

Key assumptions and sensitivity

The key assumptions to which the Tesco Bank ECL is most sensitive are macroeconomic factors, probability of default (PD), loss given default (LGD), PD threshold (staging) and expected lifetime (revolving credit facilities). The table below sets out the changes in the ECL allowance that would arise from reasonably possible changes in these assumptions from those used in Tesco Bank's calculations as at 25 February 2023 and excludes specific management overlays which are discussed further below:

		Impact on the loss allowance	
Key assumption	Reasonably possible change	2023 £m	2022 £m
Closing ECL allowance		461	489
Macroeconomic factors (100% weighted)	Upside scenario	(59)	(27)
	Base scenario	(11)	(13)
	Downside scenario 1	65	31
	Downside scenario 2	161	110
Probability of default	Increase of 10% (2022: 2.5%)	32	6
	Decrease of 10% (2022: 2.5%)	(31)	(6)
Loss given default	Increase of 2.5%	10	7
	Decrease of 2.5%	(10)	(7)
Probability of default threshold (staging)	Increase of 20%	(9)	(9)
	Decrease of 20%	13	13
Expected lifetime (revolving credit facility)	Increase of 1 year	3	11
	Decrease of 1 year	(5)	(10)

Despite stability in the performance of the underlying portfolio, the increased risk from a high inflationary environment and cost-of-living crisis creates uncertainty on future loss projections and the current model outputs. As a result, Tesco Bank has recognised certain specific management overlays, to address the prevailing downside risks and ensure the potential impacts of future stress are adequately provided for, detailed below:

Overlay	Description of adjustment	2023 £m	2022 £m
Underestimation risk	Risk that the beneficial impact of recent credit loss trends incorporated into credit risk models are transitive and may reverse due to the uncertain economic climate	68	–
Cost of living	A portion of Tesco Bank's customers may be more impacted by cost-of-living pressures, with deterioration in their ability to repay unsecured lending balances	22	75
Consumer spending	In respect of the beneficial modelling impact of lower consumer spending through the pandemic	–	113
Emergence of customer defaults	The emergence of defaults will be more aligned with previous economic downturns	–	19
War in Ukraine	Further potential inflationary pressures on cost of living	–	6
Total overlays		90	213

Forbearance

Tesco Bank 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 Tesco Bank 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.

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

Tesco Bank has well defined forbearance policies and processes. A number of forbearance options are made available to customers. 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; and
- 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.

	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 allowance for expected credit losses	
	2023 £m	2022 £m	2023 %	2022 %	2023 %	2022 %
Credit cards	102	106	3	3	49	51
Loans	30	39	1	1	31	47

(d) Insurance risk

Description of risk	Management policy
Risks accepted through the provision of insurance products in return for a premium, exposed through the wholly-owned subsidiary of Tesco Bank, TU. 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).	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.