TESCO PERSONAL FINANCE GROUP LIMITED

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 28 FEBRUARY 2018

Company Number SC173198

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DIRECTORS AND ADVISERS

Directors:	Graham Pimlott	Non-Executive Chairman
	Karl Bedlow	Chief Customer Officer
	John Castagno	Independent Non-Executive Director
	Iain Clink	Interim Chief Executive
	Robert Endersby	Independent Non-Executive Director
	Richard Henderson	Chief Risk Officer
	Declan Hourican	Chief Financial Officer
	Simon Machell	Independent Non-Executive Director
	James McConville	Independent Non-Executive Director
	David McCreadie	Managing Director
	Amanda Rendle	Independent Non-Executive Director
	Alan Stewart	Non-Executive Director
	James Willens	Senior Independent Non-Executive Director

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TESCO PERSONAL FINANCE GROUP LIMITED
STRATEGIC REPORT

The Directors present their Strategic Report for the year ended 28 February 2018.

The Annual Report and Financial Statements comprise the Strategic Report, the Directors' Report, and the Company and Consolidated Financial Statements and accompanying notes. In the Annual Report and Financial Statements, unless specified otherwise, the 'Company' means Tesco Personal Finance Group Limited and the 'Group' means the Company and its subsidiaries and joint venture included in the Consolidated Financial Statements.

Business Model

The Group is primarily focused on providing financial services and products to personal customers in the UK. The Company owns the entire issued share capital of Tesco Personal Finance plc, which is engaged in the provision of banking and general insurance services and operates using the trading name Tesco Bank. In addition, the Group owns 49.9% of Tesco Underwriting Limited (TU), an authorised insurance company. TU is accounted for as a joint venture of the Group. The Company is incorporated and registered in Scotland.

Headlines

Income Statement

- Profit before tax is 84.1% higher at £202.7m (2017: £110.1m). The key drivers of the increase in profit before tax are:
    - a lower net customer redress charge of £23.8m compared to a charge of £45.0m in the prior year. An additional payment protection insurance (PPI) charge of £35.0m (2017: £45.0m) was recognised during the year, further detail on the drivers of which is set out in note 27. This was partially offset by a provision release of £1.5m (2017: £nil) from the Group's Consumer Credit Act (CCA) customer redress provision and a credit of £9.7m (2017: £nil) received following the conclusion of negotiations with a third party in respect of previously recognised customer redress;
    - lower net restructuring charges of £nil compared to charges of £34.8m in the prior year relating to the Group's Customer 2020 (C2020) programme;
    - a charge of £nil compared to a charge of £22.8m in the prior year representing the Group's share of losses incurred by TU relating to the impact on TU's insurance reserves of a prior year change in the Ogden tables, which are used to calculate future losses in personal injury and fatal accident claims; and
    - higher unrealised gains on financial instruments of £11.0m (2017: £6.3m).
- Underlying profit before tax, which excludes items which are not reflective of ongoing trading performance, is 4.4% higher at £215.5m (2017: £206.4m)[1]. The key drivers of underlying profit are:
    - a 12.3% increase in underlying net interest income to £493.1m (2017: £439.2m), reflecting higher interest earnings on the back of strong lending growth. Underlying net interest margin has decreased slightly to 3.9% (2017: 4.0%), reflecting the impact of growth in the lower margin Mortgage book as a percentage of the Group's overall lending portfolio, partially offset by an improved Credit Card margin;
    - a 3.1% reduction in underlying non-interest income to £355.5m (2017: £366.9m). This is predominantly due to a reduction in ATM income as a result of the downward trend in ATM transactions being seen across the market as customers move towards contactless and other digital payment methods and increased pressure on Insurance renewal retention rates due to a highly competitive environment and revised Renewal Transparency rules;
    - a 0.8% increase in underlying operating expenses to £506.6m (2017: £502.4m). Cost control remains a key focus for the Group, and as such, the underlying cost:income ratio has improved to 59.7% (2017: 62.3%); and

[1] A reconciliation of statutory and underlying profit before tax is set out on page 6.

  - a 30.6% increase in underlying impairment charges to £136.5m (2017: £104.5m). This reflects a combination of balance growth and the implementation of a number of credit initiatives in recent years, which have been targeted at supporting the borrowing needs of Tesco customers in a profitable and controlled manner. The underlying impairment charge also reflects a higher gain on sale of non-performing debt, with £34.6m realised in the year (2017: £21.6m). The bad debt:asset ratio (BDAR) increased to 1.3% (2017: 1.1%).
- Income tax on the Group's profit for the year is a charge of £61.6m (2017: credit of £27.3m). The Group's current year effective tax rate is higher than the statutory rate principally due to the non-deductibility of the additional PPI charge recognised during the year. The negative effective tax rate in the prior year resulted from the availability of group relief from Tesco PLC. In future years, the Group's effective tax rate is not expected to be materially different to the statutory rate. The components of the tax charge/(credit) in the current and prior year are set out in note 11 to the Financial Statements.

Balance Sheet

- Loans and advances to customers have increased by 15.7% to £11.5bn (2017: £10.0bn). Mortgage balances reached £3.0bn (2017: £2.2bn) as the Mortgage product range continued to expand into the intermediary broker channel. The Group has also seen growth in both Credit Cards and Personal Loan balances of 12.7% and 8.1% respectively.
- Customer deposits have increased by 9.2% to £9.2bn (2017: £8.5bn), and continue to be the main source of the Group's funding. Deposits from banks at 28 February 2018 totalled £1,539.0m (February 2017: £499.8m). At the year end, the Group had entered into repurchase transactions of £200.0m (2017: £99.8m) and accessed £1,339.0m of funds from the Bank of England's (BoE) Term Funding Scheme (TFS) (February 2017: £400.0m). The Group had previously accessed the BoE's Funding for Lending Scheme (FLS), with £99.8m of repurchase transactions included within deposits from banks at 28 February 2017, all of which has now been repaid. The lower cost of funding provided by the TFS is reflected in competitive offers for the Group's borrowing customers.
- The balance sheet remains strong and well positioned to support future lending growth from both a liquidity and capital stand point. At 28 February 2018, the total capital ratio was 19.4% (2017: 19.9%) and net stable funding ratio (NSFR) was 118.3% (2017: 119.8%). The decrease in the NSFR over the year reflects the relative movements in the Group's available and required funding, with additional customer deposits resulting in increased available funding of £0.8bn, offset by a £1.6bn increase in the Group's required funding, arising from the growth in customer lending referred to above.

Strategic Priorities

The ambition of Tesco Bank is to 'be the bank for people who shop at Tesco'. In order to accelerate the Group's pursuit of this ambition, during the prior year the Group established the C2020 programme. This programme, comprising a number of initiatives and expected to provide the framework for business change over several years, continues to put the Tesco customer at the heart of the Group's activities. The Group's strategy to make it easier for Tesco customers to bank and insure with the Group is achieved by offering customers great value across all of the products offered by the Group and earning their trust through the Group's actions. The Group aims to achieve this through targeted investment in technology and data to simplify processes, making life simpler for both customers and colleagues and driving efficiency that can be reinvested in the customer offer.

In June 2017, the Group celebrated the 20th anniversary of the inception of Tesco Personal Finance in 1997. Over those 20 years, the Group has established a full range of retail banking products and seen strong growth in traditional banking markets, including Personal Current Accounts and Mortgages, as well as establishing and growing its insurance offering and improving payment services for the Group's customers.

Changes made to the Group's mobile banking App during the year have also made banking easier for the Group's customers. Improvements include faster log-in speeds and the introduction of Face ID for iPhone X. For the Group's Credit Card customers, the App has been improved to include a card scanning feature, giving customers the ability to scan card details via their mobile phone camera, and also a feature allowing customers to easily report their credit card as lost or stolen and prevent it from being used further whilst keeping their account active. The card can subsequently be unblocked or cancelled via the App.

In September 2017, the Group announced that PayQwiq, the Group's digital wallet offering, was to be rebranded as Tesco Pay+. During the year, the Group completed the roll out of Tesco Pay+ to every Tesco store in the UK and the service continued to grow, offering Tesco's shoppers the ability to pay and collect Clubcard points with one simple and convenient scan of their phone and saving them time at the checkout.

In July 2017, the Group celebrated the fifth anniversary of the launch of its Mortgage offering to customers. The Group continues to deliver value to its customers and has helped even more customers to buy their home in the period by adding to its Tesco Bank Mortgage Intermediaries broker panel, and also making available to intermediaries a specialist support team dedicated to new build purchases.

The Group is committed to providing value to its Personal Current Account customers, and continues to offer new and existing customers 3% AER credit interest on credit balances up to £3,000, as well as even more Clubcard points when they spend with their debit card in Tesco stores from 1 April 2017 to 1 April 2019. In October 2017, the Group made its Personal Current Account offering available to its customers in Northern Ireland. Around 54,000 new Personal Current Accounts were opened during the year.

During the year, the Group successfully implemented a new digital servicing platform for Motor and Home Insurance customers, making life easier for customers and colleagues. The platform enables customers to self-serve and provides the Group's customer service colleagues with a simpler, more intuitive system through which to serve customers better.

The Group now has 320 Travel money bureaux across the UK, which provided customers with over £1 billion in currency in the 12 months to 28 February 2018 and served more than 3.7m customers.

The Group’s commitment to offering attractive products and good service for customers has been rewarded with recognition as 'Best Remortgage Provider' at the 2017 Moneyfacts Awards, 'Best All-Round Current Account, Best 'In-Credit' Current Account' and 'Best Direct Mortgage Provider' at the 2018 Moneynet awards, 'Best Direct Lender' at the What Mortgage Awards 2017, and ‘Best Travel Money Provider’ at the 2017/18 Personal Finance Awards, with Tesco Pay+ being awarded 'Best Achievement in Retail Payments' at the Card and Payments Awards.

During the year, colleagues raised over £112,000 for the Group’s charity partners and volunteered over 6,400 hours to their local communities.

Bernard Higgins retired as Chief Executive of the Group in February 2018, after 10 years in the role. In January 2018, the Group announced the appointment of Gerry Mallon, who will join the Group as Chief Executive in July 2018. Until that time, Iain Clink has been appointed Interim Chief Executive.

Regulatory Developments

The Group continues to monitor and prepare for a number of regulatory changes taking effect over the next few years.

Three major components of regulatory reform relating to data regulation come into force during 2018. These are Open Banking, the second Payment Services Directive (PSD2) and the new General Data Protection Regulation (GDPR), all of which are focused on innovation, competition and consumer protection.

PSD2, the first phase of which took effect from 13 January 2018, together with Open Banking, allows customers to choose to share data from their banking products with Third Party Providers (TPPs) and bring together all of their financial relationships and data in one place, potentially leading to a fundamental change in how customers manage both their money and data over the longer term. The aim of these changes is to promote competition and enhance customer choice, providing potential opportunities for the Group to attract new customers as well as potentially increased competition from traditional banking businesses and new providers of financial services, including technology companies with strong brand reputation. The Group continues to monitor and review the risks associated with the introduction of PSD2, including the need to ensure that there is appropriate control and ownership of sensitive and confidential customer data as the use of TPPs becomes more widespread.

GDPR, which comes into effect on 25 May 2018, provides new and enhanced rights for individuals in respect of their personal information. The Group has undertaken a business-wide review in order to ensure the clear control and management of customer data and that compliant data retention policies are in place and adhered to in advance of the regulation coming into force.

Uncertainty remains around the implementation and impact of some regulatory developments including the finalisation of Basel III, which will be subject to EU and UK implementation. In addition, the Group will be subject to the minimum requirements for own funds and eligible liabilities (MREL) on an interim basis from 1 January 2020, with full implementation applicable from 1 January 2022. The requirements are factored into the Group's funding and capital plans.

Business Review

The C2020 programme continued during the year and resulted in a restructuring charge of £0.9m and a net restructuring credit of £0.9m (2017: charges of £34.8m) being recognised. The credit primarily reflects a reduction in the onerous lease provision recognised in the prior year relating to the early exit from the Group's office in central Edinburgh following sub-lease of part of the building, offset by an impairment charge of £0.9m following agreement to sell the Irish Credit Card book.

During the year, the business has continued to deliver growth across its primary products (Credit Cards, Personal Loans, Mortgages, Personal Current Accounts, Savings and Insurance), with active customer numbers increasing by 4.1% in 12 months.

Following the Bank of England's first base rate rise in over a decade in November 2017, the Group passed on a 0.15% rate increase to both its Savings and Mortgage standard variable rate and tracker customers as opposed to the full 0.25% base rate rise, reflecting the Group's desire to treat customers fairly.

Mortgage balances grew by 39.2%, reaching £3,000.7m (2017: £2,155.3m), while Credit Card balances increased by 12.7% and Personal Loans by 8.1%.

Customer deposits of £9,244.6m (2017: £8,463.2m) continue to be the Group's primary source of funding. The Group's customer deposits grew by 9.2% in the year, reflecting the value offered to customers and including an increase of 23.2% in Personal Current Account balances.

During the year, the Group increased its funding from the BoE's TFS to £1,339.0m (Feb 2017: £400.0m) in order to support future lending growth. Funding previously accessed under the BoE's FLS, of which £99.8m was included within deposits from banks at 28 February 2017, was repaid during the year.

Money services products have performed well overall as the Group continues to enhance the product range and expand the customer base. A reduction in ATM transaction volumes, due to the declining use of cash as customers move towards contactless and other digital payments, was offset by growth in other products, including Travel Money.

The total number of in-force insurance policies has remained flat year-on-year. Strong growth in the number of Home insurance policies of 7.3% has been offset by a decline of 4.1% in Motor insurance policies. Motor insurance continues to be a highly competitive market and has been impacted by regulatory change. Insurance income has declined by 7.3%, mainly as a result of falling Motor retention rates which has, in part, been impacted by the new Renewal Transparency regulation.

Financial Performance

The Group's financial performance is presented in the Consolidated Income Statement on page 25. A summary of the Group's financial performance on an underlying basis, excluding items which are not reflective of ongoing trading performance, is presented below.

	Statutory basis £m	Restructuring costs[1] £m	Customer redress[2] £m	Financial instruments[3] £m	Impact of Ogden rate changes[4] £m	Underlying basis £m
Year ended 28 February 2018						
Net interest income	493.1	–	–	–	–	493.1
Other income	366.5	–	–	(11.0)	–	355.5
Total income	**859.6**	**–**	–	**(11.0)**	**–**	**848.6**
Total operating expenses	(529.5)	(0.9)	23.8	–	–	(506.6)
Impairment	(137.4)	0.9	–	–	–	(136.5)
Operating profit	**192.7**	**–**	**23.8**	**(11.0)**	–	**205.5**
Share of profit of joint venture	10.0	–	–	–	–	10.0
Profit before tax	**202.7**	**–**	**23.8**	**(11.0)**	**–**	**215.5**

	Statutory basis £m	Restructuring costs[1] £m	Customer redress[2] £m	Financial instruments[3] £m	Impact of Ogden rate changes[4] £m	Underlying basis £m
Year ended 28 February 2017						
Net interest income	439.2	–	–	–	–	439.2
Other income	373.2	–	–	(6.3)	–	366.9
Total income	**812.4**	–	–	**(6.3)**	–	**806.1**
Total operating expenses	(580.3)	32.9	45.0	–	–	(502.4)
Impairment	(106.4)	1.9	–	–	–	(104.5)
Operating profit	**125.7**	**34.8**	**45.0**	**(6.3)**	–	**199.2**
Share of loss of joint venture	(15.6)	–	–	–	22.8	7.2
Profit before tax	**110.1**	**34.8**	**45.0**	**(6.3)**	**22.8**	**206.4**

[1] Comprising:

- depreciation and amortisation charge of £0.3m (2017: charge of £23.0m) presented within depreciation and amortisation on page 25;
- a restructuring credit of £1.2m (2017: restructuring charge of £9.9m) primarily reflecting a reduction in an onerous lease provision, presented within administrative expenses on page 25; and
- impairment on loans and advances to customers following agreement to sell the Irish Credit Card book, of £0.9m (2017: £1.9m) presented within impairment on loans and advances to customers on page 25.

All of the above costs relate to business restructuring under the C2020 programme and are not considered part of the Group's ongoing underlying results.

[2] Comprising:

- PPI provision charge of £35.0m (2017: £45.0m), partially offset by a provision release of £1.5m (2017: £nil) from the Group's CCA customer redress provision and a credit of £9.7m (2017: £nil) received during the year following the conclusion of negotiations with a third party in respect of previously recognised customer redress, relating to historical instances where certain requirements of the CCA for post-contract documentation were not fully complied with, all of which are presented within operating expenses on page 25. These costs are historical in nature and are not reflective of the Group's underlying trading performance.

[3] Comprising:

- Unrealised gains on financial instruments of £11.0m (2017: gains of £6.3m) presented within total income on page 25. Fair value movements on financial instruments reflect hedge ineffectiveness arising from hedge accounting and fair value movements on derivatives in economic hedges that do not meet the criteria for hedge accounting. Where these derivatives are held to maturity, fair value movements represent timing differences that will reverse over the life of the derivatives. Therefore, excluding these movements from underlying profit more accurately represents the underlying performance of the Group. Where derivatives are terminated prior to maturity, this may give rise to fair value movements that do not reverse.

[4] The prior year charge of £22.8m represents the Group's share of losses incurred by TU relating to the impact on TU's insurance reserves of a prior year change in the Ogden tables and is presented within share of profit/(loss) of joint venture on page 25. There is no such charge in the current year as there have been no changes to the Ogden rate during the year. The rate change in the prior year was implemented following Government consultation and is not reflective of the ongoing underlying performance of TU.

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

	2018	2017
Net interest margin [1]	**3.9%**	4.0%
Underlying cost:income ratio [2]	**59.7%**	62.3%
Cost:income ratio [3]	**61.6%**	71.4%
Bad debt:asset ratio (BDAR) [4]	**1.3%**	1.1%

[1] Net interest margin is calculated by dividing net interest income by average interest bearing assets.
[2] The underlying cost:income ratio is calculated by dividing underlying operating expenses by total underlying income.
[3] The cost:income ratio is calculated by dividing operating expenses by total income.
[4] The bad debt:asset ratio is calculated by dividing the impairment loss by the average balance of loans and advances to customers.

Capital and Liquidity Ratios

The Directors consider the following to be Key Performance Indicators for capital and liquidity reporting:

	2018	2017
Common equity tier 1 ratio [1]	**16.1%**	16.7%
Total capital ratio [2]	**19.4%**	19.9%
Net stable funding ratio [3]	**118.3%**	119.8%
Loan to deposit ratio [4]	**124.6%**	117.7%

[1] The common equity tier 1 ratio is calculated by dividing total tier 1 capital at the end of the year by total risk weighted assets and is calculated in line with the Capital Requirements Regulation (CRR).
[2] The total capital ratio is calculated by dividing total regulatory capital by total risk weighted assets.
[3] The Board Risk Committee (refer to page 13) monitors the Group's compliance with net stable funding ratio (NSFR) requirements under the Capital Requirements Directive IV (CRD IV) methodology. The NSFR is calculated under the CRD IV methodology.
[4] The loan to deposit ratio is calculated by dividing loans and advances to customers by deposits from customers.

The Group's total capital ratio remains above internal targets and regulatory requirements at 19.4% (2017: 19.9%) and leaves the Group well placed to support future growth.

The NSFR, a measure of the Group's liquidity position, is within appetite at 118.3% (2017: 119.8%). The Group maintains a liquid asset portfolio of high quality securities of £2.2bn (2017: £1.8bn).

Risk Management

Risk Management Approach

The Board of Directors has overall responsibility for determining the Group's strategy and related Risk Appetite. The Board's Risk Appetite comprises a suite of Risk Appetite statements, underpinned by corresponding measures with agreed triggers and limits. The Risk Appetite framework 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 plan and stress testing. The Risk Appetite is formally reviewed by the Board on at least an annual basis.

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

The Chief Risk Officer (CRO) performs a strategic risk management role and is responsible for managing and enhancing the RMF. The CRO is independent from any commercial function, reports directly to the Chief Executive Officer and can only be removed from his position with the approval of the Board.

The Group is exposed to a variety of risks through its day to day operations. The following table sets out the principal risks and uncertainties and how they are managed within the RMF.

Principal risks and uncertainties	Key controls and mitigating factors
Credit risk	
The risk that a borrower will default on a debt or obligation by failing to make contractually obligated payments, or that the Group will incur losses due to any other counterparty failing to meet their financial obligations.	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.
Operational risk	
The risk of potential error, loss, harm or failure caused by ineffective or inadequately defined processes, system failure, improper conduct, human error, fraud or from external events.	The Group aims to manage operational risks within defined Risk Appetite limits. An Operational Risk Framework comprising Event management, Risk and Control Self Assessment (RCSA) and Operational Risk Scenario Analysis processes is in place. Regular reporting is provided to the Executive Risk Committee (ERC) and remedial actions taken as required. The Group's ERC provides oversight of the Group's operational risk profile and provides regular reports and recommendations to the appropriate governance bodies.
A significant number of services and processes are provided by third party service providers and a key operational risk is the failure of an outsourced service provider.	The Procurement and Supplier Management policy provides consistent and robust standards for supplier sourcing and selection. The Supplier Management Framework enables the monitoring of the performance of third-party outsourced service providers and suppliers against agreed service level agreements, the management of those relationships and the improvement of service or termination of contract where appropriate.
Increased market demand for specialist personnel could result in increased costs of recruitment and retention or reduced organisational effectiveness if a sufficient number of skilled staff cannot be employed or retained.	The Executive Committee (ExCo) oversees key aspects of people risk, including talent management, performance management, retention and succession planning.
Financial crime and fraud are significant drivers of operational risk and the external threat continues to grow across the Financial Services industry.	The Group has a suite of policies that provide clear standards for the management of financial crime risks. The Group has a dedicated Financial Crime team and continually monitors emerging risks and threats. Regular updates are provided to Executive and Board level committees.
The financial services industry remains under significant threat from cyber attacks. This includes various organised groups targeting institutions through phishing, malware, denial of service and other sophisticated methods.	The Group manages cyber security risks through its Cyber Intelligence, Information Security and IT Security teams. The Group continually monitors emerging risks and threats. Regular reporting is provided to the Information Security Executive Committee and ERC.

Liquidity and Funding risk

Liquidity risk is the risk that the Group is not able to meet its obligations as they fall due. This includes the risk that a given security cannot be traded quickly enough in the market to prevent a loss if a credit rating falls.

Liquidity risk is managed through the Liquidity Management Forum, Asset and Liability Management Committee (ALCo), Board Risk Committee (BRC) and the Board. A robust liquidity position is maintained in excess of internal and regulatory requirements. The Treasury function ensures all liquidity and funding measures are managed within policy and Risk Appetite on a daily basis.

Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding.

The Group undertakes an Internal Liquidity Adequacy Assessment Process (ILAAP). Material risks to the Group are reviewed through stress testing to support an internal assessment of the level of liquidity that the Group should maintain.

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.

Market risk

The risk that the value of earnings or capital is altered through the movement of market rates. This includes interest rates, foreign exchange rates, credit spreads and equities.

Control of market risk is managed by the ALCo and the Market Risk Forum (MRF). These bodies provide oversight of the Group's market risk position at a detailed level and provide regular reports and recommendations to the BRC. The Group has no trading book.

Insurance risk

The risks accepted through the provision of insurance products in return for a premium. These risks may or may not occur as expected and the amount and timing of these risks are uncertain and determined by events outside of the Group's control.

The Group's aim is to actively manage insurance risk exposure, with particular focus on those risks that impact profit volatility. The Group has no direct underwriting risk. However the Group is exposed to underwriting risk through its joint venture, Tesco Underwriting Limited (TU). TU is a separately regulated entity and is capitalised accordingly.

TU operates a risk management framework designed to identify and manage risks to which it is exposed. This includes the use of reinsurance to limit risk exposure above certain levels and the engagement of external independent actuaries to provide assurance over the valuation of insurance liabilities.

Risk Appetite and a suite of risk policies are in place to manage risk in TU.

Regulatory risk

The risk of reputational damage, liability or material loss from failure to comply with the requirements of the financial services regulators or related codes of best practice applicable to the business areas within which the Group operates.

The Group has no appetite for breaches of rules and regulations. A dedicated Compliance Advisory team and Legal team is responsible for the Compliance policy which is approved by the Board, as well as for monitoring, challenging and providing oversight of regulatory risk and compliance across the business.

Regulatory risk (continued)

The risk of business conduct leading to poor outcomes 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.

Business areas manage conduct risk and use a range of management information to monitor the fair treatment of customers. A framework of product-led conduct management information has been developed and is reviewed by Senior Management in the business lines. Customer outcomes are also assessed as part of the development and design of new products and through annual product reviews of existing products. The ERC and the Board review and challenge delivery of fair outcomes for customers and are provided with management information.

The risk that regulatory changes such as Open Banking, PSD2 and GDPR will have an impact on how customers manage both their money and data over the longer term, with the potential for such regulatory changes to fundamentally alter the nature of competition in UK retail banking and have an impact on the Group's activities. These changes also create opportunities for traditional competitors as well as non-banking firms, particularly digitally focused technology companies who have the ability to move at pace.

The volume and pace of regulatory change remains high. The Group actively engages in relevant industry consultation and closely monitors potential changes to regulatory requirements to allow it to address possible opportunities while recognising potential competitive risks. The Group has unique opportunities arising from these regulatory changes to create additional benefits for customers due to its position within the wider Tesco PLC group.

Capital risk

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

The Group undertakes close monitoring of capital ratios to ensure it complies with current regulatory capital requirements and is well positioned to meet any anticipated future requirement. Management of capital is governed through the ALCo, the BRC and the Board.

The Group undertakes an Internal Capital Adequacy Assessment Process (ICAAP). Material risks to the Group are reviewed through stress testing to support an internal assessment of the level of capital that the Group should maintain.

Where capital is not considered to be an appropriate mitigant for a particular risk, alternative management actions are identified.

The stress testing scenarios and final ICAAP results are presented to the BRC for challenge and approval. The ICAAP is submitted to the regulator on a regular basis and forms the basis of the Total Capital Requirement given to the Group.

The prudential regulation of banks continues to develop, with a number of topics currently under consultation in both the EU and the UK. The impact of future changes to capital and funding regulation may have an impact on the Group's activities.

The Group actively engages in relevant industry consultation and closely monitors potential changes to regulatory requirements.

Brexit

On 29 March 2017, the UK triggered Article 50, formally beginning the process to leave the EU. The process of exiting the EU continues to contribute to political and economic uncertainty in the UK and Europe.

Following the EU referendum result, the political and economic outlook for the UK is uncertain. The Group has actively considered the potential risks associated with the UK's exit from the EU and their impact on both the UK financial services market and the Group itself.

While the timing and terms of any agreement with the EU remain uncertain, the Group continues to have sufficient capital resources to allow it to cope with a severe economic stress. The Group will continue to monitor the wider economic environment, particularly to assess the impact on credit risk to the Group.

The Group also continues to monitor related developments to the UK's exit from the EU, including the possibility of a second Scottish independence vote.

Change to insurance reserving discount rate

On September 2017, the Government announced its plans on discount rate reform. The changes impact TU's results, which are sensitive to changes in the insurance reserves it recognises in respect of insurance policies written, net of reinsurance.

Material changes in these reserves could have an impact on the carrying value of the Group's investment in TU. The Group continues to monitor any further developments in the discount rate consultation process, which is expected to conclude in late 2018.

Libor rate replacement

On 27 July 2017 the Head of the Financial Conduct Authority announced that the London Interbank Offered Rate (LIBOR) would be phased out and replaced with an alternative reference rate by the end of 2021. Further information on the replacement reference rate has not yet been announced.

The Group is actively considering the impact that a change in the reference rate could have on its business and continues to monitor related developments.

The following pages provide a more granular overview of the operational control processes and risk mitigants adopted by the Group.

A fuller description of these risks and controls can also be found in the Pillar 3 Disclosure Statements of Tesco Personal Finance Group Limited for the year ended 28 February 2018. These disclosures will be published in the Financial Information section of the Tesco Bank corporate website in due course.

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

Risk Management Framework (RMF)

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

The scope of the RMF extends to all principal risks faced by the Group and is underpinned by governance, controls, processes, systems and policies within the first line business areas and those of the second line RMFu.

The key components of the RMF are as follows:

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 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 28 February 2018.

The Board

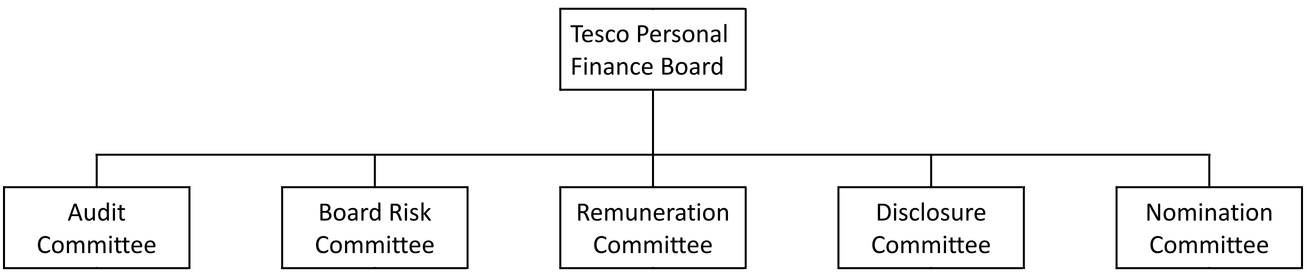
Chairman	**Executive Directors**	**Non-Executive Directors**
Graham Pimlott	Karl Bedlow	John Castagno
	Iain Clink	Robert Endersby
	Richard Henderson	Simon Machell
	Declan Hourican	James McConville
	David McCreadie	Amanda Rendle
		Alan Stewart
		James Willens

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 approves the Group's business plans, budget, long term plan, ICAAP, ILAAP and any material new product lines in line with the approved Risk Appetite. 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.

The Board has delegated responsibility for 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 to deliver the strategy in an effective and controlled way. The Board has established Board committees and the executive has established senior management committees to:

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



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 through the reporting provided to it and provides feedback where necessary to ensure that reporting remains fit for purpose.

In order to support effective governance and management of the wide range of responsibilities, the Board has established the following five sub-committees:

- Audit Committee (AC)

The AC comprises James McConville (chairman), Robert Endersby and Simon Machell.

The key responsibilities of the AC are to review the Financial Statements; review the accounting policies and practices for compliance with relevant standards; examine the arrangements made by management regarding compliance with requirements and standards under the regulatory system; review the scope and results of the annual external audit; oversee the process for selecting the external auditor and make recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditor; consider the effectiveness of the external auditor and their independence; review reports covering anti-money laundering and compliance, in particular the Money Laundering Reporting Officer annual report and Risk Assurance Report; maintain a professional relationship with the external auditor; oversee the IA function and review the internal audit programme; work closely with the BRC to avoid, as much as possible, any overlap or gap in the overall risk and assurance activities of the two committees; carry out such investigations or reviews as shall be referred to it by the Board; review the Group's plans for business continuity; approve the annual plan of Risk Assurance activity within the Group; receive and review reports, findings and recommendations from Risk; review and consider the adequacy of any follow up action, and any relevant investigation work, carried out by or on behalf of Risk; review and monitor Management's response to findings and recommendations following investigations carried out by Risk; and review the findings of external assurance reports provided by outsourced providers.

Further detail on the AC is included within the AC section of the Directors' Report.

- Board Risk Committee (BRC)

The BRC comprises Robert Endersby (chairman), John Castagno, James McConville, Graham Pimlott, Amanda Rendle, Alan Stewart and James Willens.

The role of the BRC includes the oversight and challenge of the Group's Risk Appetite and the recommendation to the Board of any changes to Risk Appetite; provision of oversight and advice to the Board on the current key risk exposures of the Group and future risk strategy; reviewing and challenging, where appropriate, the outputs from the ALCo and the ERC; overseeing that a risk culture is appropriately embedded in the business which recognises risk and encourages all employees to be alert to the wider impact on the whole organisation of their actions and decisions; reviewing the design and operation of the RMF; and reviewing the monitoring of conduct and complaints in the business and alerting the Board to any systemic conduct or cultural risks.

- Remuneration Committee (RC)

The RC comprises James Willens (chairman), Robert Endersby, Graham Pimlott and Amanda Rendle.

The role of the RC is to determine and approve remuneration arrangements for all identified Material Risk Takers within the Group as defined by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority's (FCA) Remuneration Code; approve a remuneration framework for employees of the Group below the leadership level; align, where appropriate, remuneration in the Group with Tesco PLC Group Reward Policy; 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 confirm that the remuneration policy in the Group is compliant with all applicable legislation, regulation and guidelines.

- Disclosure Committee (DC)

The DC comprises Graham Pimlott (chairman), Robert Endersby, Richard Henderson, Declan Hourican and James McConville.

The DC is responsible for reviewing formal company documents which are either destined for external publication or which, due to their size or complexity, are better reviewed in detail in a smaller group, to ensure Tesco Bank's compliance with relevant statutory and regulatory obligations.

- Nomination Committee (NC)

The NC comprises Graham Pimlott (chairman), Simon Machell, James Willens and Amanda Rendle.

The role of the NC includes 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; 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; formulating plans for succession for both executive and non-executive directors and in particular for the key roles of Chairman and Chief Executive; and identifying and nominating for the approval of the Board, candidates to fill board vacancies as and when they arise.

Executive Committee (ExCo)

The Group's Board has delegated the day to day running of the business to the Chief Executive. The Chief Executive has established the ExCo to assist in the management of the business and to deliver against strategy in an effective and controlled way. The ExCo provides general executive management of the business. Each ExCo member is accountable to the Chief Executive and to the Board for managing performance in line with the Group's Risk Appetite, long term plan, strategy and annual budget.

The principal roles and responsibilities of the ExCo include providing general executive management of the Group and monitoring performance, including financial performance, in accordance with the approved strategic plan and Risk Appetite as approved by the Board; overseeing risks and controls across the business; promoting a culture of fairness and actively promoting and encouraging the Values; striving for the successful execution of strategy; setting out a framework of reporting to the Board that is sufficient to enable the Board to fulfil its responsibilities; developing 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; authorising certain levels of spend; reviewing, challenging and providing direction relating to the delivery of fair outcomes for customers through regular updates on conduct risk that are challenged and reviewed by the Conduct Oversight and Risk Committee; determining whether to launch the Group's Recovery Plan in the event of a breach of a recovery trigger and managing the crisis thereafter (with the exception of a liquidity crisis that would be managed by the Liquidity Event Management Committee); and overseeing 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.

In order to support the ExCo, six sub-committees have been established. The ExCo receives the minutes from each sub-committee to monitor key activities and decisions taken under delegation as well as to receive updates as appropriate.

- Commercial Executive Committee (CEC)

The principal role of the CEC is to oversee performance and matters arising across the Commercial business through review of credit risk approvals, receipt of risk, risk event and internal audit reporting; manage top risks - ensuring that existing and emerging risks and issues are controlled appropriately and referred to the relevant Board or Committee when needed; approve proposals and business cases and appoint third party suppliers, in line with delegated authorities from the Board; oversee the use of budget allocated; review business financial and trading performance, and monitoring of pricing plans; review conduct risks and issues; undertake annual product reviews; identify risks to good customer outcomes, providing challenge and recommending further action to resolve and track those actions to completion; and escalate material conduct or Treating Customers Fairly risks to the ExCo.

The CEC has four sub-committees: Commercial and Credit Risk Committee; Transactional Banking Management Committee; Savings, Loans and Mortgages Management Committee and the Insurance Management Committee.

- Asset and Liability Management Committee (ALCo)

The principal role of the ALCo is to optimise the Group's balance sheet structure, within boundaries and Risk Appetite set by the Board and regulation; identify, manage and control the Group's balance sheet risks in the execution of its chosen business strategy; oversee Treasury Principal Risk management activities – Capital, Funding and Liquidity and Market Risk; review and approve Treasury Principal Risk policies and key regulatory documents; and review and approve Risk Appetite change recommendations relating to Capital, Funding and Liquidity and Market Risk.

The ALCo has three sub-committees: the Liquidity Management Forum; Market Risk Forum and Capital Management Forum.

- Executive Risk Committee (ERC)

The principal role of the ERC is to oversee all aspects of the Risk Framework, and to ensure that the three lines of defence model is operating effectively; monitor the appropriateness of and adherence to Risk Appetite and make recommendations on any changes to Risk Appetite; debate and challenge the risks inherent within strategic plans; consider and challenge policy exceptions and waivers that are in place; consider action to deliver risk management solutions, and direct resource appropriately; consider the impact of regulatory initiatives on the current and future state of compliance by Tesco Bank; review and approve key policies of Tesco Bank; oversee procurement and supplier management, with particular focus on ensuring that the key risks associated with outsourcing and third party supplier management are assessed; oversee operational resilience; and provide review and challenge relating to the culture in managing conduct risks and customer fairness within the business.

The ERC has nine sub-committees: Operational Resilience Steering Committee; Supplier Management Group; Wholesale Credit Risk Forum; Provisions Forum; Risk 2020 Steering Committee; Security Risk Committee; Conduct Oversight and Risk Committee; Prudential Risk Forum and the Chief Information Officer Risk Committee.

- Customer Division Executive Committee (CDEC)

The role of the CDEC is to approve key decisions and provide oversight and challenge of performance and matters arising across the Customer Division of the business, including, but not limited to:

- The management of risk, including conduct and the fair treatment of customers, which is owned by the business lines within the first line of defence. The CDEC provides oversight and challenge to support the effective management of risk and control of all top risks and material events facing the Customer Division.
- The management of business and financial performance, which is owned by the relevant business lines within the Customer Division. The committee provides oversight and challenge to support efficient and effective performance across the Customer Division.
- Approving activities in relation to change and project related work and considering and challenging customer outcomes, as appropriate.

The CDEC has four sub-committees: Customer Security Committee; Service Risk Committee; Data Steering Group and the Customer Division Management Committee.

- Customer 2020 Executive Steering Committee (C2020 ESC)

The ambition of Tesco Bank is to 'be the bank for people who shop at Tesco'. In order to accelerate the Group's pursuit of this ambition, the Group established the C2020 programme. The Group aims to achieve its strategy through targeted investment in technology and data to simplify processes, making life simpler for both customers and colleagues and driving efficiency that can be reinvested in the customer offer.

The role of the C2020 ESC is to oversee C2020 and steer the delivery of the C2020 strategic plan.

The C2020 ESC has one sub-committee: C2020 Programme Board.

- Information Security Executive Committee (ISEC)

The role of the ISEC is to support the Deputy Chief Executive in delivering information security and cybercrime control improvements through executive direction, support and oversight of the programme of work.

The ISEC has one sub-committee: Information Security Forum.

Three Lines of Defence

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 organisational Risk Appetite; ensuring that they are fully compliant with Group policies and, where appropriate, operating within defined thresholds; and devising, managing and reporting 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 RMFu operates under the leadership of the CRO. Risk teams reporting to the CRO are the second line of defence, and are resourced by people with expertise in each of the principal risks faced by the Group.

The RMFu is responsible for analysing, challenging, understanding and overseeing each of the principal risks; devising the suite of policies necessary to control the business, including the overarching framework for independent monitoring of the risk profile; providing oversight and challenge where required; and proposing to the Board appropriate objectives and measures to define the Group's Risk Appetite.

The RMFu uses expertise and provides frameworks, tools and techniques to assist Management in meeting their responsibilities. The RMFu has responsibility for aggregated risk reporting across the Group to ensure that risk coverage is considered holistically so that risks and issues have clear ownership and do not fall between functions.

- Third line of defence

This comprises the IA 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 and measures across the business. The IA function has an independent reporting line to the Chairman of the AC and is resourced by individuals with relevant experience and professional qualifications. In addition, IA resources are supplemented across a range of audits by external support to provide additional subject matter expertise when required.

Independent assessment is provided through the execution of an agreed plan of audits and through attendance at relevant governance committees and through stakeholder management meetings.

The primary role of IA 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 Management and the Risk function to the Board and ExCo; assessing whether all significant risks are adequately controlled; and challenging the ExCo on the effectiveness of governance, risk management and internal controls. The IA function achieves this through its core responsibilities, which include proposing an annual audit plan based on its assessment (after discussion with Management) of the significant potential risks to which the organisation could be exposed; carrying out audits of functions and processes in accordance with the annual audit plan and any additional special investigations requested by Management, the Board, the AC or the regulators; assessing the adequacy and effectiveness of the controls in the functions and processes audited, and issuing recommendations where improvement is required based on the results of work carried out; verifying compliance with those recommendations; reporting to the AC in relation to internal audit matters; and providing input to the Tesco PLC IA department's reporting to the Tesco PLC AC.

Group 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 a bi-annual basis, or earlier if there is a trigger for policy review such as a regulatory change, to ensure its continued effectiveness and applicability in line with changing risks. The RMFu provides tracking and oversight of the policy framework and is responsible for undertaking assurance and providing reports to the Board on its effectiveness.

- Stress Testing

Stress testing is the process by which the Group's business plans are regularly subjected to severe but plausible scenarios to assess the potential impact on the business, including projected capital and liquidity positions. The scenarios adopted are subject to a rigourous selection process and include hypothetical operational failures, macroeconomic stress events and customer behaviour impacts. The results, along with proposed actions, are reported to the ALCo and BRC. These are captured in both the ILAAP and the ICAAP.

- Monitoring and Reporting

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 ALCo and ERC and to each meeting of the BRC. Adherence to these limits is independently monitored, measured and reported using a suite of key indicators defined by each risk team responsible for managing the major specific risk categories faced by the Group. Decisions made at subordinate risk committees and forums are reported to senior committees as appropriate.

The Strategic Report was approved by the Board of Directors and signed by order of the Board.

Michael Mustard

Company Secretary

26 April 2018

The Directors present their Annual Report, together with the Company and Consolidated Financial Statements and Independent Auditor's Report, for the year ended 28 February 2018.

Business review and future developments

The Group's business review and future developments are set out in the Strategic Report on page 5.

Risk management

The Group's risk management disclosures are set out in the Strategic Report on pages 7 to 17.

Financial instruments

The Group's policies for hedging each major type of transaction are discussed in notes 1 and 16 to the Financial Statements.

Capital structure

The Group's capital structure is discussed in notes 32 and 39 to the Financial Statements.

Events after the reporting date

Details of events occurring after the reporting date are discussed in note 44 to the Financial Statements.

Going concern

The Directors have made an assessment of going concern, taking into account both current performance and the Group's outlook, including consideration of projections for the Group's capital and funding position. As a result of this assessment, the Directors consider that it is appropriate to adopt the going concern basis of accounting in preparing the Company and Consolidated Financial Statements.

Dividends

An interim dividend of £50.0m (2017: £50.0m) in respect of ordinary share capital was paid to Tesco PLC on 22 February 2018.

Treating Customers Fairly

Treating Customers Fairly is central to the Financial Conduct Authority's principles for businesses and remains central to the Tesco Values which sit at the heart of the business. These Values are designed to ensure that customer outcomes match their understanding and expectations.

Directors

The present Directors and Company Secretary, who have served throughout the year and up to the date of signing the Financial Statements, except where noted below, are listed on page 1.

Since 1 March 2017 to date the following changes have taken place:

	Appointed	Resigned
Richard Henderson	29 March 2017	
James Willens	12 May 2017	
Raymond Pierce		31 December 2017
Bernard Higgins		28 February 2018

Audit Committee (AC)

Introduction from the AC Chairman

The Group operates in a demanding environment, particularly with regard to economic, reputational, political and regulatory factors. The role of the AC is critical in reviewing the effectiveness of the Group's internal control framework and assurance processes and in assessing and acting upon findings from both external and internal audit. The AC keeps the current internal control framework and assurance processes under review to ensure that they adapt to the changing environment and remain appropriate for the Group.

AC composition, skills and experience

The AC acts independently of Management. This ensures that the interests of shareholders are properly protected in relation to financial reporting and internal control.

As detailed in the section of the Strategic Report on the Board, the AC comprises three Independent Non-Executive Directors. All AC members have recent and relevant experience in finance and/or the banking or insurance industry.

James McConville is a Chartered Accountant and has significant financial and banking experience gained from over 30 years in the financial services sector, thus enabling him to fulfil the role as AC Chair.

James is currently Group Finance Director at Phoenix Group Holdings and joined their Board of Directors in June 2012 with responsibility for Finance, Treasury and Investor Relations. Previous appointments include Chief Financial Officer of Northern Rock plc and a variety of senior finance and strategy related roles for Lloyds Banking Group plc, including Finance Director of the Scottish Widows Group.

Robert Endersby has spent over 30 years working in the financial services sector, both within the UK and internationally and is an Associate of the London Institute of Banking and Finance.

Robert's previous key appointments included Chief Risk Officer and member of the Executive Board of Danske Bank A/S, Vice Chairman of Danske Bank Oyj and senior risk management positions in Barclays, The Royal Bank of Scotland and ING Group. Robert currently holds Non-Executive positions with Credit Suisse International and Credit Suisse Securities (Europe) Limited.

Simon Machell has worked in financial services for over 30 years and has experience in both general and life insurance in the UK, Europe and Asia. The majority of Simon's experience was gained from a range of roles with Aviva, including Chief Executive of the RAC, Chief Executive of the general insurance business in the UK and running the insurance businesses in 14 markets across Eastern Europe and Asia. Simon holds Non-Executive roles with Pacific Life Re, Prudential Corporation (Asia), Suncorp Group and Tesco Underwriting Limited (TU).

The Chairman, Chief Executive, Chief Financial Officer, Chief Risk Officer, Internal Audit Director, Director of Financial Control and Tesco PLC Internal Audit Director attend committee meetings. The external auditor also attends.

AC responsibilities

The key responsibilities of the AC are set out in the Strategic Report on page 13.

During the year, the AC received reports from a number of business areas including Finance in relation to financial reporting and Risk in relation to regulatory compliance, fraud, bribery and corruption and integrated assurance. The AC also considered a variety of matters including the internal financial control framework and operational resilience.

Financial Statements and related financial reporting

In relation to the Financial Statements, the AC reviewed and recommended approval of the half-yearly results and annual Financial Statements and provided oversight of the statutory audit process.

During the year ended 28 February 2018, the AC considered the following matters:

- Consistency and appropriateness of, and any changes to, significant accounting policies

The AC considered and accepted Management's review of the Group's accounting policies. In particular, the AC has received reports from Management on the Group's readiness to comply with IFRS 9 'Financial Instruments', which came into force for annual periods beginning on or after 1 January 2018.

- The methods used to account for significant transactions

The AC reviewed and supported proposals from Management on the accounting for the issuance of notes in relation to securitisation transactions.

- Going concern assessment

The AC considered Management's approach to, and the conclusions of, the assessment of the Group's ability to remain as a going concern. The AC supported the conclusion that it remained appropriate to adopt the going concern basis in preparing the Financial Statements.

- Review of Financial Statements

The AC considered Management's approach to, and governance arrangements over, the preparation of the half-yearly results and annual Financial Statements and recommended to the Board that these should be approved.

- Appropriate critical accounting estimates and judgements

The AC reviewed the nature, basis for and the appropriateness of the estimates and judgements proposed by Management in the Financial Statements.

The key estimates and judgements reflected in the Group's Financial Statements for the year ended 28 February 2018 are:

  - Loan impairment provision (Refer to note 14)

  At 28 February 2018, the Group's loan impairment provision was £238.1m.

  The AC received regular reports from Management on provisioning, which assessed the adequacy of provisioning based on a number of factors. These included levels of arrears, collateral, past loss experience, defaults based on portfolio trends, and expected loss rates.

  The AC concluded that a robust governance framework existed to monitor provision adequacy and that the assumptions and judgements applied by Management were appropriate.

- Effective interest rate (EIR) (Refer to note 2)

IAS 39 requires the Group to measure the interest earned on its lending portfolio by applying the EIR methodology.

The AC received regular reports from Management summarising their approach, with particular focus given to reviewing the expected attrition rate of balances drawn, including the pay rates assumption used by Management.

The AC is satisfied that the carrying value of the assets and the associated income recognition is appropriate.

- Provision for Customer Redress (Refer to note 28)

The Group has a provision for potential customer redress in relation to Payment Protection Insurance (PPI).

The AC reviewed the key assumptions made in arriving at each element of the provision.

The AC is satisfied that the provisions and related disclosures in the Financial Statements, in respect of PPI and other customer redress provisions, are appropriate.

- Investment in Joint Venture (Refer to note 21)

The Group holds an investment in a joint venture, TU, an authorised insurance company, and recognises the carrying value of its investment and the Group's share of TU's results using the equity method of accounting.

TU's results are sensitive to changes in the insurance reserves it recognises in respect of insurance policies written, net of reinsurance. Consequently, material increases in these reserves could have an impact on the carrying value of the investment in the Company and Consolidated Statement of Financial Position.

The AC reviewed the key judgements and estimates made by TU in determining the level of reserves held at the reporting date.

The AC is satisfied that the carrying amount of the Group's investment in TU is appropriate.

- Payment fraud incident (Refer to note 41)

In November 2016, Tesco Bank's debit cards were the subject of an online fraudulent attack. The Group undertook remedial action and initiated an independent review of the issue and continues to work closely with the authorities and regulators on this incident.

The AC has reviewed the key judgements made by Management in assessing the potential financial penalty and associated uncertainty.

The AC is satisfied that the contingent liability disclosure in note 41 is appropriate.

- IT controls

The Group utilises a range of information systems to support its ongoing operations and financial reporting.

During the year, the AC received a number of reports on the Group's information systems, including the effectiveness of access rights to certain operating systems and applications used in the financial reporting process.

While ongoing improvements to access controls continue to be implemented, further improvements are required. The AC will receive further reports on the implementation of these improvements and the effectiveness of access controls during the next financial year.

Performance and effectiveness of IA

The IA function supports the AC in providing an independent assessment of the adequacy and effectiveness of internal controls and the system of risk management. The function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with the Institute of Internal Auditors International Standards of the Professional Practice of Internal Auditing.

It is essential for the AC to be able to have an honest and open relationship with both its external and internal auditors. This relationship is developed and maintained through private meetings with both Deloitte and the Internal Audit Director.

In compliance with the above standards, the AC assessed the effectiveness of the IA function with the results of the 2017 assessment being positive.

Performance and effectiveness of AC

The AC assesses the need for training on an ongoing basis and the annual agenda provides time for technical updates, which are provided by both internal and external experts. During the year, the AC received specific training on accounting and reporting developments, with the key focus being on IFRS 9. Training is also provided on an ongoing basis to meet the specific needs of individual committee members.

The effectiveness of the AC was reviewed as part of the wider Board effectiveness review which included interviews with all AC members. It was concluded that the AC continued to be effective.

Non-audit fees

Deloitte contributes an independent perspective, arising from its work, on certain aspects of the Group's internal financial control systems, and reports to the AC. The independence of the external auditor in relation to the Group is considered annually by the AC.

The Group has a non-audit services policy for work carried out by its external auditor. This is split into three categories as explained below:

1. Pre-approved for the external auditor – audit-related in nature;
2. Work for which AC approval is specifically required – transaction work and corporate tax services, and certain advisory services; and
3. Work from which the external auditor is prohibited.

The AC concluded that it was in the best interests of the Group for the external auditor to provide a limited number of non-audit services during the year due to their experience, expertise and knowledge of the Group's operations. Auditor objectivity and independence was considered for each engagement and the AC was satisfied that the audit independence was not, at any point, compromised.

Deloitte follows its own ethical guidelines and continually reviews its audit team to ensure its independence is not compromised. The fees paid to the external auditor in the year are disclosed in note 8 to the Financial Statements.

Directors' Indemnities

In terms of Section 236 of the Companies Act 2006, all Non-Executive Directors have been issued a Qualifying Third Party Indemnity Provision by Tesco Personal Finance Group Limited. All Qualifying Third Party Indemnities were in force at the date of approval of the Financial Statements.

There was also a Qualifying Third Party Indemnity Provision issued by Tesco Personal Finance Group Limited in force during the year for Raymond Pierce and Bernard Higgins until the dates of their resignation.

Our People

The Group is committed to promoting a diverse and inclusive workplace, reflective of the communities in which it does business. It approaches diversity in the broadest sense, recognising that successful businesses flourish through embracing diversity into their business strategy, and developing talent at every level in the organisation.

The Group's selection, training, development and promotion policies are designed to provide equality of opportunity for all colleagues, regardless of factors such as age, disability, gender reassignment, race, religion or belief, ethnic origin, gender, sexual orientation, marriage and civil partnership, pregnancy and maternity or trade union affiliation. Decisions are based on merit.

The Group is committed to developing the skills and knowledge and supporting the wellbeing of its colleagues in order to help achieve its objectives and create a great place to work. It ensures that the Tesco Values are reflected within its employment policies and practices to encourage engagement, enabling colleagues to be their best and able to contribute to the delivery of the Group's core purpose.

There are processes in place for understanding and responding to colleagues' needs through surveys and regular performance and development reviews. Business developments are communicated frequently to keep colleagues well informed about the progress of the Group. Ongoing training programmes also seek to ensure that colleagues understand the Group's objectives and the regulatory environment in which it operates.

The Group works with colleagues, including those with disabilities, to adapt work practices where necessary in order to help them work effectively within the business.

Colleagues are encouraged to become involved in the financial performance of the wider Tesco PLC Group through a variety of schemes, principally the Tesco savings related share option scheme (Save As You Earn) and the partnership share plan (Buy As You Earn).

During the year, the Bank became a signatory to The Women in Finance Charter, which is a pledge for gender balance across financial services and represents a commitment from HM Treasury and signatory firms to work together to build a more balanced and fair industry. The Charter commits signatory firms to supporting the progression of women into senior roles in the financial services sector; recognises the diversity of the sector and that firms will have different starting points, meaning that each firm will set its own targets; and requires firms to publicly report on progress to deliver against these internal targets in support of the accountability and transparency needed to drive change.

Cautionary statement regarding forward-looking information

Where this document contains forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements should be treated with caution due to the inherent risks and uncertainties underlying any such forward-looking information. The Group cautions users of these Financial Statements that a number of factors, including matters referred to in this document, could cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, those discussed under 'Principal risks and uncertainties' on pages 8 to 11.

Statement of Directors' Responsibilities

The following should be read in conjunction with the responsibilities of the independent auditor set out in their report on page 106.

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare such financial statements for each financial year. Under that law the Directors have prepared the Group and Company Financial Statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that year.

In preparing these Financial Statements, the Directors are required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's and Company's financial position and financial performance; and
- make an assessment of the Group's and Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the Financial Statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

Each of the Directors, whose names are listed on page 1 of the Annual Report and Financial Statements, confirms that to the best of their knowledge:

- the Financial Statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- the Strategic Report contained in the Annual Report includes a fair review of the development and performance of the business and the position of Group, together with a description of the principal risks and uncertainties that it faces; and
- the Annual Report and Financial Statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for the Company's shareholders to assess the Group's and Company's position, performance, business model and strategy.

Disclosure in respect of the Independent Auditor

So far as each Director is aware at the date of approving this report, there is no relevant audit information, being information needed by the auditor in connection with preparing this report, of which the auditor is unaware. All of the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

External Audit Partner

The external audit partner for the year to 28 February 2018 was Stephen Williams ACA who has fulfilled this role since Deloitte LLP's appointment as external auditor on 30 June 2015.

The Financial Reporting Council's Audit Quality Review (AQR) team inspected the audit of the 28 February 2017 Financial Statements of the Group as part of its 2017/18 annual inspection of audit firms. This review is in its final stages, and some matters have been identified as requiring improvement. In response, Deloitte developed an action plan to ensure that the matters identified by the AQR have been addressed in the current audit of the Group's 28 February 2018 Financial Statements.

Approved by the Board of Directors and signed by order of the Board.

Michael Mustard
Company Secretary

26 April 2018

TESCO PERSONAL FINANCE GROUP LIMITED
CONSOLIDATED INCOME STATEMENT
For the Year Ended 28 February 2018

	Note	2018 £m	2017 £m
Interest and similar income	4	673.2	618.1
Interest expense and similar charges	4	(180.1)	(178.9)
Net interest income		**493.1**	**439.2**
Fees and commissions income	5	387.0	394.0
Fees and commissions expense	5	(31.6)	(31.3)
Net fees and commissions income		**355.4**	**362.7**
Unrealised gains on financial instruments	6	11.0	6.3
Realised gain on financial instruments	7	0.1	4.2
Net other income		**11.1**	**10.5**
Total income		**859.6**	**812.4**
Administrative expenses	8	(422.7)	(425.0)
Depreciation and amortisation	23,24	(83.0)	(110.3)
Provision for customer redress	28	(23.8)	(45.0)
Operating expenses		**(529.5)**	**(580.3)**
Impairment on loans and advances to customers	9	(137.4)	(106.4)
Operating profit		**192.7**	**125.7**
Share of profit/(loss) of joint venture	21	10.0	(15.6)
Profit before tax		**202.7**	**110.1**
Income tax (charge)/credit	11	(61.6)	27.3
Profit for the year attributable to owners of the parent		**141.1**	**137.4**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the Year Ended 28 February 2018

	Note	2018 £m	2017 £m
Profit for the year		**141.1**	**137.4**
Items that may be reclassified subsequently to the income statement			
Unrealised net gains on available-for-sale investment securities before tax	11	1.8	7.1
Net gains arising on cash flow hedges before tax	11	0.4	1.6
Tax relating to items that may be reclassified subsequently to the income statement	11	(0.4)	(5.6)
Share of other comprehensive (expense)/income of joint venture	21	(6.5)	10.5
Total items that may be reclassified subsequently to the income statement		**(4.7)**	**13.6**
Total comprehensive income for the year attributable to owners of the parent		**136.4**	**151.0**

Company number SC173198

		Group		Company	
		2018	2017	**2018**	2017
	Note	**£m**	£m	**£m**	£m
Assets					
Cash and balances with central banks	13	1,318.6	802.9	3.4	3.6
Loans and advances to customers	14	11,522.4	9,961.2	–	–
Loans and advances to subsidiary companies	15	–	–	235.0	235.0
Derivative financial instruments	16	46.1	28.7	–	–
Investment securities:					
- Available-for-sale	17	925.4	966.1	–	–
- Loans and receivables	17	34.1	34.1	–	–
Prepayments and accrued income	18	49.3	42.2	0.7	0.6
Other assets	19	265.7	299.0	–	–
Investment in joint venture	21	90.0	71.0	–	–
Investment in group undertakings	20	–	–	1,219.9	1,219.9
Intangible assets	23	271.1	300.0	–	–
Property, plant and equipment	24	68.0	73.3	–	–
Total assets		**14,590.7**	**12,578.5**	**1,459.0**	**1,459.1**
Liabilities					
Deposits from banks	25	1,539.0	499.8	–	–
Deposits from customers	26	9,244.6	8,463.2	–	–
Debt securities in issue	27	1,347.6	1,204.3	–	–
Derivative financial instruments	16	88.4	133.3	–	–
Provisions for liabilities and charges	28	79.4	83.5	–	–
Accruals and deferred income	29	109.0	115.1	0.7	0.6
Current income tax liability		34.9	8.3	–	–
Other liabilities	30	144.3	148.4	–	0.2
Deferred income tax liability	22	3.7	13.7	–	–
Subordinated liabilities and notes	31	235.0	235.0	235.0	235.0
Total liabilities		**12,825.9**	**10,904.6**	**235.7**	**235.8**
Equity and reserves attributable to owners of parent					
Share capital	32	122.0	122.0	122.0	122.0
Share premium account	32	1,098.2	1,098.2	1,098.2	1,098.2
Retained earnings		500.4	409.3	3.1	3.1
Other reserves	33	44.2	44.4	–	–
Total equity		**1,764.8**	**1,673.9**	**1,223.3**	**1,223.3**
Total liabilities and equity		**14,590.7**	**12,578.5**	**1,459.0**	**1,459.1**

Profit for the year of £50.0m (2017: £50.0m) is attributable to the Company.

The Consolidated and Company Financial Statements on pages 25 to 105 were approved by the Board of Directors and authorised for issue on 26 April 2018 and were signed on its behalf by:

Declan Hourican
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the Year Ended 28 February 2018

	Note	Share capital £m	Share premium £m	Retained earnings £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Share based payment reserve £m	Total equity £m
Balance at 1 March 2017		122.0	1,098.2	409.3	18.0	(0.6)	27.0	1,673.9
Comprehensive income								
Profit for the year		–	–	141.1	–	–	–	141.1
Net gains on available-for-sale investment securities	11	–	–	–	1.5	–	–	1.5
Net gains on cash flow hedges	11	–	–	–	–	0.3	–	0.3
Share of other comprehensive expense of joint venture	21	–	–	–	(6.5)	–	–	(6.5)
Total comprehensive income		**–**	**–**	**141.1**	**(5.0)**	**0.3**	**–**	**136.4**
Transactions with owners								
Dividends to ordinary shareholders	12	–	–	(50.0)	–	–	–	(50.0)
Share based payments	33	–	–	–	–	–	4.5	4.5
Total transactions with owners		**–**	**–**	**(50.0)**	–	–	**4.5**	**(45.5)**
Balance at 28 February 2018		**122.0**	**1,098.2**	**500.4**	**13.0**	**(0.3)**	**31.5**	**1,764.8**
Balance at 1 March 2016		122.0	1,098.2	321.9	5.4	(1.6)	23.3	1,569.2
Comprehensive income								
Profit for the year		–	–	137.4	–	–	–	137.4
Net gains on available-for-sale investment securities	11	–	–	–	2.1	–	–	2.1
Net gains on cash flow hedges	11	–	–	–		1.0	–	1.0
Share of other comprehensive income of joint venture	21	–	–	–	10.5	–	–	10.5
Total comprehensive income		**–**	**–**	**137.4**	**12.6**	**1.0**	–	**151.0**
Transactions with owners								
Dividends to ordinary shareholders	12	–	–	(50.0)	–	–	–	(50.0)
Share based payments	33	–	–	–	–	–	3.7	3.7
Total transactions with owners		**–**	**–**	**(50.0)**	–	–	**3.7**	**(46.3)**
Balance at 28 February 2017		**122.0**	**1,098.2**	**409.3**	**18.0**	**(0.6)**	**27.0**	**1,673.9**

TESCO PERSONAL FINANCE GROUP LIMITED
COMPANY STATEMENT OF CHANGES IN EQUITY
For the Year Ended 28 February 2018

	Note	Share capital £m	Share premium £m	Retained earnings £m	Total equity £m
Balance at 1 March 2017		122.0	1,098.2	3.1	1,223.3
Comprehensive income					
Profit for the year		–	–	50.0	50.0
Total comprehensive income		**–**	**–**	**50.0**	**50.0**
Transactions with owners					
Dividends to ordinary shareholders	12	–	–	(50.0)	(50.0)
Total transactions with owners		**–**	**–**	**(50.0)**	**(50.0)**
Balance at 28 February 2018		**122.0**	**1,098.2**	**3.1**	**1,223.3**
Balance at 1 March 2016		122.0	1,098.2	3.1	1,223.3
Comprehensive income					
Profit for the year		–	–	50.0	50.0
Total comprehensive income		**–**	**–**	**50.0**	**50.0**
Transactions with owners					
Dividends to ordinary shareholders	12	–	–	(50.0)	(50.0)
Total transactions with owners		**–**	**–**	**(50.0)**	**(50.0)**
Balance at 28 February 2017		**122.0**	1,098.2	3.1	**1,223.3**

TESCO PERSONAL FINANCE GROUP LIMITED
CONSOLIDATED AND COMPANY CASH FLOW STATEMENTS
For the Year Ended 28 February 2018

		Group		Company	
		2018	2017	**2018**	2017
	Note	**£m**	£m	**£m**	£m
			Restated[1]		
Operating Activities					
Profit before tax		**202.7**	110.1	**50.0**	50.0
Adjusted for:					
Non-cash items included in operating profit before taxation and other adjustments[1]	37	297.4	308.8	3.9	4.3
Changes in operating assets and liabilities	37	46.9	(110.3)	(0.2)	–
Income taxes (paid)/received		(44.5)	17.2	–	–
Cash flows generated from operating activities		**502.5**	**325.8**	**53.7**	**54.3**
Investing Activities					
Purchase and disposal of intangible assets and property, plant and equipment		(53.5)	(46.1)	–	–
Purchase of available-for-sale investment securities		(179.1)	(95.5)	–	–
Sale of available-for-sale investment securities		185.4	126.6	–	–
Investment in joint venture	21	(15.5)	–	–	–
Cash flows (used in) investing activities		**(62.7)**	**(15.0)**	**–**	–
Financing Activities					
Net proceeds received in association with issuance of debt securities	27	300.0	–	–	–
Principal repayments on debt securities in issue	27	(150.0)	–	–	–
Dividends paid to ordinary shareholders	12	(50.0)	(50.0)	(50.0)	(50.0)
Interest paid on debt securities in issue[1]		(24.6)	(25.2)	–	–
Interest received on assets held to hedge debt securities in issue[1]		3.6	3.1	–	–
Interest paid on subordinated liabilities and notes		(3.9)	(4.3)	(3.9)	(4.3)
Cash flows generated from/(used in) financing activities		**75.1**	**(76.4)**	**(53.9)**	**(54.3)**
Net increase/(decrease) in cash and cash equivalents		514.9	234.4	(0.2)	–
Cash and cash equivalents[2] at beginning of year		788.6	554.2	3.6	3.6
Cash and cash equivalents[2] at end of year	13	**1,303.5**	**788.6**	**3.4**	**3.6**

[1] Refer to note 1 for further details of prior year restatement.

[2] Cash and cash equivalents comprise cash and balances with banks, excluding mandatory reserve deposits (refer to note 13).

1. Accounting Policies

Basis of preparation

The Company and Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the International Accounting Standards Board (IASB) as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to companies reporting under IFRSs.

In these Financial Statements the 'Company' means Tesco Personal Finance Group Limited and the 'Group' means the Company and its subsidiaries and joint venture. Details of these subsidiaries and joint venture are provided in notes 20 and 21. These Consolidated Financial Statements comprise the Financial Statements of the Group. The Company has elected to take the exemption under section 408 of the Companies Act 2006 not to present the Income Statement and Statement of Comprehensive Income of the Company.

The Company and Consolidated Financial Statements have been prepared under the historical cost convention as modified by the revaluation of derivative financial instruments and available-for-sale investment securities held at fair value.

The Company and Consolidated Financial Statements are presented in Sterling, which is the functional currency of the Group. The figures shown in the Financial Statements are rounded to the nearest £0.1 million unless otherwise stated.

New and amended accounting standards adopted by the Group in the year are detailed in note 43.

Change in accounting policy

During the year, the Group has reclassified cash flows relating to debt securities in issue, along with related derivatives, from operating to financing activities. This reclassification more appropriately reports these cash flows in the section of the Consolidated Cash Flow Statement in which the principal funding transactions were reported. Prior year comparatives have been restated to align to the current year approach. The impact of this restatement on the prior year Consolidated Cash Flow Statement is as follows:

Group

Line item	**Total as previously stated £m**	**Adjusted £m**	**Restated total £m**
Non-cash items included in operating profit before taxation	286.7	22.1	308.8
Interest paid on debt securities in issue	–	(25.2)	(25.2)
Interest received on assets held to hedge debt securities in issue	–	3.1	3.1
	286.7	–	**286.7**

1. Accounting Policies (continued)

Going concern

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

Principal accounting policies

A summary of the Group's accounting policies is set out below. These policies have been consistently applied to all of the years presented, unless otherwise stated.

Basis of consolidation

The Consolidated Financial Statements of the Group comprise the Financial Statements of the Company and all consolidated subsidiaries, including certain securitisation structured entities, and the Group's share of its interest in a joint venture, as at 28 February 2018.

Investment in Group undertakings

Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The results of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases. The Company's investments in its subsidiaries are stated at cost less any impairment.

Intragroup balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the Consolidated Financial Statements.

Securitisation structured entities

The Group enters into securitisation transactions in which it assigns Credit Card receivables to a securitisation structured entity which supports the issuance of securities backed by the cash flows from the securitised Credit Card receivables. Although none of the equity of the securitisation structured entities is owned by the Company, the nature of these entities means that the Group has the rights to variable returns from its involvement with these securitisation structured entities and has the ability to affect those returns through its power over them. As such they are effectively controlled by the Group and are consolidated on a line by line basis in the Consolidated Financial Statements.

Investment in joint venture

A joint arrangement is an arrangement over which the Group has joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. A joint venture is a joint arrangement whereby the Group has rights to a share of the net assets of the joint arrangement.

The Group's share of the results of a joint venture is included in the Consolidated Income Statement using the equity method of accounting. The Group's investment in a joint venture is carried in the Consolidated Statement of Financial Position at cost plus post-acquisition changes in the Group's share of the net assets of the entity, less any impairment.

If the Group's share of losses in a joint venture equals or exceeds its investment in the joint venture, the Group does not recognise further losses, unless it has incurred obligations to do so or made payments on behalf of the joint venture.

1. Accounting Policies (continued)

Revenue recognition

Net interest income recognition

Interest income and expense for all financial instruments measured at amortised cost are recognised using the Effective Interest Rate (EIR) method.

The EIR method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the expected life of the financial asset or financial liability. The EIR is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the EIR takes into account fees receivable that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual and behavioural terms of a financial instrument are considered when estimating future cash flows.

Net fees and commissions income recognition

Fees in respect of services are recognised on an accruals basis when the service to the customer has been provided. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable.

The Group generates commission from the sale and service of Motor and Home insurance policies underwritten by Tesco Underwriting Limited (TU) or, in a minority of cases, by a third party underwriter. This is based on commission rates which are independent of the profitability of underlying insurance policies. Similar commission income is also generated from the sale of white label insurance products underwritten by other third party providers. This commission income is recognised as such policies are sold, with a provision being recognised for commission expected to be repayable following the cancellation of policies by customers.

Customer loyalty programmes

The Group participates in the customer loyalty programme operated by Tesco Stores Limited. The programme operates by allowing customers to accumulate Clubcard points on purchases for future redemption against a range of Tesco products. The cost of providing Clubcard points to customers is recharged by Tesco Stores Limited to the Group and is treated as a deduction from net fees and commissions income in the Consolidated Income Statement in the period the costs are incurred.

The Group has no obligation to customers in respect of Clubcard points once the obligation with Tesco Stores Limited is settled.

Dividend income

Dividends are recognised in the Consolidated Income Statement when the entity's right to receive payment is established.

Taxation

The tax charge or credit included in the Consolidated Income Statement consists of current and deferred tax. Tax is recognised in the Consolidated Income Statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted by the reporting date.

Deferred tax is provided using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Company and Consolidated Financial Statements. Deferred tax is calculated at the tax rates that have been enacted or substantively enacted by the reporting date.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

1. Accounting Policies (continued)

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be realised.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current tax assets against current tax liabilities and it is the intention to settle these on a net basis.

Foreign currency translation

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transaction.

Monetary items denominated in foreign currency are translated at the closing rate as at the reporting date.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Consolidated Income Statement, except when deferred in equity as gains or losses from qualifying cash flow hedging instruments. All foreign exchange gains and losses recognised in the Consolidated Income Statement are presented net in the Consolidated Income Statement within the corresponding item. Foreign exchange gains and losses on other comprehensive income items are presented in other comprehensive income within the corresponding item.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available-for-sale, a distinction is made between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to the changes in the amortised cost are recognised in the Consolidated Income Statement, and other changes in the carrying amount, except impairment, are recognised in equity.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and demand deposits with banks together with short-term highly liquid investments with short term maturities.

Financial instruments

The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it creates a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms. An instrument is classified as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities.

Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss (FVTPL), loans and receivables, and available-for-sale. Management determine the classification of its financial assets at initial recognition. Purchases and sales of financial assets are recognised on the trade date – the date on which the Group commits to purchase or sell the asset.

Financial assets at FVTPL include financial assets held for trading and those designated at FVTPL at inception. Financial assets held at FVTPL are recognised at fair value with any gains or losses included in the Consolidated Income Statement in the period in which they arise. Transaction costs are expensed at the time of initial recognition. Derivative financial assets are classified as held for trading unless they are accounted for as an effective hedging instrument but are not separately categorised in the Statement of Financial Position. The Group does not currently hold any financial assets designated at FVTPL at inception.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition at fair value plus transaction costs, these assets are carried at amortised cost using the EIR method and adjusted for any impairment losses or adjustments made as part of fair value hedging arrangements.

1. Accounting Policies (continued)

Available-for-sale financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. Subsequent to initial recognition at fair value plus transaction costs, these financial assets are recorded at fair value, with the movements in fair value recognised in other comprehensive income until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the Consolidated Income Statement. For available-for-sale financial assets in fair value hedge relationships, the element of the fair value movement which relates to the hedged risk is recycled to the Consolidated Income Statement.

Financial liabilities

All of the financial liabilities held by the Group, other than derivative financial liabilities, are measured at amortised cost using the EIR method, after initial recognition at fair value. Fair value is calculated as the issue proceeds, net of premiums, discounts and transaction costs incurred. The Group does not hold any financial liabilities classified as held for trading. For financial liabilities in fair value hedge relationships, the carrying value is adjusted by the hedged item (the fair value of the underlying hedged risk) through the Consolidated Income Statement.

Derecognition of financial assets and financial liabilities

Financial assets are derecognised when the contractual rights to receive cash flows have expired or where substantially all of the risks and rewards of ownership have been transferred and the transfer qualifies for derecognition. Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

Collateral furnished by the Group under standard repurchase agreements is not derecognised because the Group retains substantially all the risks and rewards on the basis of the predetermined repurchase price, therefore the criteria for derecognition are not met. Credit Card receivables assigned by the Group to a securitisation structured entity do not qualify for derecognition, as the Group retains substantially all the risks and rewards of ownership of the securitised Credit Card receivables.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the Company and Consolidated Statements of Financial Position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle a liability simultaneously.

Impairment of financial assets

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the financial asset or group of financial assets have adversely affected the amount or timing of future cash flows expected from the financial asset or group of financial assets.

Financial assets carried at amortised cost

If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the financial asset or group of financial assets and the present value of estimated future cash flows from the financial asset or group of financial assets discounted at the EIR of the instrument(s) at initial recognition. Impairment losses are assessed individually for financial assets that are individually significant and collectively for financial assets that are not individually significant. In making the collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the estimated cash recoveries and historical loss experience for financial assets with similar credit risk characteristics.

1. Accounting Policies (continued)

Impairment losses are recognised in the Consolidated Income Statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for impairment losses. If, in a subsequent year, the amount of the impairment loss reduces and the reduction can be related objectively to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance.

When a loan is deemed uncollectable it is written off against the related provision after all of the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off received from customers or other third parties are recognised directly in the Consolidated Income Statement as a reduction in the loan impairment charge for the year.

Financial assets classified as available-for-sale

In the case of debt instruments classified as available-for-sale, the recognition of an impairment loss occurs if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event), and that have an impact on the estimated future cash flows of the financial asset and which can be reliably measured. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the Consolidated Income Statement – is removed from equity and recognised in the Consolidated Income Statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases, and the increase can be objectively related to an event occurring after the impairment loss was reported in the Consolidated Income Statement, the impairment loss is reversed through the Consolidated Income Statement.

Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments for the purpose of providing an economic hedge to its exposures to interest rate and foreign exchange risks as they arise from operating, financing and investment activities. The Group does not hold or issue derivative financial instruments for trading purposes. Derivative financial instruments are initially recognised at fair value on the contract date and are remeasured at their fair value at subsequent reporting dates.

Hedge accounting

The Group designates certain hedging instruments as either fair value hedges or cash flow hedges, where it is efficient to do so and the IAS 39, 'Financial instruments: Recognition and Measurement', criteria are met. The Group applies hedge accounting as follows:

Hedge relationships are classified as fair value hedges where the derivative financial instruments hedge the change in the fair value of fixed rate financial assets or financial liabilities due to movements in interest rates.

Hedge relationships are classified as cash flow hedges where the derivative financial instruments hedge the inflation risk on an index linked issued bond or when they hedge the Group's exposure to variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction.

To qualify for hedge accounting, the Group documents, at the inception of the hedge: the hedging risk management strategy; the relationship between the hedging instrument and the hedged item or transaction; and the nature of the risks being hedged. The Group also documents the assessment of the effectiveness of the hedging relationship, to show that the hedge has been and will be highly effective on an ongoing basis.

Fair value hedges

Changes in the fair value of derivative financial instruments that are designated as fair value hedges are recognised in the Consolidated Income Statement. The hedged item is also adjusted for changes in fair value attributable to the hedged risk, with the corresponding adjustment made in the Consolidated Income Statement.

1. Accounting Policies (continued)

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the Consolidated Income Statement over the remaining period to maturity.

Cash flow hedges

Changes in the fair value of the derivative financial instruments that are designated as hedges of future cash flows are recognised directly in other comprehensive income and the ineffective portion is recognised immediately in the Consolidated Income Statement. Amounts recognised in other comprehensive income are recycled to the Consolidated Income Statement when equivalent amounts of the hedged item are recognised in profit or loss.

When the hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time is recognised immediately in the Consolidated Income Statement.

Derivative financial instruments not in hedge accounting relationships

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the Consolidated Income Statement as they arise.

Impairment of non-financial assets

Non-financial assets are reviewed for impairment when there are indications that the carrying value may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, an impairment loss is recognised immediately in the Consolidated Income Statement and the carrying value of the asset is written down by the amount of the loss. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets for which an impairment loss has been recognised are reviewed for possible reversal of the impairment at each reporting date.

Property, plant and equipment

Items of property, plant and equipment are stated at historical cost less accumulated depreciation and any impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent expenditure is included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group. All other repairs and maintenance costs are charged to the Consolidated Income Statement in the period in which they are incurred.

Depreciation is charged to the Consolidated Income Statement on a straight-line basis so as to allocate the costs less residual values over the lower of the useful life of the related asset and, for leasehold improvements, the expected lease term. Depreciation commences on the date that the assets are brought into use. Work in progress assets are not depreciated until they are brought into use and transferred to the appropriate category of property, plant and equipment. Estimated useful lives are:

- Plant and equipment 2 to 8 years
- Fixtures and fittings 4 to 14 years
- Computer hardware 3 to 10 years
- Freehold buildings 40 years
- Leasehold improvements 15 to 20 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date. Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in administrative expenses in the Consolidated Income Statement.

During the prior year, the Group reassessed the useful life of certain of its tangible fixed assets, reducing the expected life to a maximum of one year. Refer to note 24 for further detail.

1. Accounting Policies (continued)

Intangible assets

Acquired intangible assets

Intangible assets that are acquired by the Group are stated at historical cost less accumulated amortisation and any impairment losses. Amortisation is charged to the Consolidated Income Statement on a straight-line basis over the estimated useful lives. The Group's intangible assets are computer software, for which the estimated useful lives are 3 to 10 years.

Internally generated intangible assets - research and development expenditure

Research costs are expensed in the Consolidated Income Statement as incurred.

Development expenditure incurred on an individual project is capitalised only if all of the following criteria are demonstrated:

- an asset is created that can be identified (such as software);
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Following the initial recognition of development expenditure, the cost is amortised over the estimated useful life of the asset created. Amortisation commences on the date that the asset is brought into use. Work in progress assets are not amortised until they are brought into use and transferred to the appropriate category of intangible assets.

During the prior year, the Group reassessed the useful life of certain of its intangible fixed assets, reducing the expected life to a maximum of one year. Refer to note 23 for further detail.

Leases

If a lease agreement, in which the Group is a lessee, does not transfer the risks and rewards of ownership of the asset, the lease is recorded as an operating lease.

Operating lease payments are charged to the Consolidated Income Statement on a straight-line basis over the period of the lease. Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor as compensation is charged to the Consolidated Income Statement in the period in which the termination takes place.

The Group has entered into a number of operating leases for office buildings.

Employee benefits

The Group accounts for pension costs on a contributions basis in line with the requirements of IAS 19 'Employee Benefits'. The Group made contributions in the year to a closed funded defined benefit scheme and a funded defined contribution scheme. Both of these schemes are operated by Tesco Stores Limited.

IAS 19 requires that, where there is no policy or agreement for sharing the cost of a defined benefit scheme across the subsidiaries, the Sponsoring employer recognises the net defined benefit cost of a defined benefit scheme. The Sponsoring employer of the funded defined benefit scheme is Tesco Stores Limited and the principal pension plan is the Tesco PLC pension scheme.

Share based payments

Employees of the Group receive part of their remuneration in the form of share based payment transactions, whereby employees render services in exchange for Tesco PLC shares or rights over shares (equity-settled transactions) or in exchange for entitlements to cash based payments based on the value of the shares (cash-settled transactions).

The fair value of employee share option plans is calculated at the grant date using the Black-Scholes model. The resulting cost is recognised in the Consolidated Income Statement over the vesting period. The value of the charge is adjusted to reflect expected and actual levels of vesting.

1. Accounting Policies (continued)

The grant by Tesco PLC of options over its equity instruments to the employees of the Group is treated as a capital contribution in equity. The social security contribution payable in connection with the grant of the share options is considered an integral part of the grant itself, and the charge is treated as a cash-settled transaction.

Provision for liabilities and charges and contingent liabilities

A provision is recognised where there is a present legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of economic resources will be required to settle the obligation, and the amount can be reliably estimated.

Provisions are measured at the present value of the expenditure expected to be required to settle the obligation.

A contingent liability is a possible obligation which is dependent on the outcome of uncertain future events not wholly within the control of the Group, or a present obligation where an outflow of economic resources is not likely or the amount cannot be reliably measured.

Contingent liabilities are not recognised in the Company or Consolidated Statement of Financial Position but are disclosed unless the possibility of an outflow of economic resources is remote.

Dividends paid

Dividends are recognised in equity in the period they are approved by the Group's Board.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The Group has determined the Board of Directors as its chief operating decision-maker.

Sale and repurchase agreements

Investment securities sold subject to a commitment to repurchase them at a predetermined price are retained on the Company and Consolidated Statements of Financial Position when substantially all of the risk and rewards of ownership remain with the Group. The counterparty liability is included in deposits from banks.

Encumbered assets

The Group's methodology used to identify encumbered assets is aligned to definitions used in calculating the Group's Pillar 3 encumbrance disclosures.

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies

In the course of preparing the Financial Statements, no judgements have been made in the process of applying the Group's accounting policies, other than those using estimations (which are presented separately below), that have had a significant effect on the amounts recognised in the Financial Statements.

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its Financial Statements. The Group's principal accounting policies are set out in note 1. United Kingdom company law and IFRSs require the Directors, in preparing the Group's Financial Statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. Where accounting standards are not specific and Management have to choose a policy, IAS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors', requires them to adopt policies that will result in relevant and reliable information in the light of the requirements and guidance in IFRSs dealing with similar and related issues and the IASB Framework for the Preparation and Presentation of Financial Statements.

The judgements and assumptions involved in the Group's accounting policies that are considered to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies (continued)

Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of customer loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original EIR.

The Group's loan impairment provisions are established on a portfolio basis using a statistical methodology taking into account the level of arrears, collateral, past loss experience and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates. These portfolios include Mortgages, Credit Card receivables, Personal Loans and Personal Current Accounts. The future credit quality of these portfolios is subject to estimation uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions.

The key assumptions used in the statistical models are the probability of default; the expected cash recoveries included in the loss given default; and the loss emergence period. These key assumptions are monitored throughout the year to ensure the impairment provision takes into account the most recent trends observed in each portfolio.

The table below shows a sensitivity analysis of key assumptions, demonstrating the impact on the unsecured Personal Loan receivables provision and the unsecured Credit Card receivables provision, respectively, of a variation in each.

		Consequential change in provision			
Assumption	Change in assumption	Unsecured Personal Loan receivables		Unsecured Credit Card receivables	
		2018	2017	2018	2017
		£m	£m	£m	£m
Probability of default	+/- 10%	+/- 5.1	+/- 3.9	+/- 2.5	+/- 2.0
Expected cash recoveries	+/- 10%	-/+ 2.3	-/+ 2.2	-/+ 3.2	-/+ 2.9
Loss emergence period	+/- 1 month	+/- 5.6	+/- 4.1	+/- 4.7	+/- 3.5

Individual impairment losses on secured Mortgages are estimated using an individual valuation of the underlying asset. Although the portfolio is growing, sensitivity to movement in the House Price Index remains relatively low.

The impairment loss on loans and advances is disclosed in further detail in note 9.

Effective interest rate (EIR)

IAS 39 requires the Group to measure the interest earned on its Credit Cards portfolio by applying the EIR methodology. The main area of estimation uncertainty in measuring the EIR on the Group's Credit Card portfolio is the expected attrition of the balances drawn at the reporting date.

Management use a pay rates assumption to determine the expected repayment profile of the balances drawn as at the reporting date to the expected remaining term (capped to a maximum of 5 years from origination).

An increase of the pay rates assumption by 10% will reduce the asset value by £5.0m and a corresponding reduction of the pay rates assumption will increase the asset value by £5.8m.

Provision for customer redress

The Group has a provision for potential customer redress in relation to Payment Protection Insurance (PPI). For further details, including the key assumptions made in arriving at each element of this provision and a sensitivity analysis of key assumptions in the PPI model, refer to note 28.

2. Critical Accounting Estimates and Judgements in Applying Accounting Policies (continued)

Investment in joint venture

The Group holds an investment in a joint venture, Tesco Underwriting Limited (TU), an authorised insurance company, and recognises the carrying value of its investment and the Group's share of TU's results using the equity method of accounting (see notes 1 and 21 for further details).

TU's results are sensitive to changes in the insurance reserves it recognises in respect of insurance policies written, net of reinsurance. Consequently, material increases in these reserves could have an impact on the carrying value of the investment in the Consolidated Statement of Financial Position.

The impact of any increase in reserves is determined by TU's ability to amend its pricing to reflect the increased costs of providing cover under the policies written.

A key element of the reserving calculation is the application of the Ogden tables, which are used to calculate the cost of any claim that involves compensation for loss of future benefits. The tables provide an estimate of the return to be expected from the investment of a lump sum damages award. A discount rate of 2.5% was set in 2001 and was previously used by TU in assessing its reserves for relevant cases.

Following a consultation by the Ministry of Justice (MoJ), which was launched in August 2012, a new rate of -0.75% was set by the MoJ on 27 February 2017 and was effective from 20 March 2017. The impact of this in TU was a post-tax charge of £45.7m, of which the Group recognised £22.8m in the Consolidated Income Statement for the prior year through its share of TU's results as an adjusting event after the reporting date for the prior year. The carrying value of the Group's investment in TU was correspondingly reduced by an equivalent amount. A full reconciliation of the Group's carrying value of TU is set out at note 21.

A reduction in the Ogden rate for 2018 to -1.0% would decrease the carrying value of the Group's investment in TU by £0.2m. An increase in the Ogden rate for 2018 to +1.0% would increase the carrying value of the Group's investment in TU by £1.2m.

3. Segmental Reporting

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

The Group has one operating segment covering all of the Group's activities, the results of which are set out in the Consolidated Income Statement and Group and Company Statements of Financial Position. The group is primarily focused on providing financial services and products to personal customers in the UK therefore no geographic analysis is presented.

4. Net Interest Income

	2018 £m	2017 £m
Interest and similar income		
On assets held at amortised cost		
Loans and advances to customers	646.8	592.9
Cash and balances with central banks	2.8	2.4
Investment securities - loans and receivables	1.4	1.4
	651.0	596.7
On assets held at fair value		
Investment securities - available-for-sale	22.2	21.4
	22.2	21.4
Total	**673.2**	618.1
Interest expense and similar charges		
On liabilities held at amortised cost		
Deposits from customers	(114.3)	(111.9)
Deposits from banks	(4.1)	(3.1)
Debt securities in issue	(27.8)	(26.5)
Subordinated liabilities and notes	(4.0)	(4.3)
	(150.2)	(145.8)
On liabilities held at fair value		
Interest rate swap expenses	(29.9)	(33.1)
	(29.9)	(33.1)
Total	**(180.1)**	**(178.9)**
Net interest income	**493.1**	**439.2**

5. Net Fees and Commissions Income

	2018 £m	2017 £m
Fees and commissions income		
Banking income	252.2	254.2
Insurance income	113.2	123.2
Other income	21.6	16.6
	387.0	**394.0**
Fees and commissions expense		
Banking expense	(31.6)	(31.3)
	(31.6)	**(31.3)**
Net fees and commissions income	**355.4**	**362.7**

6. Unrealised Gains on Financial Instruments

	2018 £m	2017 £m
Foreign exchange gain on financial assets	1.9	10.5
Net gains/(losses) arising on derivatives not designated as hedging instruments under IAS 39	8.0	(8.1)
Fair value hedge ineffectiveness (refer to note 16)	1.1	3.9
	11.0	**6.3**

7. Realised Gain on Financial Instruments

	2018 £m	2017 £m
Financial assets classified as available-for-sale		
Realised gain on disposals	0.1	4.2
	0.1	**4.2**

8. Administrative Expenses

	2018 £m	2017 £m
Staff costs		
Wages and salaries	114.2	107.3
Social security costs	11.8	11.6
Other pension costs	5.4	4.8
Share based payments	9.2	9.9
Other costs including temporary staff	33.6	32.2
Restructuring costs*	–	6.9
	174.2	**172.7**
Non staff costs		
Premises and equipment	74.8	72.3
Operating leases	3.6	4.2
Marketing	63.8	62.2
Auditor's remuneration (refer below)	0.8	0.6
Outsourcing and professional fees	62.1	66.2
Other administrative expenses	44.6	43.8
Restructuring costs*	(1.2)	3.0
	248.5	**252.3**
	422.7	**425.0**

*During the year, the Group recognised organisational restructuring credits within administrative expenses amounting to £(1.2)m (2017: charges of £9.9m), of which £nil (2017: £6.9m) related to staff costs and £(1.2)m (2017: £3.0m) related to property operating lease exit costs.

8. Administrative Expenses (continued)

During the year the Group obtained the following services from the incumbent auditor, Deloitte.

	2018	2017
	£'000	£'000
Audit services		
Audit of the Company and Consolidated Financial Statements	51	50
Audit of the Company's subsidiaries	702	429
	753	**479**
Non audit services		
Audit related assurance services	83	84
Other non audit services not covered above	52	79
	135	**163**
Total auditor's remuneration	**888**	**642**

The average monthly number of persons (including Executive Directors) employed by the Group split by employee function during the year, was:

	2018	2017
	Number	Number
Head office and administration	1,323	1,248
Operations	2,625	2,630
	3,948	**3,878**

9. Impairment on Loans and Advances to Customers

	2018	2017
	£m	£m
Loans and advances to customers		
Increase in impairment allowance, net of recoveries*	133.3	100.9
Impairment charge on Irish Credit Card book	0.9	1.9
Total impairment allowances, net of recoveries (refer to note 14)	**134.2**	**102.8**
Insurance premiums written off during the year as uncollectable	3.2	3.6
	137.4	**106.4**

*Recoveries include £34.6m received through the sale of non-performing debt to third parties (2017: £21.6m).

10. Directors' Emoluments

The remuneration of the Directors paid by the Group during the year was as follows:

	2018	2017
	£m	£m
Aggregate emoluments	5.9	5.2
Aggregate amounts receivable under long-term incentive schemes	2.6	2.1
Loss of office	0.3	0.6
Share based payments	0.9	1.2
Total emoluments	**9.7**	**9.1**

10. Directors' Emoluments (continued)

	2018 Number	2017 Number
Number of Directors to whom retirement benefits are accruing under defined benefit schemes	–	–
Number of Directors in respect of whose qualifying services shares were received or receivable under long term incentive schemes	5	4
Number of Directors who exercised share options in the year	–	–

The total emoluments of the highest paid Director were £2.3m (2017: £2.1m). During the year the highest paid Director did not exercise any share options (2017: £nil).

At 28 February 2018 the accrued pension and lump sum under a defined benefit scheme for the highest paid Director was £nil (2017: £nil).

During the year to 28 February 2018 two Directors (2017: three Directors) left the company. One Director (2017: one Director) was paid a sum of £0.3m (2017: £0.6m) upon leaving, in line with contractual terms and conditions.

11. Income Tax

Income tax charge/(credit)

		2018 £m	2017 £m
Current tax charge for the year		70.4	42.0
Adjustments in respect of prior years		0.8	(51.5)
Total current tax charge/(credit) for the year		**71.2**	**(9.5)**
Deferred tax credit for the year	22	(8.7)	(15.2)
Tax rate change	22	0.6	(1.3)
Adjustments in respect of prior years	22	(1.5)	(1.3)
Total deferred tax credit for the year		**(9.6)**	**(17.8)**
Income tax charge/(credit)		**61.6**	**(27.3)**

The standard rate of corporation tax in the UK was changed from 20% to 19% with effect from 1 April 2017. This gives a blended Corporation Tax rate for the Group for the full year of 19.1% (2017: 20.0%). In addition, a banking surcharge of 8% is applied to the Group's results.

11. Income Tax (continued)

The tax assessed for the full year is higher (2017: lower) than that calculated using the overall blended Corporation Tax rate for the Group. The differences are explained below:

	2018	2017
	£m	£m
Profit before taxation	202.7	110.1
Profit on ordinary activities multiplied by blended rate in the UK of 19.1% (2017: 20.0%)	38.7	22.0
Factors affecting charge for the year:		
Group relief surrendered without payment	–	(24.0)
Impact of banking surcharge	13.5	17.5
Expenses not deductible for tax purposes*	10.0	8.8
Adjustment in respect of prior years - current tax**	0.8	(51.5)
Adjustment in respect of prior years - deferred tax	(1.5)	(1.3)
Share based payments	1.5	1.1
Other tax adjustments	–	(1.7)
Tax rate change	0.6	(1.3)
Share of profit/(loss) of joint venture	(2.0)	3.1
Income tax charge/(credit)	**61.6**	**(27.3)**

*The majority of the adjustment relates to the non deductibility of an additional PPI provision of £35.0m recognised in the year (2017: £45.0m).
**The 2017 adjustment in respect of prior years arises largely as a result of group relief being made available to the Company from the Tesco PLC tax group, reducing the tax charge in respect of 2016 by £48.8m.

The March 2016 Budget Statement included an announcement that the standard rate of corporation tax in the UK would be reduced to 17% from 1 April 2020. This rate reduction was enacted during the year ended 28 February 2017 and is therefore incorporated in these Financial Statements. The rate change is expected to reduce the Group's effective tax rate in the medium term.

Income tax relating to components of other comprehensive income

	Before tax amount	Tax charge	Net of tax amount
2018	**£m**	**£m**	**£m**
Net gains on available-for-sale investment securities	1.8	(0.3)	1.5
Net gains on cash flow hedges	0.4	(0.1)	0.3
	2.2	**(0.4)**	**1.8**

	Before tax amount	Tax charge	Net of tax amount
2017	**£m**	**£m**	**£m**
Net gains on available-for-sale investment securities	7.1	(5.0)	2.1
Net gains on cash flow hedges	1.6	(0.6)	1.0
	8.7	**(5.6)**	**3.1**

11. Income Tax (continued)

Deferred tax charged directly to the Statement of Changes in Equity

2018	Before tax amount £m	Tax credit £m	Net of tax amount £m
Net gains on share based payments	3.6	0.9	4.5
	3.6	**0.9**	**4.5**

2017	Before tax amount £m	Tax credit £m	Net of tax amount £m
Net gains on share based payments	0.9	2.8	3.7
	0.9	**2.8**	**3.7**

12. Distributions to Equity Holders

	2018 £m	2017 £m
Ordinary dividend paid	**50.0**	50.0

On 22 February 2018 an interim dividend of £50.0m (£0.0410 per ordinary share) was paid. In the prior year, an interim dividend of £50.0m (£0.0410 per ordinary share) was paid on 22 February 2017.

13. Cash and Balances with Central Banks

	Group		Company	
	2018 £m	2017 £m	**2018 £m**	2017 £m
Cash at bank	376.9	156.1	–	–
Cash deposit with Tesco Personal Finance plc	–	–	3.4	3.6
Balances held with the Bank of England other than mandatory reserve deposits	926.6	632.5	–	–
Included in cash and cash equivalents	**1,303.5**	**788.6**	**3.4**	**3.6**
Mandatory reserves deposits held with the Bank of England	15.1	14.3	–	–
	1,318.6	**802.9**	**3.4**	**3.6**

Mandatory reserve deposits held with the Bank of England of £15.1m (2017: £14.3m) are not included within cash and cash equivalents for the purposes of the cash flow statement as these do not have short term maturities. These balances are not available in the Group's day to day operations and are non-interest bearing. Other balances are subject to variable interest rates based on the Bank of England base rate.

14. Loans and Advances to Customers

Group	2018	2017
	£m	£m
Secured Mortgage lending	3,010.2	2,160.7
Unsecured lending	8,766.7	7,970.9
Total secured and unsecured lending	**11,776.9**	**10,131.6**
Fair value hedge adjustment	(16.4)	23.4
Gross loans and advances to customers	**11,760.5**	**10,155.0**
Less: allowance for impairment	**(238.1)**	**(193.8)**
Net loans and advances to customers	**11,522.4**	**9,961.2**
Current	4,636.6	4,166.1
Non-current	6,885.8	5,795.1

Fair value hedge adjustments

Fair value hedge adjustments amounting to £(16.4)m (2017: £23.4m) are in respect of fixed rate Loans and Mortgages. These adjustments are largely offset by derivatives, which are used to manage interest rate risk and are designated as fair value hedges within loans and advances to customers.

Allowance for impairment

The following table shows the movement in the provision for impairment on loans and advances to customers:

Group	2018	2017
	£m	£m
At beginning of year	193.8	153.9
Amounts written off	(87.3)	(60.3)
Increase in allowance, net of recoveries*, charged to the income statement (refer to note 9)	134.2	102.8
Foreign currency translation	0.1	0.1
Unwind of discount	(2.7)	(2.7)
At end of year	**238.1**	**193.8**

*Recoveries include £34.6m received through the sale of non-performing debt to third parties (2017: £21.6m).

15. Loans and Advances to Subsidiary Companies

Company	2018	2017
	£m	£m
Floating rate subordinated note maturing 2030	190.0	190.0
Undated floating rate note	45.0	45.0
Gross loans and advances to subsidiary companies	**235.0**	**235.0**
Net loans and advances to subsidiary companies	**235.0**	**235.0**
Current	–	–
Non-current	**235.0**	**235.0**

There was no impairment charge recognised in the year on loans and advances to subsidiary companies (2017: no charge).

16. Derivative Financial Instruments

Strategy in using derivative financial instruments

The objective when using a derivative financial instrument is to ensure that the risk to reward profile of a transaction is optimised, allowing the Group to manage its exposure to interest rate and foreign exchange rate risk. The intention is to only use derivatives to create economically effective hedges. There are specific requirements stipulated under IAS 39 which must be met for a derivative to qualify for hedge accounting. As a result, not all derivatives can be designated as being in an accounting hedge relationship, either because natural accounting offsets are expected or because obtaining hedge accounting would be especially onerous.

For those derivatives where hedge accounting is applied, gains and losses are offset by hedge adjustments in the Consolidated Income Statement. For those derivatives held for economic hedging purposes which cannot be designated as being in an accounting hedge relationship, the gains and losses are recognised in the Consolidated Income Statement. In the Statement of Financial Position there is no distinction between derivatives where hedge accounting is applied and derivatives which cannot be designated as being in an accounting hedge relationship.

Fair value hedge

The Group's risk management objective of creating economically effective hedges is to use interest rate contracts to swap fixed rate exposures back to a floating rate LIBOR basis where no existing offset is available. This includes the hedging of fixed rate Personal Loans, Mortgages and certain Savings balances, holdings of fixed rate investment securities and issuances of fixed rate debt, which protects the Group against the fair value volatility of these financial assets and financial liabilities due to movements in interest rates. Each swap is defined as hedging one or more fixed rate assets or liabilities.

Cash flow hedge

The Group held five inflation linked interest rate swaps (2017: five) as cash flow hedges to mitigate the variability in cash flows associated with an inflation linked debt security issued by the Bank. The cash flows are expected to occur over the term to maturity in December 2019.

During the year, the Group entered into a series of foreign currency forward contracts which are designated as cash flow hedges and which mitigate the variability in cash flows associated with foreign currency transactions that are attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction. The cash flows are expected to occur over the period to 28 February 2019.

Ineffectiveness recognised in the Consolidated Income Statement in respect of cash flow hedges for the 12 months to 28 February 2018 was £nil (2017: £nil). Amounts are recycled from the cash flow hedge reserve when the underlying hedge item affects the Consolidated Income Statement. Therefore as the carrying value of the asset or liability is adjusted in respect of movements in the hedged risk, recycled amounts directly offset this adjustment within net interest income. Recycled amounts for the 12 months to 28 February 2018 were £1.4m (2017: £2.3m).

16. Derivative Financial Instruments (continued)

Derivatives not in a hedge relationship

All derivative financial instruments are held for economic hedging purposes, although not all derivatives are designated as hedging instruments under the terms of IAS 39. The Group has the following derivative contracts in economic hedge relationships but not in accounting hedge relationships:

- Foreign exchange forward contracts and, in the prior year, cross currency interest rate swaps, used to hedge the exchange rate risk inherent in cash flows from foreign currency assets; and
- Interest rate swaps that were not previously held in hedge accounting relationships and are viewed as trading derivatives under IAS 39.

The analysis below splits derivatives between those classified in hedge accounting relationships and those not in hedge accounting relationships.

Group	**Notional**	**Asset fair value**	**Liability fair value**
2018	**£m**	**£m**	**£m**
Derivatives in hedge accounting relationships			
Derivatives designated as fair value hedges			
Interest rate swaps	4,086.9	30.5	(86.8)
Derivatives designated as cash flow hedges			
Interest rate swaps	60.0	–	(0.7)
RPI basis swaps	60.0	11.5	–
Forward foreign exchange contracts	4.1	0.1	–
Total derivatives in hedge accounting relationships	**4,211.0**	**42.1**	**(87.5)**

Group	**Notional**	**Asset fair value**	**Liability fair value**
2018	**£m**	**£m**	**£m**
Derivatives not in hedge accounting relationships			
Interest rate derivatives			
Interest rate swaps	964.6	3.9	(0.8)
Currency derivatives			
Forward foreign exchange contracts	35.1	0.1	(0.1)
Cross currency swaps	–	–	–
Total derivatives not in hedge accounting relationships	**999.7**	**4.0**	**(0.9)**
Total derivative financial instruments	**5,210.7**	**46.1**	**(88.4)**

16. Derivative Financial Instruments (continued)

Group 2017	Notional £m	Asset fair value £m	Liability fair value £m
Derivatives in hedge accounting relationships			
Derivatives designated as fair value hedges			
Interest rate swaps	3,528.4	13.2	(116.2)
Derivatives designated as cash flow hedges			
Interest rate swaps	60.0	–	(1.7)
RPI basis swaps	60.0	11.2	–
Total derivatives in hedge accounting relationships	**3,648.4**	**24.4**	**(117.9)**

Group 2017	Notional £m	Asset fair value £m	Liability fair value £m
Derivatives not in hedge accounting relationships			
Interest rate derivatives			
Interest rate swaps	1,226.8	3.2	(6.0)
Currency derivatives			
Forward foreign exchange contracts	35.5	0.1	(0.2)
Cross currency swaps	71.4	1.0	(9.2)
Total derivatives not in hedge accounting relationships	**1,333.7**	**4.3**	**(15.4)**
Total derivative financial instruments	**4,982.1**	**28.7**	**(133.3)**

Derivatives, whether designated in hedge accounting relationships or not, are regarded as current where they are expected to mature within one year. All other derivatives are regarded as non-current.

	Assets 2018 £m	Assets 2017 £m	**Liabilities 2018 £m**	Liabilities 2017 £m
Current	1.5	1.3	(3.1)	(17.0)
Non-current	44.6	27.4	(85.3)	(116.3)
	46.1	**28.7**	**(88.4)**	**(133.3)**

The analysis below details the ineffectiveness in the fair value hedge relationships included in the Consolidated Income Statement:

	2018 £m	2017 £m
Fair value gains on interest rate swaps in designated fair value hedges	67.0	15.4
Losses on fair value hedge adjustments	(65.9)	(11.5)
Net gains in Consolidated Income Statement (refer to note 6)	**1.1**	**3.9**

17. Investment Securities

Group	2018 £m	2017 £m
Available-for-sale		
Government-backed investment securities	101.1	117.4
Gilts	581.5	572.5
Supranational investment securities	85.1	176.1
Other investment securities	155.7	98.4
Equity securities	2.0	1.7
	925.4	**966.1**
Loans and receivables		
Investment in subordinated debt issued by Tesco Underwriting Limited (TU)	34.1	34.1
	34.1	**34.1**
Current	102.3	190.4
Non-current	857.2	809.8

There were no impairment charges within the year (2017: £nil).

Available-for-sale

Included in investment securities are fixed-interest investment securities totalling £801.5m (2017: £883.2m) and variable-interest investment securities amounting to £121.9m (2017: £81.2m).

The equity security above relates to the fair value of the Group's interest in VISA Inc. preferred stock. The preferred stock may be convertible into Class A Common Stock of VISA Inc. at certain future dates, the earliest point being June 2020. Conversion is contingent upon future events, principally related to the outcome of interchange litigation against VISA Europe Limited. As such, the valuation reflects both an illiquidity discount and the risk of a reduction in the conversion rate to VISA Inc. common stock. The reduction in the conversion rate is the most significant unobservable input to the valuation.

Loans and receivables

The investment in subordinated debt issued by TU relates to subordinated notes of £34.1m (2017: £34.1m). Interest receivable on these notes is based on a rate of three month LIBOR plus a spread ranging from 350 - 450 basis points (2017: 350 - 450 basis points). No impairment charges were recognised in respect of this investment (2017: £nil).

18. Prepayments and Accrued Income

	Group		Company	
	2018 £m	2017 £m	2018 £m	2017 £m
Prepayments	10.2	7.9	–	–
Accrued income	39.1	34.3	–	–
Amounts accrued from Tesco Personal Finance Plc	–	–	0.7	0.6
	49.3	**42.2**	**0.7**	**0.6**

All amounts are classified as current at the year end.

19. Other Assets

Group	2018	2017
	£m	£m
Amount due from insurance premiums and commissions receivable	19.6	20.1
Accounts receivable and sundry receivables	236.6	270.0
Amounts due from Tesco Group subsidiaries	9.5	8.9
	265.7	**299.0**

All amounts are classified as current at the year end.

20. Investment in Group Undertakings

The Company's investment in group undertakings in the year was as follows:

Name of company	Nature of business	Place of incorporation	Ownership interest	Registered address
Tesco Personal Finance plc	Banking and general insurance services	UK	100%	EHQ, 2 South Gyle Crescent, Edinburgh, EH12 9FQ
Tesco Personal Finance Compare Limited	Insurance aggregator website service	UK	100%	EHQ, 2 South Gyle Crescent, Edinburgh, EH12 9FQ

* Tesco Personal Finance Compare Limited entered into liquidation during the year to 29 February 2016 and was dissolved by way of Members' Voluntary Liquidation on 16 April 2017.

The Company's investment in group undertakings amounted to £1,219.9m (2017: £1,219.9m).

The following companies are accounted for as subsidiaries of the Group. These are securitisation structured entities established in connection with the Group's Credit Card securitisation transactions. Although none of the equity of the securitisation structured entities is owned by the Company, the nature of these entities means that the Group has the rights to variable returns from its involvement with these securitisation structured entities and has the ability to affect those returns through its power over them. As such they are effectively controlled by the Group. The Company does not hold any investments in Group undertakings.

Name of company	Nature of business	Place of incorporation	Registered address
Delamare Cards Holdco Limited	Securitisation entity	UK	Asticus Building, 2nd floor, 21 Palmer Street, London, SW1H 0AD
Delamare Cards MTN Issuer plc	Securitisation entity	UK	Asticus Building, 2nd floor, 21 Palmer Street, London, SW1H 0AD
Delamare Cards Receivables Trustee Limited	Securitisation entity	UK	Asticus Building, 2nd floor, 21 Palmer Street, London, SW1H 0AD
Delamare Cards Funding 1 Limited	Securitisation entity	UK	Asticus Building, 2nd floor, 21 Palmer Street, London, SW1H 0AD
Delamare Cards Funding 2 Limited	Securitisation entity	UK	Asticus Building, 2nd floor, 21 Palmer Street, London, SW1H 0AD

All of the above companies have a financial year end of 31 December. The management accounts of these entities are used to consolidate the results to 28 February 2018 within these Consolidated Financial Statements.

20. Investment in Group Undertakings (continued)

Significant restrictions

As is typical for a regulated Group operating in the financial services market there are restrictions on the ability of the Group's subsidiary, Tesco Personal Finance plc, to make distributions of cash or other assets to the parent company for the following reasons:

- Assets pledged as collateral: These assets are not available for transfer to the parent company. Refer to note 35 for further details of encumbered assets.
- Regulatory capital requirements: As a regulated entity, Tesco Personal Finance plc is subject to requirements to maintain minimum levels of capital, hence restricting its ability to make distributions of cash or other assets to the parent company. Refer to note 39 for further details.

21. Investment in Joint Venture

During the year ended 28 February 2017, the Group's joint venture, Tesco Underwriting Limited (TU), recognised additional insurance reserves following a revision to the Ogden tables, which are used to calculate future losses in personal injury and fatal accident claims. As a result of the recognition of these losses, TU required a capital injection in order to maintain the required level of regulatory capital.

The Board of Tesco Personal Finance Plc approved the capital injection of £15.5m to TU in exchange for ordinary shares in TU, increasing the Group's investment in TU by an equivalent amount. The joint venture partner correspondingly approved an increase in its investment in TU's ordinary share capital. The capital injection was completed in April 2017.

The following table shows the aggregate movement in the Group's investment in its joint venture in the year:

Group	2018 £m	2017 £m
At beginning of year	71.0	76.1
Share of profit/(loss) of joint venture*	10.0	(15.6)
Acquisition of ordinary share capital	15.5	–
Share of available-for-sale reserve of joint venture **	(6.5)	10.5
At end of year	**90.0**	**71.0**

*Including, in the prior year, a charge of £22.8m, representing the Group's share of losses incurred by TU relating to the impact on TU's insurance reserves of a change in the Ogden tables. There is no such charge in the current year as there have been no changes to the Ogden rate during the year.

**The Group's share of the movement in the available-for-sale reserve represents the recognised portion of other comprehensive (expense)/income of the joint venture.

Details of the Group's joint venture

Name of company	Registered address	Nature of business	Place of Incorporation	Ownership interest 2018	Ownership interest 2017
Tesco Underwriting Limited	Ageas House, Hampshire Corporate Park, Templars Way, Eastleigh, Hampshire, SO53 3YA	Insurance	England	49.9% of Ordinary Share Capital	49.9% of Ordinary Share Capital

TU is an authorised insurance company which provides the insurance underwriting service for a number of the Group's general insurance products. TU is a private company and there is no quoted market price available for its shares.

21. Investment in Joint Venture (continued)

The Group uses the equity method of accounting for its investment in TU, which has a financial year end of 31 December. The accounting year end date for TU differs from that of the Group as it is in line with the other joint venture partner. The management accounts of TU are used to consolidate the results to 28 February 2018 within these Consolidated Financial Statements.

Summarised financial information for the joint venture

This information reflects the amounts presented in the management accounts of the joint venture (and not the Group's share of those amounts):

Group	**2018**	2017
	£m	£m
Non-current assets	876.7	879.7
Current assets	157.5	148.3
Current liabilities	(791.1)	(823.0)
Non-current liabilities	(68.3)	(68.3)
Net assets	**174.8**	**136.7**
Cash and cash equivalents	**63.3**	**42.5**
Current financial liabilities (excluding trade and other payables and provisions)	**(10.7)**	**(12.1)**
Non-current financial liabilities (excluding trade and other payables and provisions)	**(68.3)**	**(68.3)**

	2018	2017
	£m	£m
Income Statement		
Revenue	366.6	373.6
Expenses including claims costs	(346.6)	(404.8)
Profit/(loss) for the year	**20.0**	**(31.2)**
Other comprehensive (expense)/income	(13.0)	21.1
Total comprehensive income/(expense)	**7.0**	**(10.1)**
The above profit/(loss) includes the following:		
Depreciation and amortisation	(2.9)	(2.7)
Interest income	13.9	14.4
Interest expense	(2.8)	(2.9)
Income tax (charge)/credit	(1.6)	2.5

21. Investment in Joint Venture (continued)

Reconciliation of the summarised financial position

A reconciliation of the summarised financial information presented to the carrying amount of the investment in joint venture is as follows.

Group	**2018**	**2017**
	£m	**£m**
Net assets of the joint venture	174.8	136.7
Group share at 49.9%	87.2	68.2
Capitalised legal costs included in investment carrying value	2.8	2.8
Carrying value of investment in joint venture at end of year	**90.0**	**71.0**

Other information

There are no contingent liabilities or commitments in respect of the joint venture. The investment in the joint venture is classified as non-current.

22. Deferred Income Tax Liability

The deferred income tax liability can be analysed as follows:

2018 **Group**	**Accelerated capital allowances £m**	**Other £m**	**Total £m**
At beginning of year	(15.0)	1.3	(13.7)
Credited to the Consolidated Income Statement in the current year	8.5	0.2	8.7
Credited to the Consolidated Income Statement for prior years	0.4	1.1	1.5
Credited to equity	–	0.4	0.4
Change in tax rate	(0.6)	–	(0.6)
At end of year	**(6.7)**	**3.0**	**(3.7)**
Deferred tax asset to be recovered within one year			4.3
Deferred tax asset to be recovered after more than one year			2.2
			6.5
Deferred tax liability to be recovered within one year			(2.0)
Deferred tax liability to be recovered after more than one year			(8.2)
			(10.2)
Deferred tax liabilities (net)			**(3.7)**

2017 **Group**	**Accelerated capital allowances £m**	**Other £m**	**Total £m**
At beginning of year	(32.9)	1.9	(31.0)
Credited to the Consolidated Income Statement in the current year	15.1	0.1	15.2
Credited/(charged) to the Consolidated Income Statement for prior years	1.6	(0.3)	1.3
Charged to equity	–	(0.5)	(0.5)
Change in tax rate	1.2	0.1	1.3
At end of year	**(15.0)**	**1.3**	**(13.7)**
Deferred tax asset to be recovered within one year			1.4
Deferred tax asset to be recovered after more than one year			2.8
			4.2
Deferred tax liability to be recovered within one year			(3.6)
Deferred tax liability to be recovered after more than one year			(14.3)
			(17.9)
Deferred tax liabilities (net)			**(13.7)**

23. Intangible Assets

Group	Work in Progress £m	Computer software £m	Total £m
Cost			
At 1 March 2017	34.3	608.3	642.6
Additions	37.3	5.5	42.8
Transfers	(43.8)	43.4	(0.4)
Disposals	(0.3)	(0.5)	(0.8)
At 28 February 2018	**27.5**	**656.7**	**684.2**
Accumulated amortisation			
At 1 March 2017	–	(342.6)	(342.6)
Charge for the year	–	(70.7)	(70.7)
Disposals	–	0.2	0.2
At 28 February 2018	**–**	**(413.1)**	**(413.1)**
Net carrying value			
At 28 February 2018	**27.5**	**243.6**	**271.1**
Cost			
At 1 March 2016	21.7	604.6	626.3
Additions	31.3	3.6	34.9
Transfers	(17.1)	16.9	(0.2)
Disposals	(1.6)	(16.8)	(18.4)
At 28 February 2017	**34.3**	**608.3**	**642.6**
Accumulated amortisation			
At 1 March 2016	–	(262.4)	(262.4)
Charge for the year	–	(93.5)	(93.5)
Disposals		13.3	13.3
At 28 February 2017	**–**	**(342.6)**	**(342.6)**
Net carrying value			
At 28 February 2017	**34.3**	**265.7**	**300.0**

Work in progress relates primarily to the internal development of IT software assets. Intangible asset balances are non-current.

During the prior year, the Group reassessed the useful life of certain of its intangible fixed assets, reducing the expected life to a maximum of one year. This reduction in useful life reflected the impact of business restructuring commenced during the prior year. The impact of this change was to increase the amortisation charge by £19.0m over 2016/17, primarily arising from the residual amortisation of the Group's insurance platform which was replaced in 2017.

24. Property, Plant and Equipment

Group	Work in Progress £m	Plant and Equipment £m	Fixtures and Fittings £m	Computer Hardware £m	Freehold Buildings £m	Leasehold Improvement £m	Total £m
Cost							
At 1 March 2017	5.5	3.0	14.5	128.9	28.2	24.5	204.6
Additions	3.1	–	1.6	1.7	0.4	0.3	7.1
Transfers	(5.8)	–	0.7	1.6	3.9	–	0.4
Disposals	–	–	–	(7.5)	(0.2)	–	(7.7)
At 28 February 2018	**2.8**	**3.0**	**16.8**	**124.7**	**32.3**	**24.8**	**204.4**
Accumulated depreciation							
At 1 March 2017	–	(3.0)	(9.0)	(101.3)	(4.9)	(13.1)	(131.3)
Charge for the year	–	–	(2.0)	(7.9)	(0.8)	(1.6)	(12.3)
Disposals	–	–	–	7.2	–	–	7.2
At 28 February 2018	**–**	**(3.0)**	**(11.0)**	**(102.0)**	**(5.7)**	**(14.7)**	**(136.4)**
Net carrying value							
At 28 February 2018	**2.8**	**–**	**5.8**	**22.7**	**26.6**	**10.1**	**68.0**
Cost							
At 1 March 2016	4.4	3.0	14.2	129.8	28.2	22.7	202.3
Additions	1.9	–	2.2	6.5	–	1.8	12.4
Transfers	(0.8)	–	0.4	0.6	–	–	0.2
Disposals	–	–	(2.3)	(8.0)	–	–	(10.3)
At 28 February 2017	**5.5**	**3.0**	**14.5**	**128.9**	**28.2**	**24.5**	**204.6**
Accumulated depreciation							
At 1 March 2016	–	(3.0)	(8.6)	(100.1)	(3.1)	(8.6)	(123.4)
Charge for the year	–	–	(2.0)	(8.5)	(1.8)	(4.5)	(16.8)
Disposals	–	–	1.6	7.3	–	–	8.9
At 28 February 2017	**–**	**(3.0)**	**(9.0)**	**(101.3)**	**(4.9)**	**(13.1)**	**(131.3)**
Net carrying value							
At 28 February 2017	**5.5**	**–**	**5.5**	**27.6**	**23.3**	**11.4**	**73.3**

Work in progress at 28 February 2018 relates predominantly to the development of IT assets. Property, plant and equipment balances are non-current.

During the prior year, the Group reassessed the useful life of certain of its tangible fixed assets, reducing the expected life to a maximum of one year. This reduction in useful life reflected the impact of business restructuring commenced during the prior year. The impact of this change was to increase the depreciation charge by £4.0m over 2016/17 in respect of property related costs arising due to the early exit from the Group's office in central Edinburgh. The Group recognised an additional charge of £0.3m in the current year, reflecting an updated assessment of a dilapidations provision recognised in respect of those premises.

25. Deposits from Banks

Group	2018 £m	2017 £m
Deposits from banks	**1,539.0**	**499.8**
Current	200.0	99.8
Non-current	1,339.0	400.0

Deposits from banks include balances of £200.0m (2017: £99.8m) which have been sold under sale and repurchase agreements and balances of £1,339.0m (2017: £400.0m) drawn under the Bank of England's Term Funding Scheme (TFS).

26. Deposits from Customers

Group	2018 £m	2017 £m
Retail deposits	9,245.6	8,463.1
Fair value hedge adjustment	(1.0)	0.1
	9,244.6	**8,463.2**
Current	7,611.2	6,587.1
Non-current	1,633.4	1,876.1

Fair value hedge adjustments

Fair value hedge adjustments amounting to £(1.0)m (2017: £0.1m) are in respect of fixed rate Savings products. These adjustments are largely offset by derivatives, which are used to manage interest rate risk and are designated as fair value hedges within deposits from customers.

27. Debt Securities in Issue

Group	Interest rate	Par value £m	Term (years)	Maturity date	2018 £m	2017 £m
Fixed rate retail bond – issued 24 February 2011	5.2%	125.0	7.5	2018	126.1	129.2
RPI bond – issued 16 December 2011	1.0%	69.9	8	2019	69.9	67.2
Fixed rate retail bond – issued 21 May 2012	5.0%	200.0	8.5	2020	203.9	209.6
Floating rate AAA bond (A1) [1]	1M LIBOR + 0.45%	150.0	5	2019	–	149.7
Floating rate AAA bond (A2) [2]	1M LIBOR + 0.65%	350.0	7	2021	349.6	349.2
Floating rate AAA bond (A1) [3]	1M LIBOR + 0.65%	300.0	5	2020	299.9	299.4
Floating rate AAA bond (A1) [4]	1M LIBOR + 0.53%	300.0	5	2022	298.2	-
					1,347.6	**1,204.3**

[1] This Bond was issued on 6 June 2014 and was redeemed on its scheduled redemption date of 19 May 2017.
[2] This Bond was issued on 6 June 2014. The scheduled redemption date of this Bond is May 2019.
[3] This Bond was issued on 13 May 2015. The scheduled redemption date of this Bond is April 2018.
[4] This Bond was issued on 7 November 2017. The scheduled redemption date of this Bond is October 2020.

All Floating Rate Bonds were issued by Delamare Cards MTN Issuer plc and are listed on the Irish Stock Exchange. All retail bonds are listed on the London Stock Exchange. All balances are classified as non-current at the year end with the exception of £300.0m of the floating rate AAA bond (A1), which was redeemed on its scheduled redemption date in April 2018 and the fixed rate retail bond issued in February 2011, which is expected to be redeemed in August 2018. In the prior year, £150.0m of the floating rate AAA bond (A1) was classified as current.

28. Provisions for Liabilities and Charges

Group 2018	Customer Redress Provision £m	Insurance Provisions £m	Restructuring Provision £m	Other Provisions £m	Total £m
At beginning of year	68.0	4.2	6.7	4.6	83.5
Provided during the year	35.0	12.8	–	4.9	52.7
Utilised during the year	(33.8)	(13.6)	(4.4)	(2.3)	(54.1)
Released during the year	(1.5)	–	(1.2)	–	(2.7)
At end of year	**67.7**	**3.4**	**1.1**	**7.2**	**79.4**

Customer redress provision - Payment protection insurance

Of the total customer redress provision balance at 28 February 2018, £66.8m (2017: £63.8m) has been provided for customer redress in respect of potential customer complaints arising from historic sales of PPI.

In March 2017, the FCA issued a Policy Statement (PS17/3, 'Payment protection insurance complaints: feedback on CP16/20 and final rules and guidance') which confirmed a deadline for PPI claims of August 2019, supported by an FCA led communications campaign.

The policy statement also set out rules and guidance on the handling of PPI complaints in light of the Supreme Court's decision in Plevin v Paragon Personal Finance Limited (Plevin), confirming that both up-front commission arrangements and profit share arrangements should be considered in the calculation of total commission for Plevin complaints.

The Group increased its PPI provision by £35.0m (2017: £45.0m) during the year to reflect:

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

Although a significant degree of uncertainty remains with regard to the ultimate cost of settling PPI complaints, in particular the volume of complaints arising from customers ahead of the FCA confirmed time bar date of August 2019, the provision balance represents Management's best estimate at the reporting date of that cost. The PPI provision will continue to be monitored as trends in complaint volumes and levels of redress develop.

The table below details for each key assumption, actual data to 28 February 2018, forecast assumptions used in assessing the PPI provision adequacy and a sensitivity assessment demonstrating the impact on the provision of a variation in the future experience.

			Sensitivity	
Assumption	Cumulative actual	Future expected	Change in assumption	Consequential change in provision £m
Valid claims settled	123,417	29,536	+/- 1,000 complaints	+/- 1.8
Average redress per valid claim	£1,684	£1,810	+/- £100	+/- 3.0

28. Provisions for Liabilities and Charges (continued)

Customer redress provision - Consumer credit act (CCA)

The Group holds a provision of £0.9m (2017: £4.2m) in respect of customer redress relating to instances where certain requirements of the CCA for post-contract documentation were not fully complied with.

In arriving at the provision required, which was reduced by £1.5m during the year, the Group has considered the legal and regulatory position with respect to these matters and has sought legal advice which it took into account when making its judgement. The provision represents Management's best estimate at the reporting date of the cost of concluding the redress programme for Loan and Credit Card customers, and in making the estimate Management have exercised judgement as to both the timescale for completing the redress campaign and the final scope of any amounts payable.

The Consolidated Income Statement customer redress charge for the year of £23.8m (2017: charge of £45.0m) reflects the £35.0m PPI provision increase (2017: increase of £45.0m), offset by the £1.5m (2017: £nil) reduction in the CCA provision and a credit of £9.7m (2017: £nil) received following the conclusion of negotiations with a third party in respect of previously recognised customer redress relating to historical instances where certain requirements of the CCA for post-contract documentation were not fully complied with.

Insurance provision

The insurance provision relates to potential insurance policy cancellation by customers. This balance is classified as current at the year end.

Restructuring provision

The restructuring provision relates to restructuring costs arising from the Customer 2020 programme. Management expect to utilise this provision during the year ended 28 February 2019.

Other provisions

Other provisions represent:

- a dilapidations provision related to the anticipated costs of restoring leased assets to their original condition. Management expect that the provision will be utilised at the end of the lease terms, the longest of which is due to end in 2029; and
- a warranty provision in respect of debt sales. This represents post-determination date customer receipts payable to debt purchasers and provision for any accounts which may need to be bought back in future under the terms of the debt sale agreements. This balance is classified as current at year end.

29. Accruals and Deferred Income

	Group		**Company**	
	2018	2017	2018	2017
	£m	£m	£m	£m
Amounts accrued to Tesco Group subsidiaries	11.6	10.4	–	–
Amounts accrued to Tesco PLC	0.7	0.6	0.7	0.6
Other accruals	87.5	91.8	–	–
Deferred income	9.2	12.3	–	–
	109.0	**115.1**	**0.7**	**0.6**

All amounts are classified as current at the year end.

30. Other Liabilities

	Group		Company	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Accounts payable and sundry payables	117.9	119.8	–	–
Amounts owed to Tesco Group subsidiaries	8.0	11.4	–	0.2
Insurance payables	10.8	11.7	–	–
Taxation and social security	6.8	5.5	–	–
	144.3	148.4	**–**	0.2

All amounts are classified as current at the year end.

31. Subordinated Liabilities and Notes

Group and Company	**2018**	2017
	£m	£m
Floating rate subordinated loans maturing 2030	190.0	190.0
Undated floating rate notes	45.0	45.0
	235.0	235.0

Subordinated liabilities and notes comprise loan capital issued to Tesco PLC. This includes £190.0m (2017: £190.0m) of subordinated loans maturing in 2030 and £45.0m (2017: £45.0m) of undated notes with no fixed maturity date. All balances are classified as non-current at the year end.

Interest payable on the subordinated liabilities and notes is based on three month LIBOR plus a spread ranging from 60 to 220 basis points (2017: three month LIBOR plus a spread ranging from 60 to 220 basis points).

32. Share Capital and Share Premium Account

Group and Company	**2018**	**2018**	2017	2017
	Number	**£m**	Number	£m
Authorised				
A Ordinary shares of 10p each	Unlimited		Unlimited	
B Ordinary shares of 10p each	Unlimited		Unlimited	
C Ordinary shares of 10p each	1		1	
Allotted, called up and fully paid				
A Ordinary shares of 10p each	991,090,000	99.1	991,090,000	99.1
B Ordinary shares of 10p each	229,089,000	22.9	229,089,000	22.9
C Ordinary shares of 10p each	1	–	1	–
		122.0		122.0

	2018	2017
	£m	£m
Share premium reserve	1,098.2	1,098.2

33. Other Reserves

Group	**2018**	**2017**
	£m	**£m**
Cash flow hedge reserve	(0.3)	(0.6)
Available-for-sale reserve	13.0	18.0
Share based payment reserve	31.5	27.0
	44.2	**44.4**

Cash flow hedge reserve

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is included in the cash flow hedge reserve. The gain or loss relating to the ineffective portion is recognised immediately in the Consolidated Income Statement.

Available-for-sale reserve

Available-for-sale financial assets are initially recognised at fair value and measured subsequently at fair value with gains and losses being recognised in the Consolidated Statement of Other Comprehensive Income (except for impairment losses and foreign exchange gains and losses which are immediately recognised in the Consolidated Income Statement) until the financial asset is derecognised.

Gains or losses in respect of the interest rate element of the fair value movement are subsequently recycled to the Consolidated Income Statement where hedge accounting is in place.

The consolidated available-for-sale reserve also includes the Group's share of the available-for-sale reserve of its joint venture, Tesco Underwriting Limited.

Share based payment reserve

The fair value of Tesco PLC equity-settled share options granted to employees of the Group is included in the share based payment reserve.

34. Employee Benefit Liability

Defined benefit plans

The Group made contributions in the year to a closed funded defined benefit scheme operated by Tesco Stores Limited (TSL). The principal pension plan is the Tesco PLC pension scheme, a funded defined benefit pension scheme in the UK, the assets of which are held as a segregated fund and administered by the Trustee. TSL has recognised the appropriate net liability of the Tesco PLC pension scheme in accordance with IAS 19 'Employee Benefits'.

Defined contribution plans

A defined contribution scheme operated by TSL is open to all Group employees in the UK.

Detailed disclosures, in line with the requirements of IAS 19, are included in the Tesco PLC 2018 Financial Statements.

35. Risk Management

There are no differences in the manner in which risks are managed and measured between the Group and the Company. Therefore, the explanations of the management, the control responsibilities and the measurement of risk described in this section are those for the Group. The amounts included in this note are those for the Group unless otherwise stated.

Through its normal operations, the Group is exposed to a number of risks, the most significant of which are credit risk, operational risk, liquidity and funding risk, market risk, insurance risk, residual price risk and legal and regulatory compliance risk. The key risk management processes and tools are described in detail on pages 7 to 17 within the Strategic Report.

Credit Risk

Types of credit risk

- **Retail credit risk**

Retail credit risk is the risk that a borrower, who is a personal customer, will default on a debt or obligation by failing to make contractually obligated payments. 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 customers' income and outgoings, to confirm that they have the ability to repay the advances 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 supporting guides are maintained by the Credit Risk function. These policies define the minimum requirements for the management of credit activities across the credit life cycle. The guides also comprise specific product and customer related thresholds that in turn seek to ensure that the Group is operating within agreed retail credit Risk Appetite parameters.

Monitoring and reporting: Management information is produced covering all lending portfolios which is tailored to meet the requirements of different audiences within the overall governance framework. Risk Appetite Measures (RAMs) 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 to address such trends.

35. Risk Management (continued)

- **Wholesale credit risk**

Wholesale credit risk is the risk that the counterparty to a transaction will 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.

The Group does not operate in the mainstream commercial or corporate lending market. However, the Group is exposed to wholesale credit risk primarily through Treasury activities, as a result of cash management, liquidity and market risk management, with the inherent risk that these counterparties could fail to meet their obligations.

Controls and risk mitigants

Daily monitoring of exposures is undertaken, with oversight from the Market and Liquidity Risk team. Monthly reporting of RAMs is provided to the Executive Risk Committee (ERC). Escalation processes are in place for the reporting of any breached limits directly to the ERC.

The RAM limits are set out in the Wholesale Credit Risk policy which is approved by the ERC. The limits contained in the policy are approved by the ERC or Board as appropriate. The Treasury Director is responsible for ensuring that Treasury complies with counterparty credit risk limits. The Market and Liquidity Risk team reports to the Financial and Credit Risk Director, providing independent oversight that these limits are adhered to.

The Group's approach to investing 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 and 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 Wholesale Credit Risk Limit framework sets limits on the amounts that can be invested 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 (SA) to credit risk exposures. The Group has a Wholesale Credit Risk Forum where current ratings and exposures are discussed on a monthly basis by colleagues from Treasury and the Market and Liquidity Risk team. 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 Chief Financial Officer within parameters set by the Board and any exceptions or overrides to the policy must be explicitly agreed by the Chief Executive Officer and approved by the Board.

The Wholesale Credit Risk policy also provides that credit risk mitigation techniques are applied to reduce wholesale credit risk exposures. International Swaps Derivatives Association (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. The Group uses central counterparties in order to clear specified derivative transactions (predominantly interest rate swaps) thereby mitigating counterparty risk. Positions are continuously marked to market and margin in the form of collateral is exchanged on at least a daily basis. As at 28 February 2018, no additional credit risk mitigation was deemed necessary.

35. Risk Management (continued)

Credit risk exposures

The table below relates to credit risk exposures of both on and off balance sheet assets. This represents a worst case scenario of credit risk exposure at the year end. For on balance sheet assets, the balances set out below are based on net carrying amounts as reported in the Consolidated Statement of Financial Position.

	2018	2017
Credit risk exposures relating to on balance sheet items	**£m**	**£m**
Cash and balances with central banks*	1,318.6	802.9
Loans and advances to customers	11,522.4	9,961.2
Derivative financial instruments	46.1	28.7
Investment securities:		
- Available-for-sale	925.4	966.1
- Loans and receivables	34.1	34.1
Other assets*	265.7	299.0
Total credit risk exposures relating to on balance sheet items	**14,112.3**	**12,092.0**
Credit risk exposures relating to off balance sheet items		
Customer lending commitments[1]	12,400.0	12,132.0
Bank of England Funding for Lending Scheme (FLS)	–	270.0
Total credit risk exposures relating to off balance sheet items	**12,400.0**	**12,402.0**
Total credit risk exposures	**26,512.3**	**24,494.0**

* On a Company basis, credit risk exposures arise only from cash and balances with central banks of £3.4m (2017: £3.6m) and loans and advances to subsidiary companies of £235.0m (2017: £235.0m).

As shown above, 81.6% of the total maximum exposure to on balance sheet assets for the Group is derived from loans and advances to customers (2017: 82.4%) and 6.6% represents investments in financial assets classified as available-for-sale (2017: 8.0%).

[1] The Group has a potential exposure to total unused customer lending commitments. However, the likely exposure, which is impacted by factors such as customer behaviour and the regular assessment of the creditworthiness of customers, is less than the total unused commitments.

35. Risk Management (continued)

- **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 obligations.

Controls and risk mitigants

To mitigate this risk all Mortgages are secured by a first charge over the property being purchased or re-mortgaged, to safeguard the Group's assets in the event of default by a customer. No second charges are permitted. Valuation of the property is assessed as part of the application process by a RICS (the Royal Institute of Chartered Surveyors) certified valuer from the Group's approved panel of valuers for a new Mortgage and when a customer decides to re-mortgage with the Group and the loan to value (LTV) is 70% or greater. Where the LTV for new re-mortgage customers is less than 70% and additional criteria are met, valuation of the property is undertaken by an automated valuation model, as are all valuations for existing re-mortgage customers, provided additional criteria are met.

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

The table below details the value of property collateral held against the Group's Mortgage portfolio.

Collateral held against Mortgage portfolio	2018	2017
	£m	£m
Exposure*	3,000.7	2,155.3
Collateral	5,940.1	4,374.7
Cover	198.0%	203.0%

* The Mortgage balance above represents the credit risk inherent in the Mortgage products and excludes accrued interest and fair value adjustments.

- **Credit risk: Concentration risk**

Concentration risk is the risk of losses arising as a result of concentrations of exposures to a specific counterparty, economic sector, segment or geographical region.

The Group is potentially exposed to this risk were it to become concentrated in certain geographic areas or product profiles e.g. a disproportionate level of high LTV 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.

Concentration profiles

The following tables provide concentration profiles in terms of the LTV profile for the Mortgage portfolio; geographic distribution of the Group's exposures; analysis of material asset class by industry type and credit exposure by impairment status across the different exposure class.

- **Credit risk: Mortgage portfolio - LTV distribution profile**

Loans are originated on an income verified basis over a range of fixed rate and tracker products. All loans are repaid on a capital and interest basis, where the loan is repaid over the agreed term of the loan.

The table below provides the LTV distribution profile for the Group's Mortgage portfolio by weighted average balance. The overall average LTV for the portfolio is 50.5% (2017: 49.3%) which is well within agreed Risk Appetite parameters.

35. Risk Management (continued)

	2018 £m	2017 £m
Less than 50%	927.8	671.7
50% to 60%	561.6	405.3
60% to 70%	436.8	404.9
70% to 80%	478.4	311.6
80% to 90%	418.8	266.9
90% to 100%	176.4	92.8
Greater than 100%	0.9	2.1
Total*	**3,000.7**	**2,155.3**

* The Mortgage balance above represents the credit risk inherent in the Mortgage products and excludes accrued interest or fair value adjustments.

- **Credit risk: Asset class geographical distribution profile**

The Group is primarily focused on providing financial services and products to UK personal customers.

The table below provides the geographical distribution of the Group's total credit risk exposures. For on balance sheet assets, the balances set out below are based on net carrying amounts as reported in the Consolidated Statement of Financial Position.

	2018 £m	2017 £m
United Kingdom	26,262.4	24,125.8
Europe (excluding United Kingdom)	205.1	299.4
Other	44.8	68.8
Total	**26,512.3**	**24,494.0**

* On a Company basis, total credit risk exposures, being cash and balances with central banks of £3.4m (2017: £3.6m) and loans and advances to subsidiary companies of £235.0m (2017: £235.0m), are all in the UK.

- **Credit risk: Analysis by industry type**

The table below represents the distribution of exposures by industry type. The Group is primarily focused on providing financial services and products to personal customers in the UK, although it also has exposure to wholesale counterparties as detailed below. For on balance sheet assets, the balances set out below are based on net carrying amounts as reported in the Consolidated Statement of Financial Position.

	2018 £m	2017 £m
Financial institutions	983.3	809.2
Government	1,524.2	1,492.6
Individuals	23,955.0	22,113.6
Wholesale and retail trade	49.8	78.6
Total	**26,512.3**	**24,494.0**

* On a Company basis, total credit risk exposures, being cash and balances with central banks of £3.4m (2017: £3.6m) and loans and advances to subsidiary companies of £235.0m (2017: £235.0m), are all with Financial institutions.

35. Risk Management (continued)

- **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 is maintained through credit and affordability assessments at asset origination, combined with regular monitoring and reporting of asset quality to the appropriate senior management team and risk committees.

The table below presents an analysis of credit exposure by impairment status across the different exposure classes. The table predominantly relates to Banking assets; the retail instalment lending applies to credit agreements in the Insurance business. The balances set out below are based on gross loans and advances, excluding fair value hedge adjustments, as provided in note 14.

Credit quality of gross loans and advances 2018	**Retail unsecured lending £m**	**Retail mortgage lending £m**	**Retail instalment lending £m**	**Total £m**
Past due and impaired				
Less than 90 days past due	44.1	0.2	–	44.3
90–179 days past due	59.3	–	–	59.3
180 days plus past due	109.5	0.1	–	109.6
Past due but not impaired				
0–29 days past due	54.7	0.7	0.5	55.9
30–59 days past due	19.8	–	–	19.8
60–89 days past due	12.5	–	–	12.5
Neither past due nor impaired				
Low risk *	8,010.0	2,983.1	129.4	11,122.5
High risk **	326.9	26.1	–	353.0
	8,636.8	**3,010.2**	**129.9**	**11,776.9**

Gross loans and advances to customers of £17.2m (2017: £14.8m) are subject to active forbearance arrangements and are considered to be not impaired on the basis that the Group does not anticipate that the future expected cash flows of the gross loans and advances will be impacted. Of this total, £5.0m (2017: £4.9m) is included in 'neither past due or impaired' and £12.2m (2017: £9.9m) in 'past due but not impaired'.

35. Risk Management (continued)

Credit quality of gross loans and advances 2017	Retail unsecured lending £m	Retail mortgage lending £m	Retail instalment lending £m	Total £m
Past due and impaired				
Less than 90 days past due	32.4	–	–	32.4
90–179 days past due	47.8	–	–	47.8
180 days plus past due	99.2	–	–	99.2
Past due but not impaired				
0–29 days past due	47.8	0.6	0.2	48.6
30–59 days past due	15.5	–	–	15.5
60–89 days past due	9.9	–	–	9.9
Neither past due nor impaired				
Low risk *	7,426.1	2,144.4	140.1	9,710.6
High risk **	151.9	15.7	–	167.6
	7,830.6	**2,160.7**	**140.3**	**10,131.6**

***** Low risk is defined as an asset with a probability of default of less than 10%.
****** High risk is defined as an asset with a probability of default of 10% or more.

All other financial assets are deemed to be at low risk of default.

- **Credit risk: 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 who are experiencing financial difficulties. 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 amounts 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.

The Group has adopted the definition of forbearance in the European Banking Authority's (EBA) final draft Implementing Technical Standards (ITS) of July 2014. The Group reports all accounts meeting this definition, providing for them appropriately.

Controls and risk mitigants

The Group has well defined forbearance policies and processes. 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 contractual amount, that ensure 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.

35. Risk Management (continued)

The table below details the values of secured and unsecured advances that are subject to forbearance programmes, in accordance with the EBA definition.

	Gross Loans and Advances subject to Forbearance Programmes		Forbearance programmes as a proportion of total Loans and Advances by category		Proportion of Forbearance Programmes covered by impairment provision	
	2018	2017	**2018**	2017	**2018**	2017
	£m	£m	**%**	%	**%**	%
Credit Cards UK	69.6	70.4	1.5	1.8	72.3	60.0
Credit Cards Europe	0.9	1.1	2.7	2.9	40.9	40.0
Credit Cards commercial	0.1	0.1	4.7	4.3	95.0	84.7
Loans	42.4	38.2	1.0	1.0	68.2	62.9
Mortgages	5.9	4.3	0.2	0.2	0.2	0.1

- **Operational risk**

Operational risk is the risk of potential error, loss, harm, or failure caused by ineffective or inadequately defined processes, system failures, improper conduct, human error, fraud or from external events. The Group is subject to the Standardised Approach (SA) method to calculate Pillar 1 operational risk capital, as outlined in the Capital Requirements Regulation (CRR).

Financial crime and fraud are significant drivers of operational risk and the external threat continues to grow across the Financial Services industry. The industry remains under significant threat from cyber attacks. This includes various organised groups targeting institutions through phishing, malware, denial of service and other sophisticated methods. The Group has a robust risk framework and continually monitors emerging risks and threats.

Controls and risk mitigants

The Group's risks are assessed utilising a risk management framework methodology 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 should be executed within the framework;
- supporting relevant business areas to embed policies and frameworks and instil a positive risk management culture; and
- independently monitoring, assessing and reporting on operational risk profiles and losses.

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

35. Risk Management (continued)

Business units and functions assess their operational risks on an ongoing basis via a prescribed Risk and Control Self Assessment (RCSA) process and Operational Risk Scenario Analysis (ORSA). The RCSA analysis is reviewed and updated quarterly by first line business areas to reflect changes to the risk and control environment arising from changes in products, processes and systems. The RCSA outputs are reported to relevant governance bodies. This is supplemented further by an Event Management process and regular reporting of the Operational Risk profile to the ERC. The ORSA builds on RCSA and Event Management 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 II.

The ERC provides oversight of the Group's operational risk profile and provides regular reports and recommendations to the Board Risk Committee (BRC).

- **Liquidity and funding risk**

Liquidity risk is the risk that the Group is not able to meet its obligations as they fall due. This includes the risk that a given security cannot be traded quickly enough in the market to prevent a loss if a credit rating falls. Funding risk is the risk that the Group does not have sufficiently stable and diverse sources of funding.

The Group operates within a Liquidity Risk Management Policy Framework (LRMP) to ensure that sufficient funds are available at all times to meet demands from depositors; to fund agreed advances; to meet other commitments as and when they fall due; and to ensure the Board's Risk Appetite is met.

Controls and risk mitigants

Liquidity and funding risk is assessed through the Individual Liquidity Adequacy Assessment Process (ILAAP) on at least an annual basis. The ILAAP 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 LRMP to maintain liquidity risk exposures within the liquidity Risk Appetite set by the Board. The key liquidity and funding measures monitored on a regular basis are:

- the internal liquidity requirement, which 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, which 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 net stable funding ratio, which is calculated under the Capital Requirements Directive IV methodology;
- the loan to deposit ratio, which is calculated by dividing loans and advances to customers by deposits from customers;
- the encumbrance ratio, which is calculated as (total encumbered assets + total collateral received which has been re-used for refinancing transactions) divided by (total assets + total collateral received which is available for encumbrance);
- the wholesale funding ratio, which is calculated by dividing total wholesale funding by total funding;
- the annual wholesale re-financing amount, which is the value of funds requiring to be refinanced in a rolling 12 month period; and
- the minimum unencumbered assets, which is the surplus of unencumbered assets relative to the total amount of retail liabilities.

35. Risk Management (continued)

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 confirm that it is able to meet its financial obligations under normal, and stressed, market conditions.

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, expected utilisation of undrawn credit card limits, customer deposit patterns, and wholesale funding (including TFS) 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 Asset and Liability Management Committee (ALCo) 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 (BoE) TFS, repaying borrowing previously drawn under the BoE's Funding for Lending Scheme.

The table below shows the Group's primary funding sources.

Primary funding sources	**2018**	**2017**
	£m	**£m**
On balance sheet		
Deposits from banks	1,539.0	499.8
Deposits from customers	9,244.6	8,463.2
Subordinated liabilities and notes	235.0	235.0
Debt securities in issue	1,347.6	1,204.3
Total on balance sheet funding	**12,366.2**	**10,402.3**
Off balance sheet		
Treasury bills drawn under FLS (net of repurchase agreements)*	–	170.0
Total off balance sheet funding	**–**	**170.0**

*FLS drawdowns of £nil (2017: £270.0m) are shown net of Treasury bills used as collateral in repurchase agreements of £nil (2017: £100.0m).

35. Risk Management (continued)

The tables below show cash flows payable up to a period of 20 years on an undiscounted basis. These differ from the Statement of Financial Position values due to the effects of discounting on certain Statement of Financial Position items and due to the inclusion of contractual future interest flows.

Derivatives designated in a hedging relationship are included according to their contractual maturity.

Liquidity and funding risk on financial assets and liabilities

Group 2018 On balance sheet	**Within 1 year £m**	**Between 1 and 2 years £m**	**Between 2 and 3 years £m**	**Between 3 and 4 years £m**	**Between 4 and 5 years £m**	**Beyond 5 years £m**	**Total £m**
Financial assets:							
Cash and balances at central banks	1,318.8	–	–	–	–	–	1,318.8
Loans and advances to customers	6,614.4	1,395.6	929.8	598.3	385.0	3,036.1	12,959.2
Investment securities							
- Available-for-sale	90.9	97.0	49.7	114.7	138.9	496.7	987.9
- Loans and receivables	1.5	1.7	1.7	1.8	1.8	62.1	70.6
Other assets	265.7	–	–	–	–	–	265.7
Total financial assets	**8,291.3**	**1,494.3**	**981.2**	**714.8**	**525.7**	**3,594.9**	**15,602.2**
Financial liabilities:							
Deposits from banks	208.7	12.0	412.1	946.8	–	–	1,579.6
Deposits from customers	7,654.9	873.5	500.4	178.6	105.4	0.1	9,312.9
Debt securities in issue	448.3	441.4	513.7	–	–	–	1,403.4
Derivatives settled on a net basis							
- Derivatives in economic but not accounting hedges	(0.6)	–	–	–	–	–	(0.6)
- Derivatives in accounting hedge relationships	22.3	(8.2)	1.3	3.4	3.9	22.6	45.3
Other liabilities	144.3	–	–	–	–	–	144.3
Subordinated liabilities	4.9	5.9	6.4	7.6	12.7	293.9	331.4
Total financial liabilities	**8,482.8**	**1,324.6**	**1,433.9**	**1,136.4**	**122.0**	**316.6**	**12,816.3**
Off balance sheet							
Contractual lending commitments	12,400.0	–	–	–	–	–	12,400.0
Total off balance sheet	**12,400.0**	**–**	**–**	**–**	**–**	**–**	**12,400.0**

* On a Company basis, liquidity and funding risk arises only on cash and balances with central banks of £3.4m (2017: £3.6m), which are due within 1 year, and loans and advances to subsidiary companies of £235.0m (2017: £235.0m), which have the same profile as the subordinated liabilities in the Group table above.

35. Risk Management (continued)

Liquidity and funding risk on financial assets and liabilities

Group 2017 On balance sheet	**Within 1 year £m**	**Between 1 and 2 years £m**	**Between 2 and 3 years £m**	**Between 3 and 4 years £m**	**Between 4 and 5 years £m**	**Beyond 5 years £m**	**Total £m**
Financial assets:							
Cash and balances at central banks	803.0	–	–	–	–	–	803.0
Loans and advances to customers	5,486.5	1,143.9	934.0	709.4	482.7	2,476.0	11,232.5
Investment securities							
- Available-for-sale	176.4	86.5	93.5	26.2	131.0	490.9	1,004.5
- Loans and receivables	1.4	1.4	1.5	1.5	1.6	61.4	68.8
Other assets	299.0	–	–	–	–	–	299.0
Total financial assets	**6,766.3**	**1,231.8**	**1,029.0**	**737.1**	**615.3**	**3,028.3**	**13,407.8**
Financial liabilities:							
Deposits from banks	100.0	301.3	0.5	100.0	–	–	501.8
Deposits from customers	6,658.5	1,147.1	422.5	167.5	173.5	0.3	8,569.4
Debt securities in issue	173.5	443.0	435.8	210.0	–	–	1,262.3
Derivatives settled on a net basis							
- Derivatives in economic but not accounting hedges	(2.1)	(3.4)	(2.9)	(2.5)	–	–	(10.9)
- Derivatives in accounting hedge relationships	34.4	25.2	4.1	11.7	10.0	23.4	108.8
Derivatives settled on a gross basis							
- Outflows	71.5	–	–	–	–	–	71.5
- Inflows	(63.3)	–	–	–	–	–	(63.3)
Other liabilities	148.4	–	–	–	–	–	148.4
Subordinated liabilities	4.0	4.2	4.5	4.9	5.3	302.7	325.6
Total financial liabilities	**7,124.9**	**1,917.4**	**864.5**	**491.6**	**188.8**	**326.4**	**10,913.6**
Off balance sheet							
Contractual lending commitments	12,132.0	–	–	–	–	–	12,132.0
Total off balance sheet	**12,132.0**	–	–	–	–	–	**12,132.0**

35. Risk Management (continued)

The table below summarises the Group's assets which are available to support future funding and collateral needs and shows the extent to which these assets are currently pledged for this purpose.

The Group has adopted the definition of encumbered and unencumbered 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.

Group 2018	**Encumbered £m**	**Unencumbered £m**	**Total £m**
Encumbered asset summary			
Loans and advances to customers	3,654.0	7,868.4	11,522.4
Other assets	111.1	154.6	265.7
	3,765.1	**8,023.0**	**11,788.1**
Encumbered loans and advances to customers			
Securitisation – Delamare Master Trust	1,628.7		
Personal loans	989.6		
Mortgages	1,035.7		
	3,654.0		
Encumbered other assets			
Initial margin held at Clearing Houses	56.5		
Variation margin held at Clearing Houses	54.0		
Collateral held at counterparties	0.6		
	111.1		

Group 2017	**Encumbered £m**	**Unencumbered £m**	**Total £m**
Encumbered asset summary			
Loans and advances to customers	2,309.9	7,651.3	9,961.2
Other assets	156.9	142.1	299.0
	2,466.8	**7,793.4**	**10,260.2**
Encumbered loans and advances to customers			
Securitisation – Delamare Master Trust	1,853.5		
Mortgages	456.4		
	2,309.9		
Encumbered other assets			
Initial margin held at Clearing Houses	42.4		
Variation margin held at Clearing Houses	104.5		
Collateral held at counterparties	10.0		
	156.9		

35. Risk Management (continued)

Loans and advances assigned for use as collateral in securitisation transactions.

At 28 February 2018, £3,490.5m (2017: £2,529.3m) of the Credit Card portfolio had its beneficial interest assigned to a securitisation structured entity, Delamare Cards Receivables Trustee Limited, for use as collateral in securitisation transactions. The total encumbered portion of this portfolio is £1,628.7m (2017: £1,853.5m).

At 28 February 2018, Delamare Cards MTN Issuer plc had £2,362.2m (2017: £1,800.0m) notes in issue in relation to securitisation transactions, of which £950.0m (2017: £800.0m) related to externally issued notes (refer to note 27). At 28 February 2018 the Group owned £1,412.2m (2017: £1,000.0m) of class A and class D Credit Card backed notes issued by Delamare Cards MTN Issuer plc.

Of the total £1,150.0m (2017: £800.0m) class A retained Credit Card backed notes, £300.0m (2017: £630.0m) is held in a distinct pool for the purposes of collateralising the TFS drawings. All other prepositioned assets with the Bank of England are held within their single collateral pool.

Loans and advances prepositioned with Bank of England

Group	**2018**	**2017**
	£m	**£m**
Credit Card backed notes*	1,150.0	780.0
Mortgages	1,035.7	456.4
Unsecured personal loans	2,438.0	1,037.7
Total assets prepositioned as collateral with Bank of England	**4,623.7**	**2,274.1**
Collateralised FLS Drawings	–	**270.0**
Collateralised TFS Drawings	**1,339.0**	400.0

*Issued by Delamare Cards MTN Issuer plc

- **Market risk**

Market risk is the risk that the value of earnings or capital is altered through the movement of market rates. This includes interest rates, foreign exchange rates, credit spreads and equities. The Group has no trading book exposures. Market risk arises in the following ways in the Group:

- 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;
- Interest rate risk associated with TU's investment portfolio; and
- Investment risk relating to the Group's pension obligations.

Control and risk mitigants

Control of market risk exposure is managed by ALCo 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 the BRC.

35. Risk Management (continued)

- **Interest rate risk in the Banking Book**

IRRBB is the risk of value changes to both earnings and capital arising from timing differences in the re-pricing of the Group's loans and deposits and unexpected changes to the level and/or shape of the yield curve.

The Group offers lending and savings products with varying interest rate features and maturities which create re-pricing mismatches and therefore potential interest rate risk exposures. The Group is therefore exposed to interest rate risk through its dealings with retail banking products as well as through its limited wholesale market activities.

IRRBB is the main market risk that could affect the Group's 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.

The Group has established a specific Risk Appetite for IRRBB which is implemented via a robust Market Risk Policy, a range of specific risk limits and a Market Risk control framework. The Treasury function is responsible for regular stress testing of risk positions against multiple interest rate scenarios to determine the sensitivity of earnings and capital valuations to ensure compliance with Board Risk Appetite and limits.

IRRBB management information is produced by the Asset and Liability Management (ALM) team and is reviewed by ALCo at each of its monthly meetings. IRRBB primarily arises from the retail lending portfolios (including the Mortgage pipeline) and retail deposits. The ALM team is responsible for ensuring hedging strategies are implemented as required to ensure that the Group remains within its stated Risk Appetite and limits.

The main hedging instruments used are interest rate swaps and the residual exposure against the two Board Risk Appetite metrics is reported monthly to the ALCo and Board.

Capital at Risk (CaR): The CaR approach assesses the value sensitivity of the Bank'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 CaR measure is an aggregate measure of four separate risk components, each being a distinct form of interest rate risk (Repricing Risk, Basis Risk, Pipeline Risk and Prepayment Risk).

The table below shows the Group's CaR. At 28 February 2018 the Group was exposed to net residual risk via an upward rate scenario (2017: upward rate scenario).

	2018	2017
	Upward rate scenario	Upward rate scenario
Capital at Risk Sensitivity	£m	£m
Repricing risk	12.1	(6.7)
Basis risk[1]	–	4.5
Pipeline risk	(4.3)	(5.1)
Prepayment risk	(22.2)	(18.4)
Total	**(14.4)**	**(25.7)**

Net Interest Income (NII) Sensitivity: This measures the effect of a +1.0%; -0.75% (2017: +1.0%; -0.75%) parallel interest rate shock on the next 12 months NII, based on the re-pricing gaps in the existing portfolio.

	2018		2017	
	Upward Rate Shock	Downward Rate Shock	Upward Rate Shock	Downward Rate Shock
NII Sensitivity	**(1.03)%**	**0.77%**	(0.07)%	0.05%

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

[1] The reported value for re-pricing risk as at 2018 includes the basis risk component which was previously modelled and reported separately. Basis risk will be modelled in combination with all other re-pricing risks going forward.

35. Risk Management (continued)

- **Foreign exchange risk**

Foreign exchange risk is the risk that the value of transactions in currencies other than Sterling is altered by the movement of exchange rates.

The Group's Risk Appetite permits investment in non-GBP denominated bonds and the Group may raise funding from the wholesale markets in currencies other than GBP. Foreign exchange exposure arises if these are not hedged. Foreign exchange exposure may also arise through the Group's 'Click and Collect' Travel money provision and 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.

The Group's maximum exposure to foreign exchange risk at 28 February 2018 was £45.5m (2017: £119.5m), representing the Group's net assets denominated in foreign currencies.

- **Tesco Underwriting Limited investment portfolio**

The TU insurance portfolio assets are invested with a number of counterparties. These investments are predominantly comprised of government securities, corporate bonds and short term cash investments.

The main risks relate to changes in:

- interest rates affecting fair value arising as a proportion of the bonds are fixed rate in nature; and
- credit quality, as the range of assets held are issued by a variety of institutions with different credit characteristics.

Controls and risk mitigants

Portfolio management is undertaken by the TU investment committee. The Group's Finance function provides oversight and challenge.

- **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. TSL has recognised the appropriate net liability of the Tesco PLC pension scheme in accordance with IAS 19, 'Employee Benefits' (refer to note 34).

- **Insurance risk**

The Group is exposed to insurance risk through its 49.9% ownership of TU, an authorised insurance company.

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

Insurance risk is typically categorised in the following way:

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

35. Risk Management (continued)

Controls and risk mitigants

The Group's oversight of TU is primarily provided by its representation on the TU Board. TU operates a separate risk framework with dedicated risk and compliance teams and a suite of TU risk policies to ensure that the TU insurance portfolio is operating within agreed Risk Appetite. Performance of the portfolio is monitored and reported to the ERC on a monthly basis against specific key performance indicator thresholds and limits.

- **Residual price risk**

Residual price risk is the risk that the fair value of a financial instrument and its associated hedge will fluctuate because of changes in market prices, for reasons other than interest rate or credit risk. The Group has available-for-sale investment securities that are held at fair value in the Company and Consolidated Statements of Financial Position.

Controls and risk mitigants

The Group has established appropriate hedging strategies to mitigate the interest rate and foreign exchange risks. Residual price risk remains.

The table below demonstrates the Group's exposure to residual price risk at the year end. Included in the table is the expected impact of a 10% shock in market prices on the Group's available-for-sale investment securities. The figures shown are prior to hedging activities which mitigate the interest rate and foreign exchange risks.

Impact of 10 % shock in market prices		**Fair value**		**Impact of 10% shock**		**Value after 10% shock**
	2018	2017	**2018**	2017	**2018**	2017
	£m	£m	**£m**	£m	**£m**	£m
Available-for-sale:						
Government-backed investment securities	101.1	117.4	(10.1)	(11.7)	91.0	105.7
Gilts	581.5	572.5	(58.2)	(57.2)	523.3	515.3
Supranational investment securities	85.1	176.1	(8.5)	(17.6)	76.6	158.5
Other investment securities	155.7	98.4	(15.6)	(9.8)	140.1	88.6
Equity securities	2.0	1.7	(0.2)	(0.2)	1.8	1.5
	925.4	**966.1**	**(92.6)**	**(96.5)**	**832.8**	**869.6**

- **Regulatory risk**

Regulatory risk is the risk of reputational damage, liability or material loss from failure to comply with the requirements of the financial services regulators or related codes of best practice applicable to the business areas within which the Group operates. The risk of business conduct leading to poor outcomes can arise as a result of an over-aggressive sales strategy; poor management of sales processes, credit assessments and credit processes; or failure to comply with other regulatory requirements. The Group has no appetite for breaches of rules and regulations. Where breaches occur, the Group will take appropriate rectifying action. The group has no appetite for inappropriate or unfair outcomes for customers.

Controls and risk mitigants

As part of the Group's Policy Framework, a dedicated Compliance Advisory (CA) team is responsible for the Compliance policy which is approved by the Group's Board, as well as for monitoring, challenge and oversight of regulatory risk and compliance across the Group's business. Guidance and advice to enable the business to operate in a compliant manner is provided by the CA team and the Legal team.

During the year, the Group established the Prudential Regulatory Forum which is responsible for the oversight of Prudential Regulatory Authority (PRA) communications including information requests; upstream regulatory change including impact analysis, action tracking, regulatory responses; Prudential regulatory compliance and reporting; and Prudential regulatory deliverables compliance with prudential regulation.

35. Risk Management (continued)

The CA team is also responsible for the detailed regulatory policies which underpin the Compliance policy. 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, regulatory legal compliance, litigation/dispute resolution matters, 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.

Business areas manage conduct risk and use a range of management information to monitor the fair treatment of customers. A framework of product-led conduct management information has been developed and is reviewed by senior management in the business lines. Customer outcomes are also assessed as part of the development and design of new products and through annual product reviews of existing products. The ERC and the Board review and challenge delivery of fair outcomes for customers and are provided with management information.

36. Financial Instruments

Classification of financial assets and liabilities

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39.

Group 2018	Loans and receivables £m	Other (amortised cost) £m	Derivatives held for hedging £m	Available-for-sale £m	Total £m
Financial assets					
Cash and balances with central banks	1,318.6	–	–	–	1,318.6
Loans and advances to customers	11,522.4	–	–	–	11,522.4
Derivative financial instruments	–	–	46.1	–	46.1
Investment securities:					
- Available-for-sale	–	–	–	925.4	925.4
- Loans and receivables	34.1	–	–	–	34.1
Other assets	265.7	–	–	–	265.7
Total financial assets	**13,140.8**	**–**	**46.1**	**925.4**	**14,112.3**
Financial liabilities					
Deposits from banks	–	1,539.0	–	–	1,539.0
Deposits from customers	–	9,244.6	–	–	9,244.6
Debt securities in issue	–	1,347.6	–	–	1,347.6
Derivative financial instruments	–	–	88.4	–	88.4
Other liabilities	–	144.3	–	–	144.3
Subordinated liabilities	–	235.0	–	–	235.0
Total financial liabilities	**–**	**12,510.5**	**88.4**	**–**	**12,598.9**

* On a Company basis, cash and balances with central banks is £3.4m (2017: £3.6m) and loans and advances to subsidiary companies is £235.0m (2017: £235.0m), both of which are categorised as loans and receivables.

All derivative financial instruments are held for economic hedging purposes, although not all derivatives are designated as hedging instruments under the terms of IAS 39.

36. Financial Instruments (continued)

Group 2017	Loans and receivables £m	Other (amortised cost) £m	Derivatives held for hedging £m	Available-for-sale £m	Total £m
Financial assets					
Cash and balances with central banks	802.9	–	–	–	802.9
Loans and advances to customers	9,961.2	–	–	–	9,961.2
Derivative financial instruments	–	–	28.7	–	28.7
Investment securities:					
- Available-for-sale	–	–	–	966.1	966.1
- Loans and receivables	34.1	–	–	–	34.1
Other assets	299.0	–	–	–	299.0
Total financial assets	**11,097.2**	**–**	**28.7**	**966.1**	**12,092.0**
Financial liabilities					
Deposits from banks	–	499.8	–	–	499.8
Deposits from customers	–	8,463.2	–	–	8,463.2
Debt securities in issue	–	1,204.3	–	–	1,204.3
Derivative financial instruments	–	–	133.3	–	133.3
Other liabilities	–	148.4	–	–	148.4
Subordinated liabilities	–	235.0	–	–	235.0
Total financial liabilities	**–**	**10,550.7**	**133.3**	**–**	**10,684.0**

36. Financial Instruments (continued)

Offsetting

The following tables show those financial assets and liabilities subject to offsetting, enforceable master netting arrangements and similar agreements.

Group 2018	Gross and net amounts presented in Statement of Financial Position	Related amounts not offset: Financial instruments	Related amounts not offset: Collateral pledged	Net amounts
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	46.1	(37.5)	(17.5)	(8.9)
Total financial assets	**46.1**	**(37.5)**	**(17.5)**	**(8.9)**
Financial liabilities				
Derivative financial instruments	(88.4)	37.5	54.6	3.7
Repurchases, securities lending and similar agreements*	(200.0)	380.0	–	180.0
Total financial liabilities	**(288.4)**	**417.5**	**54.6**	**183.7**

Group 2017	Gross and net amounts presented in Statement of Financial Position	Related amounts not offset: Financial instruments	Related amounts not offset: Collateral pledged	Net amounts
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	28.7	(17.5)	(11.0)	0.2
Total financial assets	**28.7**	**(17.5)**	**(11.0)**	**0.2**
Financial liabilities				
Derivative financial instruments	(133.3)	17.5	114.5	(1.3)
Repurchases, securities lending and similar agreements*	(99.8)	100.0	–	0.2
Total financial liabilities	**(233.1)**	**117.5**	**114.5**	**(1.1)**

*Repurchases, securities lending and similar agreements are included within the Deposits from Banks balance of £1,539.0m (2017: £499.8m) in the Consolidated Statement of Financial Position.

For the financial assets and financial liabilities subject to enforceable master netting arrangements above, each agreement between the Group and the counterparty allows for net settlement of the relevant financial assets and financial liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

36. Financial Instruments (continued)

Fair values of financial assets and financial liabilities

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

Group	2018		2017	
	Carrying value	Fair Value	Carrying value	Fair value
	£m	£m	£m	£m
Financial assets				
Loans and advances to customers	11,522.4	11,658.8	9,961.2	10,178.2
Investment securities - loans and receivables	34.1	34.7	34.1	36.8
	11,556.5	**11,693.5**	**9,995.3**	**10,215.0**
Financial liabilities				
Deposits from customers	9,244.6	9,223.5	8,463.2	8,485.5
Debt securities in issue	1,347.6	1,354.9	1,204.3	1,210.0
Subordinated liabilities	235.0	182.9	235.0	185.0
	10,827.2	**10,761.3**	**9,902.5**	**9,880.5**

* On a Company basis, loans and advances to subsidiary companies is £235.0m (2017: £235.0m), with a fair value of £182.9m (2017: £185.0m). On a Company basis, subordinated liabilities have the same carrying value and fair value as set out in the Group table above.

The only financial assets and financial liabilities which are carried at fair value in the Statement of Financial Position are available-for-sale investment securities and derivative financial instruments. The valuation techniques and inputs used to derive fair values at the year end are described below.

36. Financial Instruments (continued)

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

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

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

Group	**Level 1**	**Level 2**	**Level 3**	**Total**
2018	**£m**	**£m**	**£m**	**£m**
Financial assets carried at fair value				
Financial assets classified as available-for-sale	923.4	–	2.0	925.4
Derivative financial instruments:				
- Interest rate swaps	–	45.9	–	45.9
- Forward foreign currency contracts	–	0.2	–	0.2
Financial assets carried at amortised cost				
Loans and advances to customers	–	–	11,658.8	11,658.8
Investment securities – loans and receivables	–	34.7	–	34.7
Total	**923.4**	**80.8**	**11,660.8**	**12,665.0**
Financial liabilities carried at fair value				
Derivative financial instruments:				
- Interest rate swaps	–	88.3	–	88.3
- Forward foreign currency contracts	–	0.1	–	0.1
Financial liabilities carried at amortised cost				
Deposits from customers	–	–	9,223.5	9,223.5
Debt securities in issue	1,354.9	–	–	1,354.9
Subordinated liabilities	–	182.9	–	182.9
Total	**1,354.9**	**271.3**	**9,223.5**	**10,849.7**

* On a Company basis, loans and advances to subsidiary companies of £182.9m (2017: £185.0m) are categorised as level 2. On a Company basis, subordinated liabilities have the same fair value and categorisation as set out in the Group table above.

36. Financial Instruments (continued)

Group 2017	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets carried at fair value				
Financial assets classified as available-for-sale	964.4	–	1.7	966.1
Derivative financial instruments:				
- Interest rate swaps	–	27.6	–	27.6
- Forward foreign currency contracts	–	0.1	–	0.1
- Cross currency swaps	–	1.0	–	1.0
Financial assets carried at amortised cost				
Loans and advances to customers	–	–	10,178.2	10,178.2
Investment securities – loans and receivables	–	36.8	–	36.8
Total	**964.4**	**65.5**	**10,179.9**	**11,209.8**
Financial liabilities carried at fair value				
Derivative financial instruments:				
- Interest rate swaps	–	123.9	–	123.9
- Forward foreign currency contracts	–	0.2	–	0.2
- Cross currency swaps	–	9.2	–	9.2
Financial liabilities carried at amortised cost				
Deposits from customers	–	–	8,485.5	8,485.5
Debt securities in issue	1,210.0	–	–	1,210.0
Subordinated liabilities	–	185.0	–	185.0
Total	**1,210.0**	**318.3**	**8,485.5**	**10,013.8**

There are three levels to the hierarchy as follows:

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

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

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

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

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

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

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

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

36. Financial Instruments (continued)

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

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

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

The estimated fair value of financial assets classified as available-for-sale, being the Group's interest in VISA Inc., is described in note 17.

There were no transfers between Levels 1 and Level 2 in the year to 28 February 2018 (2017: no transfers).

There were no transfers between Level 2 and Level 3 in the year to 28 February 2018 (2017: no transfers).

37. Cash Outflow from Operating Activities

	Group		Company	
	2018	2017	**2018**	2017
Non cash and other items included in operating profit before taxation	**£m**	£m	**£m**	£m
		Restated[1]		
Loan impairment charges (refer note 9)	134.2	102.8	–	–
Depreciation and amortisation (refer notes 23 & 24)	83.0	110.3	–	–
Gain on disposal of investment securities	(0.1)	(4.2)	–	–
Disposal of non-current assets (refer notes 23 & 24)	1.1	6.5	–	–
Provision for liabilities and charges (refer note 28)	49.7	59.6	–	–
Impairment loss on insurance premiums (refer note 9)	3.2	3.6	–	–
Share of profit/loss of joint venture (refer note 21)	(10.0)	15.6	–	–
Equity settled share based payments (refer note 11)	3.6	0.9	–	–
Interest paid on debt securities in issue	24.7	25.2	–	–
Interest received on assets held to hedge debt securities in issue	(3.6)	(3.1)	–	–
Interest on subordinated liabilities (refer note 4)	4.0	4.3	3.9	4.3
Fair value movements	7.6	(12.7)	–	–
Total [1]	**297.4**	**308.8**	**3.9**	**4.3**

Changes in operating assets and liabilities				
Net movement in mandatory balances with central banks	(0.8)	(1.2)	–	–
Net movement in loans and advances to customers	(1,738.5)	(1,528.8)	–	–
Net movement in prepayments and accrued income	(7.1)	0.9	(0.1)	0.1
Net movement in other assets	33.3	(21.9)	–	–
Net movement in deposits from banks	1,039.2	417.8	–	–
Net movement in deposits from customers	781.4	1,066.0	–	–
Net movement in accruals and deferred income	(2.4)	(12.5)	0.1	(0.1)
Provisions utilised	(54.1)	(36.1)	–	–
Net movement in other liabilities	(4.1)	5.5	(0.2)	–
Total	**46.9**	**(110.3)**	**(0.2)**	**–**

[1] Refer to note 1 for further details of prior year restatement.

38. Reconciliation of Liabilities Arising from Financing Activities

Group	At 1 March 2017	Financing Cash flows	Non-cash movements Fair value change	Accrued Interest	Other	At 28 February 2018
	£m	£m	£m	£m	£m	£m
Debt securities in issue	(1,204.3)	(150.0)	9.1	(2.6)	0.2	(1,347.6)
Subordinated liabilities and notes	(235.0)	–	–	–	–	(235.0)
Interest payable	(3.7)	28.5	–	(28.7)	–	(3.9)
Assets held to hedge fixed rate bonds	23.8	(3.6)	(5.9)	3.6	–	17.9
Total liabilities from financing activities	**(1,419.2)**	**(125.1)**	**3.2**	**(27.7)**	**0.2**	**(1,568.6)**

* Assets held to hedge fixed rate bonds are included within derivative financial instruments in the Statement of Financial Position on page 27.

Company	At 1 March 2017	Financing Cash flows	Non-cash movements Fair value change	Accrued Interest	Other	At 28 February 2018
	£m	£m	£m	£m	£m	£m
Subordinated liabilities and notes	(235.0)	–	–	–	–	(235.0)
Interest payable	(0.6)	3.9	–	(4.0)	–	(0.7)
Total liabilities from financing activities	**(235.6)**	**3.9**	**–**	**(4.0)**	**–**	**(235.7)**

39. Capital Resources

On 27 June 2013 the final Capital Requirements Directive IV (CRD IV) rules were published in the Official Journal of the European Union. Following the publication of the CRD IV rules, the PRA issued a policy statement on 19 December 2013 detailing how the rules will be enacted within the UK with corresponding time frames for implementation. The transitioning period came to an end in December 2017. The following tables analyse the regulatory capital resources of the regulated group as defined in Pillar 3 Disclosure Statements of Tesco Personal Finance Group Limited applicable as at the year end on an 'end point' position:

	End Point 2018	Transitional 2017
	£m	£m
Movement in common equity tier 1 capital:		
At the beginning of the year (on a transitional basis)	1,383.5	1,219.7
Profit attributable to shareholders	131.0	152.9
Gains and losses on liabilities arising from own credit	0.1	0.8
Other reserves	6.0	5.7
Ordinary dividends	(50.0)	(50.0)
Movement in intangible assets	28.9	63.9
Movement in material holdings	3.4	3.4
Deferred tax liabilities related to intangible assets	(8.3)	(12.9)
At the end of the year	**1,494.6**	**1,383.5**

39. Capital Resources (continued)

	End Point 2018 £m	Transitional 2017 £m
Common equity tier 1		
Shareholders' equity (accounting capital)	1,761.3	1,673.9
Regulatory adjustments		
Unrealised gains on cash flow hedge reserve	0.3	0.5
Adjustment to own credit/Additional Value Adjustments	(1.1)	(1.1)
Intangible assets	(271.1)	(300.0)
Deferred tax liabilities related to intangible assets	5.2	13.6
Material holdings in financial sector entities	–	(3.4)
Common equity tier 1 capital	**1,494.6**	**1,383.5**
Tier 2 capital (instruments and provisions)		
Undated subordinated notes	45.0	45.0
Dated subordinated notes net of regulatory amortisation	190.0	190.0
Credit risk adjustment	99.1	63.1
Tier 2 capital (instruments and provisions) before regulatory adjustments	**334.1**	**298.1**
Regulatory adjustments		
Material holdings in financial sector entities	(34.1)	(30.7)
Total regulatory adjustments to tier 2 capital (instruments and provisions)	**(34.1)**	**(30.7)**
Total tier 2 capital (instruments and provisions)	**300.0**	**267.4**
Total capital	**1,794.6**	**1,650.9**
Total risk weighted assets (unaudited)	9,267.6	8,276.3
Common equity tier 1 ratio (unaudited)	16.1%	16.7%
Tier 1 ratio (unaudited)	16.1%	16.7%
Total capital ratio (unaudited)	19.4%	19.9%

Total Capital Requirement (TCR) refers to the amount and quality of capital the Bank must maintain to comply with the Capital Requirements Regulation Pillar 1 and the Pillar 2A capital requirements. The TCR for Tesco Personal Finance Group Limited as at 28 February 2018 is 11.87% plus £39m as a static add-on for pension risk.

39. Capital Resources (continued)

The table below reconciles shareholders' equity of the Group to shareholders' equity of the regulated group as defined in the Pillar 3 disclosures as at 28 February 2018:

	2018	2017
	£m	£m
Tesco Personal Finance plc (Group) shareholders' equity	1,764.8	1,673.9
Share of joint venture's retained earnings	0.2	10.2
Share of joint venture's available-for-sale reserve	(3.7)	(10.2)
Group shareholders' equity (Pillar 3 disclosures)	**1,761.3**	**1,673.9**

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

The Group is required to submit Internal Capital Adequacy Assessment Process (ICAAP) 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 Plan that provides the framework and a series of recovery options which could be deployed in a severe stress event impacting capital or liquidity positions. The Recovery Plan is reviewed and approved by the Board on at least an annual basis.

The Group has met all relevant capital requirements throughout the year.

Leverage ratio (unaudited)

The Basel III reforms include the introduction of a capital leverage measure as defined as the ratio of tier 1 capital to total exposure. This is intended to reinforce the risk based capital requirements with a simple, non-risk based 'backstop' measure.

The Group has published the leverage ratio on a CRD IV basis using the existing exposure approach:

Exposures for leverage ratio (unaudited)	**End point**
2018	**£m**
Total balance sheet exposures	14,590.7
Adjustments for entities which are consolidated for accounting purposes but outside scope of regulatory consolidation	(3.5)
Removal of accounting value of derivatives and Securities Financing Transactions (SFTs)	(46.1)
Exposure value for derivatives and SFTs	12.7
Off balance sheet: unconditionally cancellable (10%)	1,219.4
Off balance sheet: other (20%)	41.2
Regulatory adjustment – intangible assets	(225.8)
Regulatory adjustment – other	–
Total	**15,588.6**
Common equity tier 1	**1,494.6**
Leverage ratio	9.6%

The Company's estimated end point leverage ratio is 9.6%.

39. Capital Resources (continued)

Capital Management

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

During the year capital and leverage regulations continued to evolve.

Pillar 2 capital methodologies

The PRA updated its Pillar 2 capital methodologies in July 2016 following the publication of prudential requirements for implementation of ring-fencing and in February 2017 issued a policy statement in October 2017 refining the Pillar 2A framework.

These proposals are aimed at promoting the safety and soundness of PRA-regulated firms, to facilitate a more effective banking sector and to make the PRA's Pillar 2A capital assessment more robust and more proportionate by addressing some of the concerns over the differences between SA and IRB risk weights. This will continue to be managed as part of the Bank's ICAAP in line with the PRA policy statement issued in October 2017. The PRA general safety and soundness objectives in relation to continuity of core services in the UK and ring-fencing of Bank activities where core deposits are in excess of £25bn are due to be implemented from 1 January 2019.

Management forecasts indicate that the Group will not exceed this threshold and will not automatically be required to ring-fence the Group's core activities by the 2019 implementation date.

Credit Risk

In December 2017, the BCBS finalised Basel III reforms for credit risk, including revisions to the calculation of risk weighted assets and enhancements to the robustness and risk sensitivity of the standardised approaches to credit risk, constraining the use of internal model approaches by placing limits on certain inputs and replacing the existing Basel II output floors with a more robust risk sensitive floor based on the Committees Basel III standardised approaches. The final Basel III reforms will be implemented from January 2022.

Operational risk

In December 2017, the BCBS finalised Basel III reforms for operational risk by replacing all existing approaches in the Basel II framework with a single risk-sensitive standardised approach to be used by all banks. The new standardised approach increases the sensitivity by combining a refined measure of gross income with the banks internal historical losses. The final Basel III reforms will be implemented in January 2022.

Leverage

At present the Group has no minimum UK leverage requirement as it is currently exempt from the UK Leverage Framework regime, which only applies to institutions with retail deposits over £50 billion or more. In December 2017, the BCBS finalised Basel III reforms for leverage ratio. The final Basel III reforms will be implemented in January 2022.

The initial assessment indicate that these reforms will have a minor impact on the Group's leverage ratio.

The Group is subject to reporting and disclosure requirements under the CRR and is not currently subject to temporary modifications of the UK leverage ratio framework.

39. Capital Resources (continued)

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

MREL requires banks to maintain at all times a sufficient aggregate amount of own funds and eligible liabilities (that may be bailed-in if required). MREL will, on full implementation, be set on a firm-specific basis and calculated as the sum of two components: a loss absorption amount, being the amount needed to absorb losses up to and in resolution; and a recapitalisation amount which reflects the capital that a firm is likely to need post resolution.

MREL is expected to be set annually over the transitional period until 1 January 2022. Prior to 31 December 2019, MREL will be equal to an institution's minimum regulatory capital requirements. An Interim MREL requirement of 18% of risk-weighted assets from 1 January 2020 until 31 December 2021 has been set. The Group is working towards implementation of these requirements and has reflected requirements in its strategic plan.

IFRS 9

The Group will implement IFRS 9 from 1 March 2018 and does not expect a negative capital impact (unaudited) on common equity tier 1 in the first year of adoption under the transitional provisions. Common equity tier 1 is expected to reduce by approximately 164 bps (unaudited) on an end point basis.

40. Related Party Transactions

During the year the Group had the following transactions with related parties:

Transactions involving Directors and other key connected persons

For the purposes of IAS 24, 'Related Party Disclosures', the Group's key Management personnel comprise Directors of the Group. The captions in the Group's primary Financial Statements include the following amounts attributable, in aggregate, to key connected persons of both the Group and Tesco PLC, the Company's ultimate parent undertaking.

Group	**2018**	2017
	£m	£m
Loans and advances to customers[1]		
At the beginning of the year	0.4	1.0
Loans issued during the year	–	0.1
Loan repayments during the year	(0.1)	(0.1)
Loans outstanding at the end of the year	**0.3**	**1.0**
Interest income earned	–	–
Deposits from customers[1]		
Deposits at the beginning of the year	0.8	0.8
Deposits received during the year	0.6	1.6
Deposits repaid during the year	(0.7)	(0.7)
Deposits at the end of the year	**0.7**	**1.7**
Interest expense on deposits	–	–

No provisions have been recognised in respect of loans and advances to related parties (2017: £nil).

[1] The opening and closing balances reported are in respect of related parties of the Group at the reporting date in each year.

40. Related Party Transactions (continued)

Remuneration of key Management personnel

The amount of remuneration incurred by the Group in relation to the Directors is set out below in aggregate. Further information about the remuneration of Directors is provided in note 10.

Group	**2018**	2017
	£m	£m
Short-term employee benefits	6.0	5.2
Termination benefits	0.3	0.6
Post employment benefits	–	–
Other long term benefits	2.6	2.1
Share based payments	0.9	1.2
Total emoluments	**9.8**	**9.1**

Trading transactions

Group	**2018 Tesco PLC**	**2018 Tesco PLC subsidiaries**	**2018 Tesco Underwriting Limited**	2017 Tesco PLC	2017 Tesco PLC subsidiaries	2017 Tesco Underwriting Limited
	£m	**£m**	**£m**	£m	£m	£m
Interest received and other income	–	24.3	71.2	–	35.6	78.5
Interest paid	(4.0)	–	–	(4.3)	–	–
Provision of services	–	(83.4)	(1.1)	–	(73.4)	(1.3)

Company	**2018 Tesco PLC**	**2018 Tesco PLC subsidiaries**	**2018 Tesco Underwriting Limited**	2017 Tesco PLC	2017 Tesco PLC subsidiaries	2017 Tesco Underwriting Limited
	£m	**£m**	**£m**	£m	£m	£m
Interest received and other income	–	4.0	–	–	4.3	–
Interest paid	(4.0)	–	–	(4.3)	–	–
Provision of services	–	–	–	–	–	–

Balances owing to/from related parties are identified in notes 17, 19, 26, 27, 29, 30, and 31.

For the year ended 28 February 2018 the Group generated 58% (2017: 58%) of its insurance commission from the sale and service of Motor and Home insurance policies underwritten by TU, a joint venture company and therefore a related party. Customer premiums on such sales are collected directly by the Group and the net premium is remitted to TU. Investment transactions with TU are identified in note 21.

Ultimate parent undertaking

The Company's ultimate parent undertaking and controlling party is Tesco PLC which is incorporated in England. The Financial Statements for Tesco PLC can be obtained from its registered office at Tesco House, Shire Park, Kestrel Way, Welwyn Garden City, AL7 1GA.

41. Contingent Liabilities and Commitments

Contingent liability

In November 2016, Tesco Bank's debit cards were the subject of an online fraudulent attack. The Group undertook immediate remedial action and an independent review of the issue and continues to work closely with the authorities and regulators on this incident.

There is a possibility of a financial penalty in relation to this incident, which may or may not be material. It is not practicable to reliably estimate any impact of this at the date of these Financial Statements.

Lending commitments

Mortgage offers made are legally binding commitments made by the Group to provide secured funding to customers. Undrawn Mortgage commitments relate to formal offers made to customers during the application process whereby the customer has successfully passed eligibility and affordability checks but has not yet received the funds.

Under an undrawn Credit Card commitment the Group agrees to make funds available to a customer in the future. Undrawn Credit Card commitments may be unconditionally cancelled or may continue, providing all facility conditions are satisfied or waived.

Under a Personal Current Account overdraft commitment the Group agrees to make funds available to a customer in the future. Personal Current Account overdraft commitments are usually for a specified term and may be unconditionally cancelled or may continue, providing all facility conditions are satisfied or waived.

Further detail on undrawn lending commitments is included in the liquidity and funding risk disclosure in note 35.

The contractual amounts do not represent the amounts at risk at the reporting date but the amounts that would be at risk should the available facilities be fully drawn upon.

Capital commitments

At 28 February 2018 the Group had capital commitments related to property, plant and equipment of £nil (2017: £3.9m) and intangible assets of £1.1m (2017: £1.2m). This is in respect of IT software development and IT hardware. The Group's Management are confident that future net revenues and funding will be sufficient to cover this commitment.

Operating lease commitments

The future minimum lease payments under non-cancellable operating leases are as follows:

Group	**2018**	**2017**
	£m	**£m**
No later than one year	4.9	5.2
Later than one year and no later than five years	20.8	20.1
Later than five years	27.4	33.0
	53.1	**58.3**

42. Share Based Payments

The Group charge for the year recognised in respect of share based payments is £10.7m (2017: £10.4m), which is made up of share option schemes and share bonus payments. Of this amount, £7.8m (2017: £4.5m) will be equity-settled and £2.9m (2017: £5.9m) cash-settled.

Share option schemes

The Group had three share option schemes in operation during the year, all of which are equity-settled schemes using Tesco PLC shares:

- The Savings-related Share Option Scheme (1981) permits the grant to colleagues of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three or five years with contributions from colleagues of an amount between £5 and £500 per four-weekly period. Options are capable of being exercised at the end of the three or five-year period at a subscription price of not less than 80% of the average of the middle-market quotations of an ordinary share over the three dealing days immediately preceding the offer date.

- The Discretionary Share Option Plan (2004) permitted the grant of approved, unapproved and international options in respect of ordinary shares to selected executives. Options are normally exercisable between three and ten years from the date of grant at a price not less than the middle-market quotation or average middle-market quotations of an ordinary share for the dealing day or three dealing days preceding the date of grant. The vesting of options will normally be conditional upon the achievement of a specified performance target related to the annual percentage growth in earnings per share over a three-year period. There were no discounted options granted under this scheme.

- The Performance Share Plan (2011) permits the grant of options in respect of ordinary shares to selected executives. Options are normally exercisable between the vesting date(s) set at grant and ten years from the date of grant for nil consideration. The exercise of options will normally be conditional upon the achievement of specified performance targets over a three-year period and/or continuous employment.

42. Share Based Payments (continued)

The following table reconciles the total number of share options outstanding under each share option scheme and the weighted average exercise price (WAEP):

	Savings-related share option scheme Options	Savings-related share option scheme WAEP (pence)	Approved share option scheme Options	Approved share option scheme WAEP (pence)	Unapproved share options scheme Options	Unapproved share options scheme WAEP (pence)
Outstanding at 28 February 2017	**3,522,224**	**162.20**	**183,586**	**341.79**	**221,617**	**354.32**
Granted	1,184,513	168.00	–	–	–	–
Forfeited	(573,424)	188.26	(88,650)	338.40	(99,157)	338.40
Exercised	(75,222)	150.09	–	–	–	–
Outstanding at 28 February 2018	**4,058,091**	**160.43**	**94,936**	**344.96**	**122,460**	**367.20**
Exercisable at 28 February 2018	**19,559**	**282.00**	**94,936**	**344.96**	**122,640**	**367.20**
Exercise price range (pence)	**–**	**282.00**	**–**	**338.40 to 427.00**	**–**	**338.40 to 427.00**
Weighted average remaining contractual life (years)	**–**	**0.43**	**–**	**1.58**	**–**	**0.88**
Outstanding at 29 February 2016	**3,584,756**	**159.63**	**210,181**	**341.36**	**237,426**	**353.26**
Granted	539,072	190.00	–	–	–	–
Forfeited	(579,345)	172.66	(26,595)	338.40	(15,809)	338.40
Exercised	(22,259)	150.18	–	–	–	–
Outstanding at 28 February 2017	**3,522,224**	**162.20**	**183,586**	**341.79**	**221,617**	**354.32**
Exercisable at 28 February 2017	**64,114**	**335.50**	**183,586**	**341.79**	**221,617**	**354.32**
Exercise price range (pence)	**-**	**322.00 to 364.00**	**-**	**338.40 to 427.00**	**-**	**338.40 to 427.00**
Weighted average remaining contractual life (years)	**–**	**0.43**	**–**	**2.64**	**–**	**2.02**

Share options were exercised on a regular basis throughout the financial year. The average Tesco PLC share price during the year ended 28 February 2018 was 187.90p (2017: 184.31p).

42. Share Based Payments (continued)

The fair value of share options is estimated at the date of grant using the Black-Scholes option pricing model. The following table gives the assumptions applied to the options granted in the respective periods shown. No assumption has been made to incorporate the effects of expected early exercise.

Group	2018 Savings - related share options schemes	2017 Savings - related share options schemes
Expected Dividend Yield (%)	2.2% - 3.6%	1.4%
Expected Volatility (%)	29 - 32%	29 - 32%
Risk free interest rate (%)	0.9 - 1.0%	0.4 - 0.7%
Expected life of option (years)	3 or 5	3 or 5
Weighted average fair value of options granted (pence)	42.42	52.83
Probability of forfeiture (%)	10 - 11%	10 - 11%
Share price (pence)	187.00	211.00
Weighted average exercise price (pence)	168.00	190.00

Volatility is a measure of the amount by which a price is expected to fluctuate in the period. The measure of volatility used in Tesco PLC's option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share over a period of time. In estimating the future volatility of Tesco PLC's share price, the Tesco PLC Board considers the historical volatility of the share price over the most recent period that is generally commensurate with the expected term of the option, taking into account the remaining contractual life of the option.

Share Bonus Schemes

Selected executives participate in the Group Bonus Plan, a performance-related bonus scheme. The amount paid to colleagues is based on a percentage of salary and is paid partly in cash and partly in shares. Bonuses are awarded to selected executives who have completed a required service period and depend on the achievement of corporate and individual performance targets.

Selected executives participate in the Performance Share Plan (2011). Awards made under this plan will normally vest on the vesting date(s) set on the date of the award for nil consideration. Vesting will normally be conditional on the achievement of specified performance targets over a three-year performance period and/or continuous employment.

The fair value of shares awarded under these schemes is their market value on the date of the award. Expected dividends are not incorporated into the fair value.

The number of Tesco PLC shares and weighted average fair value (WAFV) of share bonuses awarded during the year were:

	2018 Shares (number)	2018 WAFV (pence)	2017 Shares (number)	2017 WAFV (pence)
Group Bonus Plan	1,305,466	180.35	2,407,464	159.04
Performance Share Plan	2,494,746	181.12	3,404,300	160.15

43. Adoption of New and Amended International Financial Reporting Standards

Standards, amendments and interpretations issued which became effective in the current year

During the year to 28 February 2018, the Group has adopted the following new amendments to accounting standards which became effective with relevant EU endorsement for annual periods beginning on or after 1 January 2017:

Amendments to IFRS 12 'Disclosure of interests in other entities'

These amendments are part of the Annual Improvements 2014-2016 process and are effective for annual periods beginning on or after 1 January 2017. These amendments clarify the scope of the disclosure requirements in relation to interests that are classified in accordance with IFRS 5 'Non-current Assets Held for Sale or Discontinued Operations'. There has been no impact on the Group of the adoption of these amendments.

Amendments to IAS 7 'Statement of cash flows: Disclosure initiative'

These amendments are effective for annual periods beginning on or after 1 January 2017. They extend the disclosures required by IAS 7 about an entity's liquidity and aim to improve disclosures about an entity's debt. These amendments have resulted in additional disclosures relating to movements in liabilities arising from financing activities for the Group. These additional disclosures are included in note 38.

Amendments to IAS 12 'Income taxes: Recognition of deferred tax assets for unrealised losses'

These amendments are effective for annual periods beginning on or after 1 January 2017. They clarify the accounting for deferred tax assets for unrealised losses on debt instruments measured at fair value. There has been no impact on the Group of the adoption of these amendments.

Standards, amendments and interpretations issued but not yet effective

IFRS 9 'Financial instruments'

IFRS 9 is effective for annual periods beginning on or after 1 January 2018. It is a replacement for IAS 39 'Financial instruments: Recognition and Measurement', excluding the part of IAS 39 related to macro hedge accounting. Macro hedge accounting requirements are out of the scope of IFRS 9 and instead the IASB is developing a separate model. Entities are therefore permitted to continue accounting for macro hedge portfolios in line with IAS 39.

The principle features of IFRS 9 are as follows:

Classification and measurement of financial assets and financial liabilities:

IFRS 9 will require the Group's financial assets to be classified as either held at amortised cost, fair value through other comprehensive income (FVOCI) or fair value through profit or loss, dependent on the business model and cash flow characteristics of the financial asset. From a review of the Group's balance sheet at 28 February 2018, the Group expects the following classification changes to take place:

- Cash and balances with central banks, loans and advances to customers, loans to joint ventures and other assets that are all classified as loans and receivables under IAS 39 will be classified and measured at amortised cost under IFRS 9; and
- Debt and equity investment securities classified as available-for-sale under IAS 39 will classified and measured at FVOCI under IFRS 9.

There is no change in the measurement basis of these balances as a result of the adoption of IFRS 9.

43. Adoption of New and Amended International Financial Reporting Standards (continued)

Recognition of impairment:

IFRS 9 requires the Group to recognise expected credit losses (ECL) on all financial assets, and to update the amount of ECL recognised at each reporting date to reflect changes in the credit risk of financial instruments. The ECL is measured under a three stage approach:

1. Upon origination of an asset, a loss allowance is established that is equal to the 12-month ECL, being the portion of lifetime expected losses resulting from default events that are possible within the next 12 months. Financial assets where 12-month ECL is recognised are considered to be 'stage 1'.
2. Where a significant increase in credit risk since initial recognition is identified, a loss allowance equal to the lifetime ECL is established. This is considered to be 'stage 2'.
3. Where there is objective evidence that leads to an asset being considered credit impaired, a full impairment loss equal to the lifetime expected credit loss is established. This is considered to be 'stage 3' and it is not expected to change significantly from IAS 39.

The assessment of credit risk and the estimation of ECL are required to be unbiased, forward-looking and probability-weighted, determined by evaluating at the reporting date for each financial asset a range of possible outcomes using reasonable and supportable information about past events, current conditions and forecasts of future events and economic conditions. The estimation of ECL also takes into account the time value of money.

The ECL is determined by multiplying together the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) for the relevant time period and for each collective segment and by discounting back to the balance sheet date. Each of these inputs is explained further below.

- Probability of Default (PD): Represents the likelihood a customer will default over the relevant period, being either 12 months or the expected lifetime (refer below).
- Exposure at Default: Represents the expected amount due by the customer at the point of default. The Group derives the EAD from the current exposure to the counterparty and potential changes allowed under the contract.
- Loss Given Default: Represents the Group's expectation of the extent of the loss if there is a default. The LGD assumes that once an account has defaulted, the portion of the defaulted balance will be recovered over a maximum period of 60 months from the point of default. LGD models take into account, when relevant, the valuation of collateral, collection strategies and contracted debt sales.
- Significant Increase in Credit Risk (SICR): At each reporting date, the change in credit risk of the financial asset will be observed using a set of quantitative and qualitative criteria, together with a backstop based on arrears status. Quantitative criteria compare the lifetime PD at the reporting date with the lifetime PD that was expected at the reporting date at initial recognition. The Group has established a threshold for each account to conclude whether there has been a SICR. Qualitative criteria include forbearance offered to distressed borrowers and information received on credit limit decreases or pre-delinquency information. The Group has adopted a backstop measure where an account is more than 30 days past due on its contractual payments, in line with the rebuttable presumption in IFRS 9.
- Expected lifetime: The expected lifetime of a financial asset is the contractual term. In the case of revolving products, the Group will measure credit losses over the period that it will be exposed to credit risk.
- Forward-looking information: The expected credit loss calculation and the measurement of significant deterioration in credit risk both incorporate forward-looking information using a range of macro-economic scenarios.
- Definition of default: An account is deemed to have defaulted when it meets one or more of the established quantitative or qualitative criteria. Quantitative criteria are met when an account is more than 90 days past due on its contractual payments. Qualitative criteria are indications that a customer is in significant financial difficulty, such as forbearance or insolvency. An instrument is considered to no longer be in default when it no longer meets any of the default criteria and has remained up to date on its contractual payments for a period of at least 3 months.

43. Adoption of New and Amended International Financial Reporting Standards (continued)

Hedging

The IFRS 9 hedge accounting requirements are designed to allow hedge accounting to be more closely aligned with financial risk management. The Group will implement IFRS 9 hedge accounting requirements to its fair value hedges of the Group's existing available-for-sale portfolio and its cash flow hedges on transition to IFRS 9.

In line with Tesco PLC policy, the Group will adopt IFRS 9 in respect of its micro hedge accounting from 1 March 2018. As permitted under IFRS 9, the Group will elect to continue to apply the existing hedge accounting requirements of IAS 39 for its portfolio hedge accounting until the new macro hedge accounting standard is implemented.

Transition

The mandatory application date for IFRS 9 for the Group is 1 March 2018. The classification and measurement and impairment requirements will be applied retrospectively at this date by adjusting the opening balance sheet, with no requirement to restate comparative periods. Hedge accounting relationships within the scope of IFRS 9 will transition prospectively.

The adoption of IFRS 9 at 1 March 2018 is expected to result in a decrease in the Group's total assets of £223m, with a related deferred tax asset of £57m. The overall impact on equity is therefore expected to be a reduction in equity of approximately £166m. The impact on the Company will be a decrease in total assets and equity of approximately £1m.

The expected increase in impairment provisions will reduce the Group's common equity tier 1 capital ratio by 164 bps (unaudited) on a fully loaded basis. The adoption of the regulatory capital transition arrangements will allow the Group to spread the expected increase in provision over a 5 year period from 1 March 2018. As a result of this, the Group does not expect a negative capital impact in the first year of adoption of IFRS 9 (unaudited). The Group's common equity tier 1 capital is disclosed in note 39.

These estimates remain subject to change as the Group continues to fully implement IFRS 9 throughout the financial year to 28 February 2019.

IFRS 15 'Revenue from contracts with customers'

IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted.

IFRS 15 introduces a five step approach to revenue recognition and will be applicable to all contracts with customers, with certain exceptions. Both the Group's interest income and fee income integral to financial instruments fall outside the scope of IFRS 15 and will be accounted for in line with the other applicable standards, predominantly IFRS 9, 'Financial Instruments' from 1 March 2018 (refer above). All other fees and commissions income falls within the scope of IFRS 15.

Under IFRS 15, the Group will recognise revenue when performance obligations are satisfied, to the extent that the Group expects entitlement to consideration. The standard also specifies a comprehensive set of disclosure requirements regarding the nature, extent and timing, as well as any uncertainty, of revenue and corresponding cash flows with customers.

The Group continues to assess the impact of IFRS 15. Additional revenue disclosures in line with the new IFRS 15 requirements will be included for the first time in the Financial Statements for the year ended 28 February 2019.

Amendments to IFRS 15 'Clarifications to IFRS 15, 'Revenue from Contracts with Customers''

These amendments are effective for annual periods beginning on or after 1 January 2018. They clarify how the principles of IFRS 15 should be applied in determining recognition of contract revenue and provide transitional relief on modified and completed contracts for entities implementing the standard.

The Group continues to assess the impact of IFRS 15.

43. Adoption of New and Amended International Financial Reporting Standards (continued)

Amendments to IFRS 4 'Applying IFRS 9, 'Financial Instruments', with IFRS 4, 'Insurance Contracts''

These amendments are effective for annual periods beginning on or after 1 January 2018. They permit insurance entities to adopt certain transitional arrangements to address the temporary accounting consequences of the different effective dates of IFRS 9, 'Financial Instruments', and IFRS 17, 'Insurance Contracts'. These amendments are expected to impact the Group's share of results from its joint venture, TU, as TU will defer the adoption of IFRS 9 until 2021 as permitted by these amendments.

Amendments to IAS 28 'Measuring an associate or joint venture at fair value'

These amendments are part of the Annual Improvements 2014-2016 process and are effective for annual periods beginning on or after 1 January 2018. They clarify that the option for a venture capital organisation and other similar entities to measure investments in associates and joint ventures at fair value through profit and loss is available separately for each associate or joint venture, and that election should be made at initial recognition. These amendments will not impact the Group.

Amendments to IFRS 2 'Classification and measurement of share-based payment transactions'

These amendments are effective for annual periods beginning on or after 1 January 2018. They clarify how to account for certain types of share-based payment transactions. These amendments are not expected to impact the Group.

IFRIC 22 'Foreign currency transactions and advance consideration'

This IFRIC is effective for annual periods beginning on or after 1 January 2018. It clarifies the accounting for advance consideration in a transaction that is denominated in a foreign currency. This IFRIC is not expected to impact the Group.

IFRS 16 'Leases'

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early adoption is permitted provided IFRS 15 is applied on or before the same date.

IFRS 16 is a replacement for IAS 17 'Leases'. IFRS 16 removes the distinction between finance and operating leases and instead provides a single lessee accounting model. The Group, as a lessee, will be required to recognise lease liabilities and corresponding right-of-use assets for all applicable leases. The new standard also provides the option not to recognise 'short-term' leases and leases of 'low-value' assets. Where this exemption is taken, such leases will continue to be expensed to the income statement over the term of the lease.

The income statement recognition pattern for the Group's leases will differ from the current pattern for operating leases, with interest on the liabilities and depreciation expense on the right-of-use assets recognised separately. In the cash flow statement, lease payments will be categorised within financing activities rather than operating activities.

IFRS 16 does not significantly change the accounting for leases by lessors.

The Group continues to evaluate the full impact of IFRS 16, but expects to recognise right-of-use assets on its balance sheet at the adoption date in respect of property assets currently accounted for as operating leases. A corresponding lease liability will also be recognised, representing the future payments to be made under these leases, discounted at the rate implicitly defined in the lease or, where no rate is defined in the lease, the Group's incremental borrowing rate at lease inception.

The Group expects to apply the requirements of IFRS 16 retrospectively, therefore restating prior year comparatives.

Amendments to IAS 28 'Long-term interests in associates and joint ventures'

These amendments are effective for annual periods beginning on or after 1 January 2019, subject to EU endorsement. They clarify that long-term interests in an associate or joint venture to which the equity method is not applied should be accounted for using IFRS 9. These amendments are not expected to impact the Group.

43. Adoption of New and Amended International Financial Reporting Standards (continued)

Amendments to IFRS 9 'Prepayment features with negative compensation'

These amendments are effective for annual periods beginning on or after 1 January 2019. They allow companies to measure particular prepayable financial assets with so-called negative compensation at amortised cost or at fair value through other comprehensive income if a specified condition is met, instead of at fair value through profit or loss. These amendments are not expected to impact the Group.

Amendments to IAS 23 'Borrowing costs eligible for capitalisation'

These amendments are effective for annual periods beginning on or after 1 January 2019, subject to EU endorsement. They clarify that if a specific borrowing remains outstanding after the related qualifying asset is ready for intended use or sale, it becomes part of general borrowings. These amendments are not expected to impact the Group.

Amendments to IAS 12 'Income tax consequences of payments on financial instruments classified as equity'

These amendments are effective for annual periods beginning on or after 1 January 2019, subject to EU endorsement. They clarify that the income tax consequences of dividends on financial instruments classified as equity should be recognised according to where the past transactions or events that generated distributable profits were recognised. These amendments are not expected to impact the Group.

Amendments to IFRS 3 and IFRS 11 'Measurement of previously held interest in obtaining control over a joint operation'

These amendments are effective for annual periods beginning on or after 1 January 2019, subject to EU endorsement. The amendments to IFRS 3 clarify that obtaining control of a business that is a joint operation is a business combination achieved in stages. The acquirer should remeasure its previously held interest in the joint operation at fair value at of the acquisition date.

The amendments to IFRS 11 clarify that the party obtaining joint control of a business that is a joint operation should not remeasure its previously held interest in the joint operation.

The impact of these amendments on the Group is dependent on any future change in ownership of a joint operation.

Amendments to IAS 19 'Plan amendment, curtailment or settlement'

These amendments are effective for annual periods beginning on or after 1 January 2019, subject to EU endorsement. When a plan event (i.e. a plan amendment, curtailment or settlement) occurs, IAS 19 requires a company to update its assumptions and remeasure its net defined benefit liability or asset. These amendments clarify that after a plan event companies should use these updated assumptions to measure current service cost and net interest for the remainder of the reporting period. These amendments are not expected to impact the Group.

IFRIC 23 'Uncertainty over income tax treatments'

This IFRIC is effective for annual periods beginning on or after 1 January 2019, subject to EU endorsement. It clarifies how the recognition and measurement requirements of IAS 12 'Income taxes' are applied where there is uncertainty over income tax treatments. The impact of this IFRIC on the Group is still being assessed.

IFRS 17 'Insurance contracts'

IFRS 17 is effective for annual periods beginning on or after 1 January 2021, subject to EU endorsement. Early adoption is permitted provided IFRS 9 and IFRS 15 are also applied.

IFRS 17 is a replacement for IFRS 4 'Insurance Contracts'. IFRS 17 requires insurance liabilities to be measured at a current fulfilment value and provides a more uniform measurement and presentation approach for all insurance contracts.

IFRS 17 is relevant to the Group's joint venture, TU, which provides the insurance underwriting service for a number of the Group's general insurance products. The full impact on the Group is still being assessed.

43. Adoption of New and Amended International Financial Reporting Standards (continued)

Early Adoption of New Standards

The Group did not early adopt any new or amended standards in the year ended 28 February 2018.

44. Events After the Reporting Date

The Group redeemed £300.0m of AAA (A1) Notes issued by MTN Issuer plc on their scheduled redemption date in April 2018. The process of accumulating funds in advance of the scheduled redemption commenced in October 2017. At the reporting date, £200.0m of cash had been accumulated in Delamare Cards Funding 1 Limited (Funding 1) in advance of the redemption. An additional £100.0m was accumulated after the reporting date.

TU completed a share capital reduction of £20.6m and also repaid loan capital of £10.4m in March 2018. Following the share capital reduction, TU distributed capital of £20.6m. The Group has recognised its share of this distribution, being £10.3m, through a reduction in the carrying value of its investment in TU. The Group's investment in subordinated debt issued by TU has decreased by £5.2m, reflecting the Group's share of loan capital repaid.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF TESCO PERSONAL FINANCE GROUP LIMITED

Report on the audit of the Financial Statements

Opinion

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 28 February 2018 and of the Group's profit for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (IASB);
- the parent Company Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the Financial Statements of Tesco Personal Finance Group Limited (the 'parent Company') and its subsidiaries (the 'Group') which comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Comprehensive Income;
- the Consolidated and Company Statements of Financial Position;
- the Consolidated and Company Statements of Changes in Equity;
- the Consolidated and Company Cash Flow Statements; and
- the related Notes 1 to 44 of the Financial Statements.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the Financial Statements section of our report.

We are independent of the Group and the parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (FRC) Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the Financial Statements is not appropriate; or
- the directors have not disclosed in the Financial Statements any identified material uncertainties that may cast significant doubt about the Group's or the parent Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Financial Statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Report, other than the Financial Statements and our auditor's report thereon.

Our opinion on the Financial Statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the Financial Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Financial Statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the Financial Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of Financial Statements that are free from material misstatement, whether due to fraud or error.

In preparing the Financial Statements, the directors are responsible for assessing the Group's and the parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the Financial Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these Financial Statements.

A further description of our responsibilities for the audit of the Financial Statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinions on the other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the Financial Statements are prepared is consistent with the Financial Statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and of the parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent Company Financial Statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Stephen Williams ACA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Edinburgh, United Kingdom
26 April 2018