital conservation buffer requirement | | 0.6% | 0.0% |
| 66 | of which: countercyclical buffer requirement | | 0.0% | 0.0% |
| 67 | of which: systemic risk buffer requirement | | 0.0% | 0.0% |
| 67a | of which: Global Systemically Important Institution or Other Systemically Important Institution buffer | | 0.0% | 0.0% |
| 68 | Common equity tier 1 available to meet buffers (as a % of risk exposure amount) | | 12.1% | - |
| 69 | [non relevant in EU regulation] | | - | - |
| 70 | [non relevant in EU regulation] | | - | - |
| 71 | [non relevant in EU regulation] | | - | - |
| | **Amounts below the thresholds for deduction (before risk weighting)** | | - | - |
| 72 | Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short | *b* | 3.5 | - |
| 73 | Direct and indirect holdings of the Common Equity Tier 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions) | *f* | 71.0 | 71.0 |
| 74 | Empty set in the EU | | - | - |
| 75 | Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in 38(3) are met) | | - | - |
| | **Applicable caps on the inclusion of provisions in Tier 2** | | | |
| 76 | Credit risk adjustments included in Tier 2 in respect of exposures subject to standardised approach (prior to the application of the cap) | *a* | 44.6 | 36.1 |
| 77 | Cap on inclusion of credit risk adjustments in Tier 2 under standardised approach | | 78.2 | 72.4 |
| 78 | Credit risk adjustments included in Tier 2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap) | | - | - |
| 79 | Cap for inclusion of credit risk adjustments in Tier 2 under internal ratings based approach | | - | - |
| | **Capital Instruments subject to phase out arrangements (between 1 January 2013 and 1 January 2022)** | | - | - |
| 80 | Current cap on Common Equity Tier 1 instruments subject to phase out arrangements | | - | - |
| 81 | Amount excluded from Common Equity Tier 1 due to cap (excess over cap after redemptions and maturities) | | - | - |
| 82 | Current cap on Additional Tier 1 instruments subject to phase out arrangements | | - | - |
| 83 | Amount excluded from Additional Tier 1 due to cap (excess over cap after redemptions and maturities) | | - | - |
| 84 | Current cap on Tier 2 instruments subject to phase out arrangements | | - | - |
| 85 | Amount excluded from Tier 2 due to cap (excess over cap after redemptions and maturities) | | - | - |

## Appendix 4: Capital Instrument Key Features

| Capital instruments key features: | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Common Equity Tier 1 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 |
| 1 | Issuer | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc | Tesco Personal Finance Plc |
| 2 | Unique identifier (e.g., CUSIP, ISIN or Bloomberg identifier for private placement) | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement | Private Placement |
| 3 | Governing law(s) of the instrument | English Law | English Law | English Law | English Law | English Law | English Law | English Law | English Law | English Law |
| 4 | Transitional CRR Rules | Common Equity Tier 1 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 |
| 5 | Post-transitional CRR Rules | Common Equity Tier 1 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 |
| 6 | Eligible at Solo /(sub-) consolidated/ solo & (sub-) consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated | Solo and Consolidated |
| 7 | Instrument type (types to be specified by each jurisdiction) | Common Equity | Dated Floating Rate Subordinated Notes | Undated Floating rate Subordinated Notes | Dated Floating Rate Subordinated Notes | Undated Floating rate Subordinated Notes | Undated Floating rate Subordinated Notes | Dated Floating Rate Subordinated Notes | Dated Floating Rate Subordinated Notes | Dated Floating Rate Subordinated Notes |
| 8 | Amount recognised in regulatory capital (currency in million, as of most recent reporting date) | £1,219.9m comprising nominal and premium | £20m | £9m | £10m | £16m | £20m | £35m | £95m | £30m |
| 9 | Nominal amount of instrument | £0.10 | £20m | £9m | £10m | £16m | £20m | £35m | £95m | £30m |
| 9a | Issue price | £1.00 | £20m | £9m | £10m | £16m | £20m | £35m | £95m | £30m |
| 9b | Redemption price | n/a | £20m | £9m | £10m | £16m | £20m | £35m | £95m | £30m |
| 10 | Accounting classification | Shareholders equity | Liability - amortised cost | Shareholders equity | Liability - amortised cost | Shareholders equity | Shareholders equity | Liability - amortised cost | Liability - amortised cost | Liability - amortised cost |
| 11 | Original date of issuance | £10m 12 Aug 1997<br>£10m 21 Nov 1997<br>£20m 2 Jan 1998<br>£20m 1 Apr 1998<br>£25m 30 Sep 1998<br>£6.5m 18 Nov 1998<br>£20m 30 Apr 1999<br>£20m 30 Jun 1999<br>£20m Sep 1999<br>£22.4m 17 Nov 1999<br>£10m 29 Feb 2000<br>£20m 13 Mar 2000<br>£10m 19 Apr 2000<br>£10m 31 May 2000<br>£14m 31 Aug 2000<br>£10m 30 Nov 2001<br>£25m 7 Apr 2009<br>£25m 17 Jun 2009<br>£180m 26 Jan 2010<br>£50m 5 Mar 2010<br>£60m 20 May 2010<br>£39m 4 Aug 2010<br>£39m 6 Sep 2010<br>£40m 27 Sep 2010<br>£25m 15 Nov2010<br>£25m 8 Dec2010<br>£20m 21 Jan 2011<br>£147.5m 25 Feb 2011<br>£50m 10 Mar 2011<br>£61.5m 28 Sep 2011<br>£45m 26 Apr 2012<br>£140m 22 Jul 2013 | 10 Apr 2002 | 10 Apr 2002 | 19 Sep 2002 | 19 Sep 2002 | 10 Dec 2002 | 28 Apr 2003 | 31 Dec 2007 | 25 Feb 2010 |
| 12 | Perpetual or dated | Perpetual | Dated | Perpetual | Dated | Perpetual | Perpetual | Dated | Dated | Dated |
| 13 | Original maturity date | No maturity | 29 March 2030 | No maturity | 29 March 2030 | No Maturity | No Maturity | 29 March 2030 | 29 March 2030 | 29 March 2030 |
| 14 | Issuer call subject to prior supervisory approval | No | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| 15 | Option call date, contingent call dates and redemption amount | n/a | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest | Earliest option call date 31 March 2025, may repay on any date if a Regulatory Event or Tax Event occurs, redemption can be in whole or in part at par value plus accrued interest |
| 16 | Subsequent call dates, if applicable | n/a | each quarter thereafter until maturity | each quarter thereafter until maturity | each quarter thereafter until maturity | each quarter thereafter until maturity | each quarter thereafter until maturity | each quarter thereafter until maturity | each quarter thereafter until maturity | each quarter thereafter until maturity |
| 17 | Fixed or floating dividend/coupon | Floating | Floating | Floating | Floating | Floating | Floating | Floating | Floating | Floating |
| 18 | Coupon rate and any related index | n/a | 3month GBP LIBOR plus 0.60 per cent per annum | 3month GBP LIBOR plus 1.20 per cent per annum | 3month GBP LIBOR plus 0.60 per cent per annum | 3month GBP LIBOR plus 2.20 per cent per annum | 3month GBP LIBOR plus 2.20 per cent per annum | 3month GBP LIBOR plus 1.60 per cent per annum | 3month GBP LIBOR plus 1.00 per cent per annum | 3month GBP LIBOR plus 1.75 per cent per annum |
| 19 | Existence of a dividend stopper | No | No | No | No | No | No | No | No | No |

| Capital instruments key features: | | Common Equity Tier 1 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 | Tier 2 |
|---|---|---|---|---|---|---|---|---|---|---|
| 20a | Fully discretionary, partially discretionary or mandatory (in terms of timing) | Fully discretionary | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory |
| 20b | Fully discretionary, partially discretionary or mandatory (in terms of amount) | Fully discretionary | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory | Mandatory |
| 21 | Existence of step-up or other incentive to redeem | No | No | No | No | No | No | No | No | No |
| 22 | Non-cumulative or cumulative | Non-cumulative | Cumulative | Cumulative | Cumulative | Cumulative | Cumulative | Cumulative | Cumulative | Cumulative |
| 23 | Convertible or non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible | Non-convertible |
| 24 | If convertible, conversion trigger(s) | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 25 | If convertible, fully or partially | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 26 | If convertible, conversion rate | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 27 | If convertible, mandatory or optional conversion | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 28 | If convertible, specify instrument type convertible into | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 29 | If convertible, specify issuer of instrument it converts into | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 30 | Write-down features | No | No | No | No | No | No | No | No | No |
| 31 | If write-down, write-down trigger(s) | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 32 | If write-down, full or partial | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 33 | If write-down, permanent or temporary | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 34 | If temporary write-down, description of write-up mechanism | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to | All subordinated notes - Columns 3-10 | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities | All liabilities except the subordinated liabilities |
| 36 | Non-compliant transitional features | No | No | No | No | No | No | No | No | No |
| 37 | If yes, specify non-compliant features | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |

## Appendix 5: Encumbered and Unencumbered Assets

Asset encumbrance guidelines, issued by the European Banking Authority, set out four tables for the disclosure of asset encumbrance:

- Template A reports the encumbered and unencumbered assets carrying and fair values;
- Template C shows the carrying amount of encumbered assets/collateral received along with associated liabilities; and
- Template D discloses narrative information relating to the impact of the Group's business model on the level of encumbrance, as well as the importance of encumbrance in the funding model. Note, Template B is not required for disclosure as the Group does not have a trading book and is below the fair value of collateral minimum limit. Month on month volatility is not deemed significant and hence the figures below are shown as spot rather than rolling month averages.

These tables have been included as an appendix on the basis that these disclosures represent draft guidelines with more extensive guidelines expected at a later date, which will be transformed into a binding technical standard.

**Template A - Assets**

| Assets of the reporting institution | Carrying amount of encumbered assets (£m) | Fair value of encumbered assets (£m) | Carrying amount of unencumbered assets (£m) | Fair value of unencumbered assets (£m) |
|---|---|---|---|---|
| Loans on demand | - | | 493.5 | |
| Equity instruments | - | - | 74.6 | 79.6 |
| Debt securities | 32.9 | 32.9 | 947.1 | 947.1 |
| Other assets | - | | 478.6 | |
| Loans and advances other than on demand | 2,738.5 | | 6,206.6 | |

**Template C - Encumbered assets/collateral received and associated liabilities**

| | Matching liabilities, contingent liabilities or securities lent (£m) | Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered (£m) |
|---|---|---|
| **Carrying amount of selected financial liabilities** | **1,033.6** | **2,771.4** |
| of which: derivatives | 151.5 | 120.5 |
| of which: deposits | 82.1 | 1,753.0 |
| of which: debt securities | 800.0 | 897.9 |
| of which: other sources of encumbrance | - | - |

**Template D - Information on importance of encumbrance**

The Group defines risk appetite for Total encumbrance and Product encumbrance for Credit cards, Personal Loans and Mortgages as part of the Group's ILAA process. Assigning and/or pledging assets as part of the Group secured funding and repo markets give rise to the Group encumbrance.

## Appendix 6: Analysis of the Number of Directorships held by Members of the Board

The following breakdown shows the number of directorships held by members of the Group:

| Name | Position within Tesco Personal Finance Group Ltd | Changes in the year | Executive | Non-Executive |
|---|---|---|---|---|
| Graham Pimlott | Independent Non-Executive Chairman | | 1 | 2 |
| Karl Bedlow | Managing Director, Insurance | Appointed 29/01/16 | 1 | 0 |
| Peter Bole | Chief Financial Officer | | 1 | 0 |
| Feike Brouwers | Chief Risk Officer | Appointed 05/08/15 | 1 | 0 |
| Iain Clink | Deputy Chief Executive | | 1 | 0 |
| Robert Endersby | Independent Non Executive | | 0 | 1 |
| Bernard Higgins | Chief Executive | | 1 | 1 |
| Simon Machell | Independent Non Executive | | 0 | 2 |
| James McConville | Independent Non Executive | | 1 | 1 |
| David McCreadie | Managing Director, Banking | Appointed 09/12/15 | 1 | 0 |
| Deanna Oppenheimer | Non-Executive | | 0 | 4 |
| Raymond Pierce | Senior Independent Non Executive | | 0 | 4 |

Multiple directorships within the same group are treated as a single role.

Gareth Bullock resigned as Independent Non-Executive Director on 9th December 2015.

Information on their skills and experience is set out in their biographies on the Tesco Bank corporate website: http://corporate.tescobank.com/61/about-us/board-and-executive-committee

## Appendix 7: Regulatory Capital Requirements and Buffers (end point)

| Capital buffer | Description | Capital requirement |
|---|---|---|
| Pillar 1 | Sets out the minimum capital requirements that firms are required to meet for credit, market and operational risk. | 8% of risk weighted assets, of which 4.5% is to be met with Common Equity Tier 1 capital. |
| Pillar 2A / individual capital guidance | Sets out requirements on firms with regard to their internal capital adequacy assessment processes, internal procedures and control mechanisms. | To be met with at least 56% Common Equity Tier 1 capital. |
| Systemic importance buffers | The purpose of the buffers for systemically important institutions is to allocate capital within the system to systemic banks in line with the greater costs of their distress or failure to the economy.<br>In the UK, this consists of the buffer for global systemically important banks, applied at the group level, and the systemic risk buffer, to apply to ring-fenced banks and large building societies).<br>The list of global systemically important banks is published by the Financial Stability Board. The Group is not deemed to be globally systemic bank.<br>Consultation is expected to be finalised in 2016, with implementation planned for 2019. This buffer is to be applied by the PRA to ring fenced banks and building societies.<br>In addition, the PRA may apply a buffer for other systemically important institutions, to be identified by the PRA during 2016. | 0% - 2.5% risk weighted assets, to be met with Common Equity Tier 1 capital. |
| Capital conservation buffer | The purpose of this buffer is to enable firms to absorb losses in stressed periods.<br>All firms will be subject to a capital conservation buffer of 2.5% of risk weighted assets at both group and solo level.<br>The buffer will be phased in from 1 January 2016, starting at 0.625%, increasing each subsequent year by an additional 0.625% to reach its final level of 2.5% by 1 January 2019. | 2.5% risk weighted assets, to be met with Common Equity Tier 1 capital. |
| Countercyclical buffer (CCB) | Requires firms to build up capital when aggregate growth in credit is judged to be associated with a build-up of system wide risk. The buffer may be reduced by the regulator in a period of stress.<br>The CCB must be held in the form of common equity and is required to be implemented from January 2016.<br>The Financial Policy Committee is responsible for setting the UK CCB rate that applies to UK exposures of banks incorporated in the UK. | The Financial Policy Committee has kept the UK CCB rate at 0% during the period to February 2016. |
| PRA buffer (PRA requirement) | The PRA may impose a firm-specific buffer incremental to Pillar 1, Pillar 2A and the CRD IV buffers to replace the Capital Planning Buffer (CPB).<br>More information is to be provided by the PRA on the transition to this buffer. In the meantime, firms are required to continue with CPB policy. | Firm specific, set in Common Equity Tier 1 capital at PRA's discretion. |

## Glossary of Terms

| | Definition |
|---|---|
| **A** | |
| Asset encumbrance | A claim against a property by another party. Encumbrance usually impacts the transferability of the property and can restrict its free use until the encumbrance is removed. |
| **B** | |
| Basel II | The capital adequacy framework issued by the BCBS (June 2006) in the form of the 'International Convergence of Capital Measurement and Capital Standards'. |
| Basel III | The capital reforms and introduction of a global liquidity standard proposed by the BCBS in 2010 and due to be phased in, through CRD IV from 2014 onwards. |
| **C** | |
| Capital conservation buffer | A capital buffer designed to ensure that banks are able to build up capital buffers outside of periods of stress which can then be drawn upon as losses are incurred. |
| Capital requirements directive (CRD) | A legislative package relating to capital adequacy, issued by the European Commission and adopted by EU member states.<br>CRD I, II and III were issued in 2006, 2010 and 2011 respectively.<br>CRD IV came into force on 1 January 2014 and implements the Basel III proposals together with transitional arrangements for some of its requirements. |
| Capital resources | Eligible capital held in order to satisfy capital requirements. |
| Common Equity Tier 1 capital (CET1) | The highest form of regulatory capital under CRD IV, comprising common shares issued, related share premium, retained earnings and other reserves less regulatory adjustments. |
| Countercyclical capital buffer (CCB) | A capital buffer which aims to ensure that capital requirements take account of the macro-economic financial environment in which banks operate. This aims to provide the banking sector as a whole with additional capital to protect it from potential future losses. In times of adverse financial or economic circumstances, when losses tend to deplete capital and banks are likely to restrict the supply of credit, the CCB should be released to help avoid a credit crunch. |
| Counterparty credit risk | The risk that a counterparty to a transaction could default before the final settlement of the transaction's cash flows. |
| CRD IV | Legislation published in June 2013 (in force from 1 January 2014) by the European Commission, comprising the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR) and together forming the CRD IV package.<br>Implements the Basel III proposals in addition to new proposals on sanctions for non-compliance with regulatory rules, corporate governance and remuneration.<br>The rules have been implemented in the UK via PRA policy statement PS7/13 with some elements subject to transitional phase in. |
| Credit quality step | A step in the PRA's credit quality assessment scale which is based on the credit ratings applied by external credit assessment institutions. The scale is used to assign risk weightings to exposures under the standardised Approach. |
| Credit Conversion Factor | Used to determine the exposure at default (EAD) in relation to credit risk exposure. The credit conversion factor is an estimate of the proportion of undrawn commitments expected to be drawn down at the point of default. |
| Credit risk | The risk that a borrower or counterparty fails to repay the interest or capital on a loan or other financial instrument. |
| Credit risk mitigation | Techniques used to reduce the credit risk associated with an exposure. |
| Credit Valuation Adjustments | Adjustments to the fair value of derivative assets to reflect the credit worthiness of the counterparty. |
| **D** | |
| Derivatives | Financial instruments whose value is based on the performance of one or more underlying assets. |
| **E** | |
| Exposure | A claim, contingent claim or position which carries a risk of financial loss. |

| | |
|---|---|
| Exposure at default (EAD) or exposure value | The amount expected to be outstanding after any credit risk mitigation, if and when the counterparty defaults. EAD reflects both drawn down balances as well as an allowance for undrawn commitments and contingent exposures. |
| External Credit Assessment Institutions | These include external credit rating agencies such as Standard & Poor's, Moody's and Fitch. |
| **F** | |
| Fair value | The price that would be received to sell an asset or paid to transfer a liability between market participants. |
| Forbearance | This takes place when a concession is made on the contractual terms of a loan in response to a counterparty's financial difficulties. |
| Funding Risk | The risk that the institution does not have sufficiently stable and diverse sources of funding. |
| **I** | |
| Impaired exposures | Exposures where it is not expected that all contractual cash flows will be collected or will be collected when they are due. |
| Impairment charge and impairment provisions | Provisions held on the balance sheet as a result of the raising of an impairment charge against profit for the incurred loss inherent in the lending book. Impairment provisions may be individual or collective. |
| Impairment losses | The reduction in value that arises following an impairment review of an asset which has determined that the asset's value is lower than its carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate. |
| Insurance risk | The risks accepted through the provision of insurance products in return for a premium. That, over time, the combined cost of claims, administration and acquisition of the contract may exceed the aggregate amount of premiums received and the investment income. |
| Interest Rate Risk (IRR) | The risk arising predominantly from the mismatch between interest rate sensitive assets and liabilities, but also to the investment term of capital and reserves, and the need to minimise income volatility. |
| Internal Capital Adequacy Assessment Process | The institution's own assessment, based on Basel II requirements, of the level of capital needed in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events. |
| International Swaps and Derivatives Association (ISDA) master agreement | A standardised contract developed by the ISDA which is used as an umbrella contract for bilateral derivative contracts. |
| **L** | |
| Leverage ratio | Tier 1 capital divided by the exposure measure. |
| Liquidity risk | Liquidity risk is the risk that the institution has insufficient cash resources to meet its obligations as they fall due or can only do so only at excessive cost. |
| **M** | |
| Mark-to-Market approach | One of three methods available to calculate exposure values for counterparty credit risk. The method adjusts daily to account for profits and losses in the value of related assets and liabilities. |
| Market risk | The risk that the value of the institution's assets, liabilities, income or costs might vary due to changes in the value of financial market process. This includes interest rates, foreign exchange rates, credit spreads and equities. |
| Minimum capital requirement | The minimum regulatory capital that must be held in accordance with Pillar 1 requirements for credit, market and operational risk. |
| **O** | |
| Operational risk | The risk of loss, resulting from ineffective or inadequately designed internal processes, system |

| | |
|---|---|
| | failure, improper conduct, human error or from external events. |
| Over-the-Counter derivatives | Derivatives for which the terms and conditions can be freely negotiated by the counterparties involved, unlike exchange traded derivatives which have standardised terms. |
| **P** | |
| Past due loans | Loans are past due when a counterparty has failed to make a payment in line with their contractual obligations. |
| Pillar 1 | The first pillar of the Basel II framework sets out the minimum regulatory capital requirements for credit, market and operational risks. |
| Pillar 2 | The second Pillar of the Basel II framework, known as the Supervisory Review Process, sets out the review process for a bank's capital adequacy; the process under which supervisors evaluate how well banks are assessing their risks and the actions taken as a result of these assessments. |
| Pillar 3 | The third pillar of the Basel II framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market. |
| Prudential Regulatory Authority (PRA) | Responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms in the UK. |
| **R** | |
| Regulatory capital | The capital that a bank holds, determined in accordance with rules established by the PRA. |
| Residual maturity | The length of time remaining from present date until the maturity of the exposure. |
| Retail loans | Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as Mortgages and Credit Cards. |
| Risk Appetite | The level and types of risk that a firm is willing to assume to achieve its strategic objectives. |
| Risk Weighted Assets (RWA) | Calculated by assigning a degree of risk expressed as a percentage (risk weight) to an exposure value in accordance with the applicable standardised and IRB approach rules. |
| **S** | |
| Securitisation | A transaction or scheme whereby the credit risk associated with an exposure, or pool of exposures, is grouped and where payments to investors is dependent upon the performance of the underlying exposure or pool of exposures. |
| Securities Financing Transactions (SFT) | The act of lending, or borrowing, a stock, derivative, or other security to or from an investor or firm. |
| Stress testing | The term used to describe techniques where plausible events are considered as vulnerabilities to ascertain how this will impact the capital resources which are required to be held. |
| Securitisation Structured Entity | A corporation, trust, or other non-bank entity, established for a defined purpose, including for carrying on securitisation activities. Structured entities are designed to isolate its obligations from those of the originator and the holder of the beneficial interests in the securitisation. |
| Standardised approach | In relation to credit risk, the method for calculating credit risk capital requirements using risk weightings that are prescribed by the regulator. Standardised approaches, following prescribed methodologies also exist for calculating market and operational risk capital requirements. |
| Subordinated liabilities | Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer. |
| **T** | |
| Tier 1 capital | A component of regulatory capital, comprising Common Equity Tier 1 capital and other Tier 1 capital. Other Tier 1 capital includes qualifying capital instruments such as non-cumulative perpetual preference shares and other Tier 1 capital securities. |
| Tier 2 capital | A component of regulatory capital, comprising qualifying subordinated loan capital and related on-controlling interests. |
| **W** | |
| Wrong way risk | The risk that arises from the correlation between a counterparty exposure and the credit quality of the counterparty. The risk that the probability of default increases with exposure. |