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Northern Rock (Asset Management) plc
(formerly Northern Rock plc)
Annual Report and Accounts
2009

CONTENTS

CHAIRMAN'S STATEMENT

The Company was renamed Northern Rock (Asset Management) plc on 31 December 2009 as a result of the legal and capital restructuring of Northern Rock plc and I became Chairman on 1 January 2010 Northern Rock (Asset Management) plc remains in public ownership and is authorised and regulated by the Financial Services Authority (FSA) as a mortgage provider, but is not a deposit taker It currently holds a residential mortgage book of £49 7 billion and a portfolio of personal unsecured loan accounts of £3 9 billion

While the Company no longer undertakes any new lending, it is business as usual for our customers There are no changes to product terms and conditions and our customers can expect the same high level of service received in the past

Economic conditions remain challenging and have placed increased financial strain on many households, and we remain committed to the fair treatment of all of our customers The Company's debt management teams have worked hard to develop their processes during 2009 and engage with customers who face financial difficulty to secure a fair and appropriate repayment arrangement These activities will be an area of continued focus in 2010

Although, as anticipated, Northern Rock (Asset Management) plc remained loss making for the full year it is encouraging to see that financial performance in the second half of 2009 showed an improvement We look forward as a Board to that momentum being maintained in 2010

GOVERNANCE

The current Board was appointed on 1 January 2010 and comprises strong banking and operational expertise which will be essential to oversee the activities of Northern Rock (Asset Management) plc

The Board includes Gary Hoffman as Chief Executive, providing the continuity of leadership and management following the business restructure and he is also Chief Executive of the new Northern Rock plc

Andy Tate was promoted to the Board from the Company's existing senior management team, as Chief Operating Officer on 1 January 2010

The Non-Executive Directors comprise three directors who served on the previous Northern Rock Board, Kent Atkinson, Bob Davies and Philip Remnant, and two new directors, Sue Langley (appointed 1 January 2010) and Keith Morgan, the UKFI representative (appointed 1 January 2010)

REMUNERATION

Over the past year there has been significant attention paid to remuneration and in particular bonuses at financial institutions Northern Rock needs to attract and retain appropriately skilled colleagues who have a wide range of alternative career opportunities in the financial services sector and elsewhere

For 2009 performance, the Remuneration Committee have agreed a bonus scheme for all colleagues, including senior management, with the FSA and UKFI The Company has agreed with the FSA that the 2009 bonus awards for senior management will be paid in three equal annual instalments, commencing in March 2010, and will be subject to clawback

Subject to achievement of a financial threshold, the amount available for distribution as bonuses was derived from corporate achievement across a range of challenging objectives, including a successful legal and capital restructuring The total cost of bonuses for 2009 amounts to £14 9 million, including £1 5 million in respect of the UK Bank Payroll Tax

NORTHERN ROCK IN THE COMMUNITY

Northern Rock has been a substantial contributor to the wider community over many years, both through The Northern Rock Foundation and through a wide and varied programme of charitable work, undertaken by colleagues throughout the business

In line with the commitment made when first taken into public ownership, the Company donated £15 million to the Foundation during 2009 and a further £15 million will be donated to the Foundation in 2010 Such donations enable the Foundation to support community and charitable causes, mainly in the North East of England and Cumbria

CONCLUSION

It is evident to me in the short time I have been here as Chairman that good progress was made during 2009 The Chief Executive's Report that follows provides the operational and performance detail that evidences this There is a strong management team in place and a fully committed workforce who have been resilient through a very tough period The Board looks forward to building on that foundation as we continue to shape the future of Northern Rock (Asset Management) plc during 2010 in the best interests of taxpayers, our customers and all our stakeholders

Richard Pym
Chairman

23 March 2010

CHIEF EXECUTIVE'S REPORT

I am pleased to report that the Company made good progress during 2009 against our objective of delivering value to the UK taxpayer while providing a high level of service to customers

Throughout 2009, the Company worked closely with the Government and the Financial Services Authority (FSA) in preparation for the legal and capital restructure which was core to our business plan This included supporting the Government in the submission of a revised State aid application to the European Commission (EC) as well as working with the FSA to demonstrate the robustness of our future business plan

BUSINESS PLAN

A key objective of the Company's original business plan, announced in March 2008, was to repay the Government loan, primarily through a programme of accelerated mortgage redemptions This was achieved by actively encouraging existing customers to remortgage to other lenders During 2008 this policy was very effective and enabled the Company to reduce the Government loan ahead of its plan

The Company embarked on a review of its strategy in the autumn of 2008 in response to the significant deterioration in the external environment The plan review specifically set out to address the risk of higher capital requirements as loan losses increased The plan also addressed how Northern Rock could support increased market capacity following a significant contraction in mortgage market supply during 2008

In February 2009, we announced that we had agreed a revised business plan with the Government The key features of the revised plan were

- Slowing down the rate of mortgage redemptions
- Offering up to £14 billion of new mortgage lending in 2009/2010
- Changing the repayment profile of the Government loan to reflect the new mortgage lending and slower redemptions
- Implementing a legal and capital restructure of the Company, designed to maximise value for the taxpayer and facilitate the new mortgage lending

In October 2009, the EC announced that it had approved the Government's State aid package for Northern Rock This enabled the plan to restructure the business to proceed, creating two separate companies from 1 January 2010

- **Northern Rock (Asset Management) plc**, the existing company which holds £49 7 billion of residential mortgages and unsecured loans of £3 9 billion Northern Rock (Asset Management) plc holds the Government loan plus Northern Rock's non-deposit wholesale and secured funding instruments Northern Rock (Asset Management) plc does not hold any retail deposits and does not offer any new mortgage lending
- **Northern Rock plc**, a new bank authorised by the FSA as a deposit taker which will undertake new lending Northern Rock plc holds retail deposits, some wholesale deposits and a mortgage book of approximately £10 billion

The successful achievement of the restructure marked a major milestone for the Company and is a capital efficient solution aimed at serving taxpayers' best interests Furthermore, it has been completed without disruption for customers

FINANCIAL AND OPERATIONAL PERFORMANCE

The Company's financial performance improved through 2009 on both an underlying and statutory basis, with the Company reporting a statutory profit before tax of £466 7 million in the second half of the year The reduced statutory full year loss before tax of £257 5 million reflected higher net interest income, good control of costs and impairment charges lower than forecast as well as a clawback of certain charges received upon approval of State aid in October

HELPING CUSTOMERS IN DIFFICULTY

The past financial year has been a difficult one for some of our customers, who have been impacted by the economic conditions

With this in mind we have put in place a range of innovative rescue solutions designed to provide practical help and support for customers who find themselves in financial difficulty To date, we have successfully assisted more than 1,700 customers facing financial difficulty, many with families, to stay in their homes

The Company has invested significantly in its debt management function, more than doubling the resources available with the primary focus of increasing the level of customer contact We actively engaged in the design and improvement of Government rescue schemes in early 2009 and were one of the first lenders to operate the Government's Homeowner Mortgage Support Scheme

This complements our specific commitment not to take possession of a property until at least six months after the first arrears event On average, we work with customers for a significantly longer period of time than this In all cases, repossession remains a last resort

As a result of these actions, the number of properties in possession has fallen from over 4,000 at its peak to 2,061 at the end of 2009

The number of residential customers in arrears increased during 2009, reflecting broader economic conditions and the impact these have had on the Company's mortgage book Arrears of more than three months stood at 4 28% at 31 December 2009

Arrears stabilised during the last quarter of 2009, reflecting the investment we have made in our debt management capabilities and function, along with greater affordability of mortgages as a result of low interest rates

SUPPORTING MORTGAGE MARKET CAPACITY

In order to support capacity in the UK mortgage market, gross mortgage lending accelerated during the second half of the year with the Company achieving its 2009 lending target of £4 billion

The quality of new lending remained high, with an average loan-to-value (LTV) ratio of new lending at 56% All lending during the year has been done on a responsible basis and was carefully underwritten with affordability for customers a key consideration

NORTHERN ROCK IN THE COMMUNITY

Northern Rock has been a substantial contributor to the wider community over the years, both through The Northern Rock Foundation and through direct activity by colleagues

In line with the commitment made when the Company was taken into public ownership, it has paid £15 million to The Northern Rock Foundation during 2009 Such donations enable the Foundation to support community and charitable causes mainly, but not exclusively, in the North East of England and Cumbria I am pleased to report that a further £15 million will be donated to The Northern Rock Foundation in 2010

During 2009, the Company worked closely with a number of debt advice agencies as well as supporting colleagues in a wide range of broader community activities

Going forward, Northern Rock's community strategy is being refocused towards being known for helping communities in financial difficulty, utilising the skills inherent within the organisation In 2010 and beyond, Northern Rock will actively encourage its colleagues to participate in community activities in support of this objective We are currently engaging with The Northern Rock Foundation and more widely to establish the precise nature of this programme

OUTLOOK

The outlook for the UK economy remains uncertain After a contraction in the economy during 2009, with increases in unemployment and house price deflation, conditions appear to have stabilised, but economic recovery is still expected to be relatively weak

The current low level of the Bank Base Rate means that loan repayments remain affordable for those in employment The Company's future performance is likely to be influenced by the timing and extent of increases in Bank Base Rate

Unemployment and house prices will remain the key drivers of the Company's loan impairments, but there have been signs of an improvement in both of these indicators during the last few months of 2009, resulting in a reduced loan impairment charge in the second half of the year Loan loss impairment charges are expected to remain high during 2010, relative to historic norms, but below the level recorded in 2009

It is over two years since Northern Rock entered public ownership During that time the Company has made good progress in pursuit of its objectives that include repayment of State aid and delivering value for taxpayers We are looking forward, not back, and my colleagues across the business remain committed to delivering a high standard of service for all our customers We are on the right trajectory and I am confident that, with the current strong management team in place, we are well positioned to deliver against our objectives in 2010

Gary Hoffman
Chief Executive

23 March 2010

THE BOARD

During 2009, the number of meetings attended by each Director was as follows

	Board	Audit	Nominations	Remuneration	Risk
Number of meetings held in 2009	**17**	**8**	**6**	**7**	**12**
Chairman					
R A Sandler CBE	17/17		6/6	7/7	
Non - Executive Directors					
L P Adams	17/17			7/7	12/12
M K Atkinson	16/17	8/8			11/12
J R Coates	16/17	8/8			11/12
R J Davies	17/17		6/6	7/7	
J F Devaney	14/17			7/7	11/12
P J Remnant	17/17	8/8	6/6		
T W Scholar	9/17	4/8			6/12
Executive Directors					
G A Hoffman	17/17				
A F Godbehere (Resigned 31 January 2009)	1/1				

During 2009 the Chairman of each Committee was as follows

Mr Adams was Chairman of the Risk Committee, Mr Atkinson was Chairman of the Audit Committee, Mr Devaney was Chairman of the Remuneration Committee and Mr Sandler was Chairman of the Nominations Committee

Mr Sandler, Mr Adams, Mr Coates, Mr Devaney and Mr Scholar all resigned as Directors of the Company with effect from 1 January 2010

The current membership of the Committees is set out on pages 7 to 8

CORPORATE GOVERNANCE

Since the Company's shares were delisted following their transfer to the Solicitor for the Affairs of Her Majesty's Treasury as nominee for Her Majesty's Treasury in 2008, the full requirements of the UKLA's Listing Rules and the Combined Code on Corporate Governance (the Combined Code), do not apply to the Company

This corporate governance section summarises

- The composition of the Board at the date of this report, and
- The governance regime in place at the date of this report

The Operating and Financial Review on pages 19 to 29 also addresses certain governance matters in relation to events in 2009

COMPOSITION OF THE BOARD

The Directors in office at the date of this report are

Richard Pym – Non-Executive Chairman
Mr Pym was appointed to the Board as Non-Executive Chairman on 1 January 2010 He is Chairman of the Nominations Committee and a member of the Remuneration Committee He is Non-Executive Chairman of Bradford & Bingley plc and was Group Chief Executive of Alliance & Leicester plc from 2002 to 2007 Mr Pym has held a number of financial and management roles during his career, including The Burton Group plc, BAT Industries plc, British Gas and Thomson McLintock & Co He was formerly a Vice President of the British Bankers Association, a Non-Executive Director of Selfridges plc, and Chairman of Halfords Group plc Mr Pym is a Fellow of the Institute of Chartered Accountants in England and Wales, a Non-Executive Director of British Land Company plc and Old Mutual plc, and Non-Executive Chairman of BrightHouse Group Ltd

Gary Hoffman – Chief Executive Officer
Mr Hoffman was appointed to the Board as Chief Executive Officer on 1 October 2008 Previously Group Vice-Chairman and Executive Director of Barclays plc, he joined Barclays in 1982 as a graduate in economics from Cambridge University He is a Non-Executive Director of Visa Europe, Trinity Mirror plc and Havilland Bank He is also Chief Executive Officer of Northern Rock plc and Vice-Chairman of Coventry City Football Club

Kent Atkinson – Non-Executive Director
Mr Atkinson was appointed to the Board as a Non-Executive Director on 5 August 2008 and is Chairman of the Audit Committee and a member of the Risk Committee He was previously Group Finance Director of Lloyds TSB plc, and subsequently a Non-Executive Director He is the Senior Independent Director of Coca-Cola HBC SA He is a Non-Executive Director of Standard Life plc, Gemalto NV and Millicom International Cellular SA He was previously the Senior Independent Director of Cookson Group plc and Telent plc (previously Marconi Corporation plc)

Bob Davies – Non-Executive Director
Mr Davies was appointed to the Board as a Non-Executive Director on 10 October 2008 and is Chairman of the Remuneration Committee and a member of the Nominations Committee He was Chairman of the CBI in the North East until December 2008 and is a Non-Executive Director of Barratt Developments plc

He was Chairman of Biffa plc, from 2006 to 2008 and Chief Executive of Arriva plc from 1998 to May 2006 Mr Davies was formerly a Non-Executive Director of British Energy Group plc and Northern Business Forum Limited

Sue Langley – Non-Executive Director
Ms Langley was appointed to the Board as a Non-Executive Director on 1 January 2010 and is a member of the Risk and Remuneration Committees She is currently Director of Market Operations and North America for Lloyd's of London, joining in July 2007 Previously, she was Chief Operating Officer and a member of the Executive team for the Hiscox Group Ms Langley is a member of the London Market Reform Group, is currently a Board Member of Acord and is a Vice President of The Insurance Institute of London (IIL) She is also a trustee of Lloyd's Charities Trust Prior to joining Hiscox, Ms Langley worked for Thomson Tour Operations and PricewaterhouseCoopers, where she was a Principal Consultant specialising in change management

Keith Morgan – Non-Executive Director
Mr Morgan was appointed to the Board as a Non-Executive Director on 1 January 2010 and is Chairman of the Risk Committee and a member of the Audit Committee He is Head of Wholly-Owned Investments at UKFI, responsible for managing the Government's shareholdings in Northern Rock and Bradford & Bingley plc Previously, he was an Executive Director of Sovereign Bancorp in the United States with responsibility for the integration of Sovereign into Banco Santander and was Director of Strategy and Planning at Abbey National plc Before joining Abbey National plc in 2004, Mr Morgan spent 18 years at L E K Consulting, where he was a Partner specialising in financial services

Philip Remnant – Non-Executive Director
Mr Remnant was appointed to the Board as Non-Executive Director on 22 February 2008 and is a member of the Audit and Nominations Committees He is Chairman of the Shareholder Executive, a Non-Executive Director of UKFI and is a Senior Adviser of Credit Suisse's investment banking division in Europe Previously, he was a Vice Chairman of Credit Suisse First Boston in Europe, was Director General of the Takeover Panel between 2001 and 2003 and held senior investment banking positions with BZW and Kleinwort Benson

Andy Tate – Chief Operating Officer
Mr Tate was appointed to the Board as an Executive Director on 1 January 2010 He has 25 years' experience in retail banking, initially with National Westminster Bank plc and then Royal Bank of Scotland plc At Royal Bank of Scotland plc he held a number of senior positions in strategy, change management and operations, latterly as the Head of its Collections and Recoveries operations His responsibilities include debt management and mortgage operations

GOVERNANCE STRUCTURE

OVERVIEW

Following the commencement of public ownership on 22 February 2008, the governance of the Company was regulated principally by a framework document agreed between the Company and its shareholder, Her Majesty's Treasury (HMT), which sets out how the day to day shareholder relationship between the Company and HMT would work in practice

Following the restructuring of the Company on 1 January 2010, the framework document has been replaced by a new framework document (The Framework Document) agreed between the Company and UK Financial Investments Limited (UKFI) (acting on behalf of HMT as shareholder of the Company and provider of financial support) This sets out how the relationship between the Company and UKFI will work in practice

BASIC PRINCIPLES

The relationship between the Company and UKFI operates according to the following principles under which UKFI

- Appoints the Chairman of the Board and is entitled to appoint one or more Non-Executive Directors
- Is required to consent to the appointment of other members of the Board proposed for appointment by the Nominations Committee and agrees the terms on which the Directors are appointed and incentivised
- Agrees with the Board the high level objectives of the business plan and any revisions to it
- Reviews with the Board from time to time the Company's strategic options
- Requires that the Board is accountable to it for delivering the agreed business plan
- Gives the Board the freedom to take the action necessary to deliver the business plan
- Monitors the Company's performance to satisfy itself that the business plan is on track
- Must give its consent for certain significant actions

IMPLEMENTATION OF BASIC PRINCIPLES

BOARD STRUCTURE AND GOVERNANCE

In accordance with the Framework Document, the Company operates a corporate governance structure which, so far as practicable and in light of the other provisions of the Framework Document, or as otherwise may be agreed with UKFI, takes appropriate account of best practice for a company listed on the Official List, including the Combined Code

In connection with the restructuring of the Company and emerging best practice, during 2009 the Board comprehensively reviewed its corporate governance processes

The Board operates the following main committees

- Audit Committee
- Risk Committee
- Remuneration Committee
- Nominations Committee

The work of these committees is described below

BOARD APPOINTMENTS AND MONITORING

It is a key principle of the Framework Document that UKFI and the Chairman share a common view about Board composition (including size, balance of experience and background) and succession To achieve this

- The Chairman and either the Chairman of UKFI or a senior employee nominated by the Chairman of UKFI (the Nominated Official) will discuss and confirm Board composition and succession regularly in the light of performance and the requirements of the business plan
- Two Non-Executive Directors nominated by UKFI (the Shareholder Directors) serve on the Board These two Non-Executive Directors are currently Mr Remnant and Mr Morgan The Shareholder Directors liaise with and report to representatives of UKFI from time to time in relation to the business of the Company and decisions made or to be made by the Board in order to assist with the exercise of their powers and duties as Directors of the Company
- The Chairman will discuss with the Nominated Official any impending changes to Board membership
- The Chairman of the Nominations Committee will meet with the Nominated Official as necessary to obtain UKFI's approval to any proposed Board changes before they become subject to the formal appointment/ consent procedure
- The Company's Articles of Association require that each Director stands for re-election at least every three years and that Directors appointed by the Board should be subject to election at the first opportunity after their appointment The Directors to retire by rotation would be those in office longest since their previous re-election The Shareholder Directors are expressly exempted by the Company's Articles of Association from having to retire by rotation Non-Executive Directors are appointed for a specified term (normally two years for new or renewed appointments entered into after 31 December 2008) subject to re-election in accordance with the above procedures
- The Board will ensure that suitably rigorous appraisals are made of the effectiveness of the Chairman and the Board
- UKFI has certain monitoring and information access rights, and its consent has to be obtained for certain material actions and transactions

THE BOARD

The Board met 17 times during 2009 and details of attendance at Board and Committee meetings are given on page 4 Where Directors were absent from Board or Committee meetings, on each occasion the Board or respective Committee was satisfied with the apologies that were offered

During 2009, the Board was responsible for developing and delivering a plan to restructure the Company in order to reduce the Company's regulatory capital requirements and meet the State aid requirements of the European Commission

The Board has a written schedule of matters reserved for its determination Reserved matters include corporate governance arrangements and the relationship with UKFI, responsibility for overall management of the Company's long-term objectives and commercial strategy, financial reporting and control, setting an appropriate risk appetite and maintaining a sound system of internal control and risk management, and the approval of half year results and the Annual Report and Accounts

BALANCE OF EXECUTIVE AND NON-EXECUTIVE DIRECTORS

More than half of the Board comprises Non-Executive Directors, all of whom have experience in a range of commercial or banking activities

BOARD COMMITTEES

In accordance with the requirements of the Framework Document the Board has a number of Committees The Chairman and membership of each Committee are set out below

Each Committee has detailed terms of reference clearly setting out its remit and authority The following paragraphs set out details of the Committees and the particular work that they undertake

AUDIT COMMITTEE

The Audit Committee currently comprises Mr Atkinson (Chairman), Mr Remnant and Mr Morgan

The Committee considers and, where appropriate, advises the Board on all matters relating to regulatory, prudential and accounting requirements that affect the Company It reports to the Board on both financial and non-financial controls and monitors the integrity of the financial statements of the Company and any formal announcements relating to the Company's financial performance As part of its remit it oversees anti-money laundering and whistle blowing procedures

An important aspect of its role is to ensure that an objective and professional relationship is maintained with the external auditors The Audit Committee has responsibility for recommending the appointment, re-appointment and removal of the external auditors

The Audit Committee reviews the scope and results of the annual external audit, its cost effectiveness, and the independence and objectivity of the external auditors It also reviews the nature and extent of any non-audit services provided by the external auditors The external auditors can attend all meetings of the Audit Committee, have direct access to the Committee and its Chairman at all times and are invited annually to meet with the Committee in the absence of management

The Head of Internal Audit provides further assurance that the significant risks identified by the business are properly managed The Head of Internal Audit also has direct access to the Audit Committee and its Chairman The Committee regularly receives reports of reviews conducted throughout the Company by the Internal Audit and Compliance function

The Audit Committee met eight times in 2009 In March 2009, the Audit Committee reviewed and confirmed the effectiveness of the external auditors The external auditors were consequently re-appointed at the 2009 Annual General Meeting until the conclusion of the next Annual General Meeting

RISK COMMITTEE

The Risk Committee currently comprises Mr Morgan (Chairman), Mr Atkinson, and Ms Langley

The main role of the Risk Committee is to review, on behalf of the Board, the key risks inherent in the business, the systems of control necessary to manage such risks, and to present its findings to the Board

This responsibility requires the Risk Committee to keep under review the effectiveness of the Company's risk management frameworks and systems of internal control, which include financial, operational, compliance and risk management controls and to foster a culture that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of the Company The Risk Committee fulfils this remit by reinforcing management's risk management awareness and making appropriate recommendations to the Board on all significant matters relating to the Company's risk appetite, strategy and policies

The Risk Committee regularly reviews reports from Compliance including reports regarding regulatory risks and issues The Committee is also responsible for approval, and ongoing review and oversight of progress of the compliance monitoring plan

It is primarily responsible for considering the current and prospective macroeconomic and financial environment, drawing on financial stability assessments such as those published by the Bank of England, the Financial Services Authority and other authoritative sources relevant to the risk policies of the Company

The Risk Committee receives reports from Compliance in relation to its responsibility to consider any major findings of the Financial Services Authority and management's response to any risk management review undertaken by the Chief Risk Officer, Internal Audit or the external auditors

To assist the Board in discharging its responsibilities for the setting of risk policy, the Risk Committee periodically reviews the Company's material risk exposures in relation to the Board's risk appetite and the Company's capital adequacy

The Risk Committee also ensures that the public disclosure of information regarding the Company's risk management policies and key risk exposures is in accordance with statutory requirements and financial reporting standards

The Risk Committee met twelve times during 2009 and reviewed the Company's suite of policies for Board approval which included Risk review sessions facilitated by the Risk function

NOMINATIONS COMMITTEE

The Nominations Committee currently comprises Mr Pym (Chairman), Mr Davies and Mr Remnant

Subject to compliance with the requirements of the Framework Document (as set out above), the Committee monitors and reviews the membership of, and succession to, the Board of Directors and the Committee makes recommendations to the Board in this regard One of its functions is to identify potential Executive and Non-Executive Directors taking into account the requirement for the members of the Board to have an appropriate range of skills and experience

The Nominations Committee met six times during 2009

REMUNERATION COMMITTEE

The Remuneration Committee currently comprises Mr Davies (Chairman), Ms Langley and Mr Pym

Subject to compliance with the requirements of the Framework Document (as set out above), the Committee is responsible for considering and advising the Board on the remuneration policy for Executive Directors and the Chairman, and for determining their remuneration packages In discharging its responsibilities, the Remuneration Committee can take professional advice from within and outside the Company

It is the Board's responsibility to determine the remuneration policy for Non-Executive Directors within the limits set out in the Articles of Association The Remuneration Committee also determines the level of remuneration for the Company's Executive Committee Directors (comprising management at the level immediately below the Board)

The Remuneration Committee met seven times during 2009

EXECUTIVE COMMITTEE

The Board delegates authority to the Executive Committee to oversee the prudent day to day management of the Company's affairs The Committee comprises Mr Hoffman (Chief Executive Officer), Ms Belsham (Director of Transition Management), Mr Haggerty (Commercial Director), Mr Jones (Chief Financial Officer), Mr Tate (Chief Operating Officer) and Mr Williamson (Chief Risk Officer)

The Committee considers, in the first instance, all reports made to the Board and Board Committees, except in relation to matters reserved to the Board for its own determination The function of the Committee and its sub-committees, together with a description of the role and responsibilities of the Committee members, is set out in the Executive Governance Manual

A Delegated Authorities Manual which specifies the level of authority to be exercised by the Executive Committee and various individuals also exists

The following sub-committees which report to the Executive Committee are in place

- Retail Credit Risk Committee
- Operational Risk and Compliance Committee
- Assets and Liabilities Committee

RELATIONSHIP BETWEEN THE CHAIRMAN AND THE CHIEF EXECUTIVE

A clear division of responsibility exists between the Chairman, who is responsible for running the Board, and the Chief Executive who has responsibility for running the business This division is set out in writing and has been agreed by the Board

INDUCTION AND TRAINING

It is the Company's policy that every Director should receive appropriate training when appointed to the Board, and subsequently as necessary The Company's personalised induction process is designed to ensure that every new Director understands their responsibilities as a Director of the Company The Board Governance Manual supports this process The process also enables Directors to build an understanding of the Company, its business and the market in which it operates

To enable the Board to function effectively, all Directors have full and timely access to all information which may be relevant to the discharge of their duties and obligations The Company also arranges additional, specific training and support for any Director who requests it The Chairman ensures that all Directors are properly briefed on issues to be discussed at Board meetings All Directors are able to obtain further advice or seek clarity on issues raised at Board meetings from within the Company or from external professional sources All Directors have access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures and applicable rules and regulations are observed

Where necessary, Directors are able to take independent professional advice at the Company's expense

BOARD EVALUATION

During 2009, a Board effectiveness appraisal was conducted by the Chairman with assistance from the Company Secretary All Executive Directors, Non-Executive Directors and the Chairman participated in the appraisal of the Board and its Committees to ensure that their operation continued to be of the highest standard The appraisal process consisted of a questionnaire and a series of meetings with Directors that canvassed their views on a wide range of matters including the effectiveness of the Board, its Committees and the Chairman In addition, the evaluation also considered the Board meeting process, the composition of the Board and the interaction between the Board and its Committees

The Company Secretary reported to the Board on the outcome of the evaluation exercise, which confirmed that the Board and its Committees were discharging their responsibilities effectively The appraisal produced a number of recommendations to further improve effectiveness of the Board which were implemented during the course of 2009

INTERNAL CONTROL AND RISK MANAGEMENT

A description of the Company's approach to all aspects of financial and other risk management and the related use of derivatives is set out in notes 16 and 40 to the Accounts Material risk exposures are maintained within the Board approved risk appetite and are subject to Board policy statements which further define specific exposure limits and controls, appropriate to each of the risks concerned

The Board of Directors is responsible for the Company's system of risk management, regulatory compliance and internal control The systems are designed to ensure that the key risks taken by the Company in the conduct of its business are identified and evaluated so that appropriate controls are put in place to manage those risks Such systems are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, but not absolute, assurance against material misstatement or loss The Board of Directors is not aware of any significant failures in internal control that arose in the business of the Company during 2009 that have not been identified and dealt with in accordance with the internal control procedures of the Company

The Company's Internal Audit function provides a degree of assurance as to the operation and validity of the system of internal control and planned corrective actions are independently monitored for timely completion

DIRECTORS' REMUNERATION REPORT

SUMMARY

With effect from 1 January 2010, Northern Rock plc was restructured and re-named Northern Rock (Asset Management) plc (the Company) Separately, a new company was created named Northern Rock plc

The Company and Northern Rock plc are not quoted companies as the issued shares in both entities are held by the Solicitor for the Affairs of Her Majesty's Treasury as Nominee for HM Treasury Accordingly the requirements of the Directors' Remuneration Report Regulations (the Regulations) and the Combined Code on Corporate Governance (the Combined Code) do not apply to them There is no statutory requirement on them to publish a Directors' Remuneration Report, however in preparing this report, the Company has voluntarily complied with the Regulations insofar as it considers this to be practicable

This report is in three sections The first section reports on the remuneration policy applied and the remuneration paid to Directors by the Company during 2009 It also details how the principles of the Combined Code relating to Executive Director remuneration were applied by the Company during 2009 The second section reports on resourcing and the remuneration policy to be applied by the Company for 2010 The third section sets out detail of directors' individual remuneration for 2009

As Northern Rock plc is a different corporate entity to the Company, this report does not address the remuneration policy to be applied by Northern Rock plc in 2010 and subsequent years Nevertheless, it should be noted that the employment contracts of all employees of the Company (including that of Gary Hoffman, its only executive director as at 31 December 2009) transferred to Northern Rock plc on 1 January 2010 pursuant to the Transfer of Undertakings (Protection of Employment) Regulations (TUPE), as applied by the Transfer Regulations

The services of Mr Hoffman and of Mr Tate (an employee of the Company whose employment transferred to Northern Rock plc, and who became an executive director of the Company on 1 January 2010) are made available by Northern Rock plc to the Company under a services agreement between the two companies Accordingly, since 1 January 2010 Mr Hoffman has been Co-CEO of the Company and Northern Rock plc

REMUNERATION POLICY AND REMUNERATION PAID BY THE COMPANY DURING 2009

COMPLIANCE

Throughout 2009 the Company complied with the provisions of the Combined Code relating to Directors' remuneration insofar as practicable

THE REMUNERATION COMMITTEE

The Committee operated within agreed terms of reference and, during 2009, consisted entirely of Non-Executive Directors, namely Mr Devaney (Chairman), Mr Adams, Mr Davies, and the Chairman of the Company, Mr Sandler

The Committee was responsible for making recommendations to the Board of Directors (the Board) on the Company's general policy relating to executive remuneration and for determining, on behalf of the Board, specific remuneration packages for the Chairman, the Executive Directors and the Executive Committee, being the level of management immediately below the Board Neither the Chairman nor the Chief Executive were present when their own remuneration was under consideration The Committee met on seven occasions during 2009

The Committee took advice from both inside and outside the Company on a range of matters, including the scale and composition of the total remuneration package payable in comparable financial institutions to people with similar qualifications, skills and experience The following persons and advisors provided advice or services that materially assisted the Committee in its consideration of Executive Directors' remuneration matters during 2009

- Internal support was provided to the Committee by the Company Secretary and Human Resources Director
- Hewitt New Bridge Street LLP provided advice to the Company on the design of the bonus scheme implemented during 2009
- The Chief Executive Officer provided advice in relation to the Executive Committee members who report to him
- Mercer Limited, who are the consulting actuaries to the Company, advised on various pension issues relating to Directors and employees
- Freshfields Bruckhaus Deringer LLP advised the Company on various remuneration and service contract matters and on compliance with the Regulations They are the Company's principal legal advisors

REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

The Board adopted a company-wide remuneration policy during 2009, with the aim of attracting, developing and retaining the best available talent as the foundation for becoming a truly customer and colleague centric organisation

REMUNERATION PACKAGES DURING 2009

Executive Directors' remuneration packages comprised basic salary, bonus, pension benefits and certain other benefits in kind

BASIC SALARY

The Committee's objective was that Executive Directors' basic salaries should be paid at an appropriately competitive level No salary increases for Executive Directors took effect during 2009

Relevant salary information is as follows

As Chief Executive Officer, Mr Hoffman was paid a salary of £700,000 per annum

Ms Godbehere served as Chief Financial Officer between 1 and 31 January 2009 at a salary of £75,000 per month Following her resignation from the Board, this salary continued until Ms Godbehere left the Company (without payment of compensation) on 28 February 2009

BONUS SCHEME

In order to encourage strong performance and continued adherence to corporate values, the Committee implemented a bonus scheme during 2009 which linked a proportion of remuneration to the performance of the Company

Under the bonus scheme, payment of bonuses was subject to achievement of a financial threshold requiring the Committee to determine, on the basis of a rounded assessment, that there had been a sustained improvement in the Company's financial and operational performance over the relevant financial year within a prudent risk management framework

Subject to achievement of the financial threshold, the amount available for distribution as bonuses was derived from corporate achievement against a range of objectives Performance against each metric was subject to a qualitative assessment at the year end by reference to the circumstances in which performance was delivered

The level of individual awards was based on an assessment of individual achievement against objectives If maximum levels of corporate and individual performance were achieved, the maximum level of bonus payable to Executive Directors was 120% of basic annual salary Where individual performance was deemed to be unacceptable, no bonus was payable Bonuses were to be paid in three equal instalments with the first instalment being paid in the March following the end of the relevant financial year, and the remaining instalments being paid on the first and second anniversaries of the first payment date

Unless otherwise agreed by the Committee in its absolute discretion, receipt of each instalment was conditional on the individual remaining employed and not under notice (whether given or received) on the relevant payment date Any outstanding instalments of the bonus becomes payable on a change of control The deferred element of any bonus award would not vest if the information regarding corporate performance indicators on which the bonus was based is subsequently found to have been mis-stated and the Committee therefore concludes that the relevant bonus was inappropriate

Following communication of the terms of the bonus scheme to employees in July 2009, the FSA issued its Code of Practice on Remuneration in Financial Services The Company agreed with the FSA that bonus awards made for 2009 would vest and be paid in three equal annual instalments while payments made for subsequent years would vest and be paid in four annual instalments in each case subject to the conditions detailed above

Mr Hoffman has waived his entitlement to any bonus payable for 2008 and 2009 under the above scheme A long term incentive scheme is being designed for Mr Hoffman that will be aligned to the achievement of a number of performance objectives for both Northern Rock plc and Northern Rock (Asset Management) plc This will cover his tenure as Chief Executive and will only pay out upon a return to profitability, or upon the return of Northern Rock plc to private ownership

The total cost of bonuses for 2009 amounted to £14 9 million, including £1 5 million in respect of the UK Bank Payroll Tax which applied to 36 employees

PENSION BENEFITS

The Company did not provide pension arrangements for Ms Godbehere The Company paid an amount equal to 40% of Mr Hoffman's annual salary towards pension arrangements maintained by him

POLICY ON EXECUTIVE DIRECTORS' SERVICE CONTRACTS

It was the policy of the Company that Executive Directors' service contracts should be terminable by the Company on 12 months' notice given at any time, and that each Executive Director should be permitted to terminate his employment by giving 6 months' notice

During 2009, two Executive Directors served the Company – Mr Hoffman who was employed by the Company until his employment transferred to Northern Rock plc with effect from 1 January 2010, and Ms Godbehere who ceased to be a Director on 31 January 2009 and left the Company on 28 February 2009 Although the employments of both Mr Hoffman and Ms Godbehere ceased during 2009 without liability of the Company to pay compensation on termination, the following information is provided in relation to their service contracts

Mr Hoffman served the Company under a service contract dated 23 July 2008, terminable by either party on 12 months' notice given at any time after 1 October 2009 Mr Hoffman's contract could be terminated immediately by the Company on payment of an amount equal to the salary only (excluding other benefits) that he would have received during his notice period The contract contained provisions under which the termination amount would be paid in monthly instalments, and such instalments would be reduced by an amount equal to the monthly remuneration derived by Mr Hoffman from other activities commencing during the notice period In addition, unless terminated for gross misconduct, Mr Hoffman would, if terminated, remain entitled to any outstanding instalments of the payments to which he is entitled as compensation for the loss of entitlements under long term incentive arrangements with his previous employer (as set out in the footnote to the Directors Individual Remuneration table on page 15)

Ms Godbehere served the Company under a service contract dated 22 February 2008 Ms Godbehere's contract was terminable by the Company on payment in lieu of notice of an amount equal to the salary only (and not other benefits) that she would have received during her notice period

POLICY ON EXTERNAL NON-EXECUTIVE DIRECTORSHIPS HELD BY EXECUTIVE DIRECTORS

Executive Directors were permitted to hold one external non-executive directorship unrelated to the Company's business, provided that the time commitment was not material Executive Directors were permitted to retain any fees arising from such a non-executive directorship Ms Godbehere and Mr Hoffman were permitted to retain all non-executive directorships held by them at the date of their appointment to the Board, and the fees therefrom

REMUNERATION OF THE CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The fees for the Chairman and Non-Executive Directors described below were set at levels sufficient to attract the calibre of Non-Executive Director needed to assist the Company during and following its strategic review

The Chairman and the Non-Executive Directors were entitled to fees from the Company and it was the Company's policy that they did not participate in bonus, incentive or pension schemes They are reimbursed for travel and other reasonable expenses incurred in the furtherance of their duties

Mr Sandler commenced his appointment as Non-Executive Chairman on 1 October 2008 (upon relinquishing his Executive Chairman role), and served the Company under a letter of appointment dated 4 December 2008 Under the terms of Mr Sandler's letter of appointment, he was entitled to an annual fee of £350,000 Mr Sandler resigned as Non-Executive Chairman and as a Director with effect from 1 January 2010 and was appointed Non-Executive Chairman of Northern Rock plc on 1 January 2010

The fees paid to Non-Executive Directors during 2009 were as follows

Non-Executive Director's Basic Fee	£60,000
Additional Fee for Membership of a Board Committee	£5,000
Additional Fee for Chairman of the Risk Committee	£20,000
Additional Fee for Chairman of other Board Committees	£15,000

Set out below are details of the letters of appointment and fee arrangements of Non-Executive Directors who remained in service on 31 December 2009

All Non-Executive Directors referred to below (other than Mr Remnant and Mr Scholar who may terminate their respective appointments on one day's notice as detailed in paragraph (b) below) served under letters of appointment for a fixed term of two years, subject to termination by either party on three months' notice at any time or, if the Company anticipated that it would cease to be in public ownership, by the Company providing notice at any time that it considered appropriate, so that the appointment terminated on the day that the Company was returned to the private sector

(a) Mr Adams and Mr Devaney were appointed as Non-Executive Directors of the Company by letters of appointment dated 23 November 2007 and 16 November 2007 respectively that were for a fixed term expiring on 31 December 2008 Their appointments were renewed by letters of appointment dated 22 December 2008 for a two year fixed term (commencing on 1 January 2009 and expiring on 31 December 2010)

Mr Adams and Mr Devaney were entitled to a basic fee of £60,000 per annum Mr Adams was entitled to an additional fee of £20,000 per annum for chairing the Risk Committee and a further additional fee of £5,000 per annum for membership of the Remuneration Committee Mr Devaney was entitled to an additional fee of £15,000 per annum for chairing the Remuneration Committee and a further additional fee of £5,000 for membership of the Risk Committee

Mr Adams and Mr Devaney resigned as Non-Executive Directors of the Company with effect from 1 January 2010, with Mr Adams becoming a Non-Executive Director of Northern Rock plc with effect from 1 January 2010

(b) The Shareholder Directors, Mr Remnant and Mr Scholar, were appointed as Non-Executive Directors of the Company by initial letters of appointment dated 22 February 2008 expiring on 21 February 2009 Their appointments were renewed under letters of appointment dated 19 February 2009 for a two year fixed term expiring on 21 February 2011, subject to termination by the Company on three months' notice or by the individual on one day's notice, or if the Company anticipated that it would cease to be in public ownership, by the Company providing notice at any time that it considered appropriate, so that the appointment terminated on the day that the Company was returned to the private sector Mr Remnant's and Mr Scholar's appointments could also be terminated at any time by payment of a sum equal to the fees that would otherwise be payable for the three month notice period

Mr Remnant and Mr Scholar were entitled to a basic fee of £60,000 per annum Mr Remnant was entitled to an additional fee of £5,000 per annum for membership of the Audit Committee and a further additional fee of £5,000 per annum for membership of the Nominations Committee Mr Scholar was entitled to an additional fee of £5,000 per annum for membership of the Audit Committee and a further additional fee of £5,000 per annum for membership of the Risk Committee Mr Scholar waived all of the fees to which he was entitled during 2009 and resigned as a Non-Executive Director with effect from 1 January 2010 Mr Remnant continues to serve as a Non-Executive Director of the Company

(c) Mr Atkinson, Mr Coates and Mr Davies were appointed as Non-Executive Directors of the Company under letters of appointment dated 1 August 2008 in the case of Mr Atkinson and Mr Coates, and 12 September 2008 in the case of Mr Davies The appointments were for a fixed term of 12 months commencing on the date of signature of the letter of appointment and expiring on 4 August 2009 in the case of Mr Atkinson and Mr Coates, and 9 October 2009 in the case of Mr Davies

Mr Atkinson, Mr Coates and Mr Davies were each entitled to a basic fee of £60,000 per annum Mr Atkinson and Mr Coates were entitled to an additional fee of £5,000 per committee per annum in respect of their membership of each of the Audit and Risk Committees Mr Davies was entitled to receive an additional fee of £5,000 per committee per annum in respect of his membership of the Remuneration and Nomination Committees

Mr Davies' appointment was extended by a letter dated 2 October 2009 in accordance with which his appointment will terminate on the earliest of 9 October 2011, the date on which the Company is returned to the private sector, the expiry of three months' notice given at any time by either party, or the date on which the Company terminates the appointment by payment in lieu of the fees that would have been due to Mr Davies for the notice period (or part thereof)

Mr Atkinson s and Mr Coates' appointments were both extended by letter dated 28 July 2009 in accordance with which their respective appointments would terminate on the earliest of 9 October 2011, the date on which the Company is returned to the private sector, the expiry of three months' notice given at any time by either party, or the date on which the Company terminates the appointment by payment in lieu of the fees that would have been due for the notice period (or part thereof)

Mr Atkinson and Mr Davies continue as Non-Executive Directors of the Company Mr Coates resigned as a Non-Executive Director with effect from 1 January 2010 and became a Non-Executive Director of Northern Rock plc with effect from 1 January 2010

RESOURCING AND REMUNERATION ARRANGEMENTS FOR THE COMPANY IN 2010

COMPLIANCE

The Company intends to comply in so far as practicable with the provisions of the Combined Code relating to Directors' remuneration throughout 2010

THE REMUNERATION COMMITTEE

Following changes to the composition of the Board in connection with the legal and capital restructure of the Company, with effect from 1 January 2010 the Remuneration Committee of the Company consists entirely of Non-Executive Directors, namely Mr Davies (Chairman), Ms Langley, and the Chairman of the Company, Mr Pym

The Committee operates within agreed terms of reference pursuant to which it will be responsible for making recommendations to the Board on the Company's general policy relating to executive remuneration and for determining, on behalf of the Board, specific remuneration terms for the Chairman and any Executive Directors employed in the future It will also be responsible for recommending and monitoring the level and structure of the remuneration for any Company Secretary and members of Senior Management (being the level of management immediately below the Board) employed by the Company in the future

The Committee will oversee remuneration policy as it applies to all employees of the Company As explained below, as at the date of publication of this report, the Company has no employees as it is the recipient of services provided by Northern Rock plc However as part of the commitment made by HM Treasury to the European Commission, it is expected that the Company will need the services of its own employees in the build up to the completion of operational separation from Northern Rock plc and the Remuneration Committee will be responsible for developing an appropriate remuneration policy in such circumstances

Approval of UKFI, on behalf of HM Treasury (the Shareholder), is required for remuneration packages and any incentivisation arrangements for Executive Directors The Shareholder's interest is primarily in ensuring that remuneration levels are sufficient to attract and motivate high calibre individuals to drive delivery of the Company's strategic and funding plan and that incentives for Directors are aligned with the stated objectives of the Tripartite Authorities

The Chairman of the Committee will discuss remuneration proposals with the Shareholder at an early stage to ensure that the views of the Shareholder may be taken into account

The Committee is authorised by the Board to obtain outside professional advice, and is responsible for the appointment of any consultants to advise in respect of Executive Director remuneration

REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

During 2010, the Committee will develop a remuneration policy (including a policy on executive service contracts) that is closely aligned to achievement of the objectives of the business plan

ARRANGEMENTS FOR THE PROVISION OF EXECUTIVE DIRECTOR SERVICES

As described above, with effect from 1 January 2010 Mr Hoffman has served as Co-CEO of Northern Rock plc and the Company On that date, Mr Hoffman became an employee of Northern Rock plc upon the transfer to that company, pursuant to the Transfer Regulations, of the service contract dated 23 July 2008 between the Company and Mr Hoffman In addition to the Services Agreement under which Mr Hoffman and other staff are made available to the Company (as described below), Mr Hoffman's duties and role in relation to Northern Rock plc and the Company are set out in a letter dated 11 December 2009

Mr Tate, Director of Debt Management of the Company since 1 October 2008, was appointed to the Board of the Company as Chief Operating Officer with effect from 1 January 2010 On that date, Mr Tate became an employee of Northern Rock plc upon the transfer to the Company, pursuant to the Transfer Regulations, of the service contract dated 1 October 2008 between the Company and Mr Tate Pursuant to the terms of this service contract, Mr Tate's employment is terminable by 12 months' notice from Northern Rock plc or six months' notice from Mr Tate, served at any time

Pursuant to the terms of a Services Agreement between Northern Rock plc and the Company dated 7 December 2009, Northern Rock plc is required to provide certain services to the Company for a period following the restructure of the Company referred to above These include the services of Mr Hoffman and Mr Tate

In accordance with the Services Agreement, Northern Rock plc invoices the Company monthly in arrears for the cost of services rendered to the Company plus a margin of ten per cent The cost of services rendered is based on an assessment of monthly actual operating costs which include employment costs relating to Mr Hoffman and Mr Tate (among certain other items such as non-operational costs and real estate costs) Operational costs are allocated between Northern Rock plc and the Company based on a number of agreed cost allocation drivers which create an appropriate split of operational costs dependent on the respective volume of business done by each of Northern Rock plc and the Company during the relevant month Fifty per cent of employment costs relating to Mr Hoffman and Mr Tate are charged to the Company

Liability for bonuses relating to 2008 and 2009 transferred from the Company to Northern Rock plc with effect from 1 January 2010 pursuant to the Transfer Regulations However, in accordance with the provisions of the Services Agreement, Northern Rock plc is indemnified by the Company against any amount payable to any employee employed by the Company immediately prior to 1 January 2010 by way of a bonus for the 2009 bonus year and/or a deferred bonus for the 2008 bonus year

POLICY ON EXTERNAL NON-EXECUTIVE DIRECTORSHIPS HELD BY EXECUTIVE DIRECTORS

Executive Directors are permitted to hold one external non-executive directorship unrelated to the Company's business, provided that the time commitment is not material Executive Directors are permitted to retain any fees arising from such a non-executive directorship Mr Hoffman has been permitted to retain all non-executive directorships held by him at the date of his appointment to the Board, and the fees therefrom

REMUNERATION OF THE CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The fees for the Chairman and Non-Executive Directors described below were set at levels sufficient to attract the calibre of Non-Executive Director appropriate for the Company

The Chairman and the Non-Executive Directors are entitled to fees from the Company and it is the Company's policy that they do not participate in bonus, incentive or pension schemes

Mr Pym commenced his appointment as Non-Executive Chairman of the Company on 1 January 2010 Mr Pym serves the Company under a letter of appointment dated 22 December 2009 Under the terms of Mr Pym's letter of appointment, he is entitled to an annual fee of £62,800 Mr Pym's appointment as Non-Executive Chairman will terminate on the earliest of 31 December 2012, the date on which the Company is returned to the private sector, the expiry of four months' notice given at any time by either party, or the date on which the Company terminates the appointment by payment in lieu of these fees that would have been due to Mr Pym for the notice period (or part thereof)

The standard annual fee structure that has been put in place for Non-Executive Directors with effect from 1 January 2010 is as follows

Non-Executive Director's Basic Fee	£50,000
Additional Fee for Membership of a Board Committee	£5,000
Additional Fee for Chairman of the Risk Committee	£20,000
Additional Fee for Chairman of other Board Committees	£15,000

Set out below are details of the letters of appointment for Non-Executive Directors of the Company

Mr Atkinson, Mr Davies and Mr Remnant remain on the Board, having joined the Company as Non-Executive Directors on 5 August 2008, 10 October 2008 and 22 February 2008 respectively The terms of their respective letters of appointment are described above save that the fee structure set out above applies to them with effect from 1 January 2010

Ms Langley and Mr Morgan were appointed as Non-Executive Directors of the Company by letters of appointment dated 14 December 2009 and 22 December 2009 respectively in accordance with which the appointments will terminate on the earliest of 1 January 2012, the date on which the Company is returned to the private sector, or the expiry of three months' notice given at any time by either party, or the date on which the Company terminates the appointments by payment in lieu of the fees that would have been due for the balance of the notice period

As the UKFI appointed representative to the Board, Mr Morgan has waived any fee for his services as a Non-Executive Director of the Company

DIRECTORS' REMUNERATION REPORT (continued)

DIRECTORS' INDIVIDUAL REMUNERATION

Details of Directors' individual remuneration are set out below

	Salary/ fees £000	Pension contributions £000	Other £000	Total for 2009 £000	Total for 2008 £000
Chairman					
R A Sandler CBE	**350**			**350**	760
Executive Directors					
G A Hoffman	**700**	**280**[1]	**400**[2]	**1,380**	645
A F Godbehere (resigned 31 January 2009)	**75**			**75**	786
Non-Executive Directors					
L P Adams	**85**			**85**	115
M K Atkinson	**80**			**80**	29
J R Coates	**70**			**70**	29
R J Davies	**70**			**70**	16
J F Devaney	**80**			**80**	115
P J Remnant	**70**			**70**	60
T Scholar	**–**			**–**	–
Total benefits in kind			**118**[3]	**118**	358
Directors who left the Board in 2008					1,507
	1,580	**280**	**518**	**2,378**	4,420

1 As described on page 11 the Company pays an amount equal to 40% of Mr Hoffman's annual salary towards pension arrangements maintained by him

2 As disclosed in the announcement of his appointment on 23 July 2008, Mr Hoffman is entitled to three annual payments of £400,000 (less deductions) as compensation for the loss of entitlements under long term incentive arrangements with his previous employer The first payment was made on 1 October 2008 Mr Hoffman voluntarily offered to defer the payment due on 1 October 2009 and it was paid in 2010 The final payment is due on 1 October 2010

3 Benefits in kind includes £107 166 for Mr Hoffman which comprises his company car and fuel allowance (£12 840) private medical insurance (£793) and travel and accommodation costs (£49 752) plus an associated charge to taxation of £43 781 Ms Godbehere s travel and accommodation costs were £5 660 plus an associated charge to taxation of £4,981

Mr Scholar waived all fees in respect of 2009

For 2009, the remuneration of the highest paid Director was £1,207,166 plus personal pension arrangements of £280,000 (2008 – £9[illegible]9,000 with no pension contributions)

R J Davies
Chairman of the Remuneration Committee
23 March 2010

CORPORATE SOCIAL RESPONSIBILITY REPORT

INTRODUCTION

Corporate Social Responsibility (CSR) reporting is broken down into a number of interconnecting areas and a summary of our key activities is presented in this report

GOVERNANCE AND ACCOUNTABILITY

GOVERNANCE

Details of Northern Rock (Asset Management) plc's Board of Directors and governance structures are detailed in the Corporate Governance Report on pages 5 to 9

ACCOUNTABILITY

FINANCIAL PERFORMANCE

The Company has committed to provide regular and transparent reporting, releasing detailed financial statements for the half year and full year These detailed releases have been supported by quarterly trading updates in 2009

BUSINESS ETHICS AND HUMAN RIGHTS

GROUP TREASURY

Where appropriate, treasury dealing takes place in accordance with the rules and guidance in the Financial Services Authority (FSA) Handbook Any treasury dealing outside the scope of the FSA regulation, such as money market deposits and foreign exchange, is covered by the Non Investment Products Code (NIPs Code) This is a voluntary code (endorsed by the FSA) that lays down what is generally considered to be good market practice As well as market practice covering dealing and settlement processes, it also covers other areas such as marketing and incentives, entertaining and gifts, gambling and drug and alcohol abuse

The Company does not deal with counterparties who are on sanctions lists published by HM Treasury In addition, all potential new counterparties, and their beneficial owners, are reviewed to ensure they are not classified as Politically Exposed Persons

The Group compliance and treasury control and compliance teams conduct periodic reviews to assess how our policies, procedures and practices compare to FSA regulations and best practice in the NIPs Code

PENSION SCHEME

During 2009, the Company Pension Scheme (which was renamed the Northern Rock (Asset Management) Pension Scheme with effect from 1 January 2010) has maintained the risk-averse investment strategy that was adopted by the Trustees in October 2007 This prudent position has remained in place while funding negotiations have been taking place between the Company and the Trustees However, a new funding agreement was put in place in December 2009 and it is, therefore, anticipated that there will be some – relatively minor – changes in investment strategy during 2010 to reflect this agreement As at the date of this report the nature of any such changes remains under discussion between the Company and the Trustees It is possible that such changes could involve an allocation to higher-risk assets, including quoted equities, which would most likely be via pooled funds The Trustees require the managers of pooled funds used for such purposes to adhere to the Institutional Shareholders' Committee's Code on the responsibilities of Institutional Investors

BETTER PAYMENT PRACTICE AND THE LATE PAYMENT OF COMMERCIAL DEBTS (INTEREST) ACT 1998, AS AMENDED BY THE LATE PAYMENT OF DEBT REGULATIONS 2002

The Company recognises the importance of making creditor payments on time, thereby ensuring that our suppliers do not encounter unnecessary cash flow problems as a result of late payments being made Ensuring that the provisions of the Act have been fully communicated and implemented also ensures that the Company will not incur risks to reputation as a result of non-compliance A look ahead date on payment run parameters ensures late payments are kept to a minimum The only invoices not meeting the agreed payment date should be those subject to query or dispute Creditor days are included in the Directors' Report

MARKETPLACE

COMPETITIVE FRAMEWORK

The Company is determined to ensure that it does not take unfair advantage of Government support during the period of public ownership The Company has operated under a self-imposed competitive framework since March 2008 and actively managed its product range during the year to maintain balances within the parameters of the competitive framework The Company has agreed to a revised set of compensatory measures as part of the EC State aid process, approval for which was granted on 28 October 2009

OUR CUSTOMERS

Customers are of paramount importance to the Company Our aim is to offer products and services in an open, honest and fair way As our business and our industry changes, we are increasingly mindful of customer needs Commercial decisions are considered in the context of how they will impact upon customers We are also seeking to ensure that our business plan supports the relationship we have with customers

We also recognise that the general economic environment means that increasing numbers of customers will require additional support and assistance – particularly where they have a current account overdraft facility, or are struggling to meet their mortgage repayments We actively seek to identify the most constructive way forward, with a view to providing whatever support we can offer Details of how we have helped customers in difficulty are outlined in the Chief Executive's Report on pages 2 to 3

ENGAGEMENT

CUSTOMER INSIGHT

A new centralised customer insight team has enabled greater understanding of our customers and markets There are three key work streams Treating Customers Fairly (TCF), Brand Tracking and Development and Customer Experience Using an external consultancy, we monitor on a quarterly basis the extent to which we are meeting our TCF commitments and action plans have been developed to ensure that we continually make improvements that matter to our customers We have introduced new ways to monitor and measure our brand performance in relation to the market place and have included our customers' opinions when developing our brand proposition We monitor our customer experience throughout their lifetime with the Company Our insight programme is aligned with our business requirements and our customer and market insight enables us to tailor our products and services to meet the needs of our customers and the wider market

It is encouraging to note that our customer satisfaction scores continue to improve and were up 6 percentage points from 80% in 2008 to 86% in 2009

WORKPLACE

COLLEAGUE ENGAGEMENT

It is essential that the Company maintains a highly engaged workforce It makes our Company a more attractive place to join, work in and do business with It is proven that those companies with a high engagement score have colleagues that display pride and loyalty to the Company which leads to enhanced performance Engagement also significantly improves customer satisfaction and increases profitability The benefits can be reduced absence and sickness, greater job satisfaction, improved performance and greater achievement.

To ensure we understand the levels of colleague engagement we survey colleagues on an annual basis We conducted our latest survey of colleagues in October 2009, attracting a 92% response rate The results of this survey are used to help inform the business on the changes it needs to make, ultimately to support tangible improvements in business performance

HEALTH AND SAFETY

ACCIDENT REPORTING

In 2009 there were 5 RIDDOR reportable accidents (down from 7 in 2008) and we continue to be below the national average Over the year we have also refreshed our accident reporting process to ensure that all lessons to be learnt from accidents are implemented immediately

SICKNESS ABSENCE

During 2009, a total of 44,367 days were lost due to all types of sickness absence across the Company This represents a significant decrease (39%) on 2008 figures and reflects the effort made by all colleagues to reduce sickness levels

ENVIRONMENT

The key environmental impacts arising from our corporate operations have been identified as the use of energy, carbon dioxide emissions, waste, water use, corporate transport and staff transport to work Where practical we are also committed to ensuring that environmental awareness and best practice form an integral part of our decision making process

ENERGY

The Company is committed to controlling the environmental impact from all our uses of energy and continues to hold Energy Efficiency Accreditation, awarded by The Carbon Trust, managed by the National Energy Foundation and moderated by The Energy Institute

As part of our ongoing commitment to energy management and in anticipation of ensuring full compliance with the requirements of the Carbon Reduction Commitment a dedicated energy manager was appointed during the year

In order to ensure we have quality data a programme to install "smart meters" in all of our sites is underway and will be completed in 2010

CARBON DIOXIDE

CO_2 emissions per employee arising from corporate travel amounted to 0 11 tonnes

To ensure that there is renewed focus on ways to mitigate our impact on the environment in relation to corporate and personal travel a corporate travel plan manager was appointed

Output of CO_2 per employee for 2009 from electricity and gas has reduced to 2 08 tonnes (from a revised figure of 2 58 tonnes in 2008) reflecting our ongoing commitment to reduce emissions wherever we can

WASTE

Where feasible we reduce and re-use consumable items and comprehensive recycling facilities are available at all head office sites These include facilities for waxed and plastic cups, cans, bottles, toner cartridges, waste electrical equipment, mobile phone batteries, paper and cardboard All paper waste throughout the Company is recycled securely

WATER

Water usage is monitored across all sites and targeted against the DEFRA environmental reporting guidance for offices The figure for 2009 is 0 04m^3 per employee per working day, showing a reduction of 0 007m^3 from 2008 – substantially below the 0 05m^3 target

COMMUNITY

THE NORTHERN ROCK FOUNDATION

Since demutualisation in 1997, the Company has supported The Northern Rock Foundation, which supports community and charitable causes, mainly in the North East of England and Cumbria Following the Company entering into public ownership, a commitment has been made that the Foundation will receive £15 0 million per year in 2008, 2009 and 2010 The donation for 2009 amounts to £15 0 million (2008 – £15 0 million), with a further £15 0 million accrued in the accounts for 2009 reflecting the commitment for 2010 This results in £220 million having been paid since the Foundation's inception in 1997

CORPORATE SOCIAL RESPONSIBILITY REPORT (continued)

Further information on The Northern Rock Foundation can be obtained from,

The Northern Rock Foundation
The Old Chapel
Woodbine Road
Gosforth
Newcastle upon Tyne
NE3 1DD

Telephone	0191 2848412
Fax	0191 2848413
Minicom	0191 2845411
email	generaloffice@nr-foundation org uk

COMMUNITY ENGAGEMENT

STAFF MATCHED GIVING SCHEME
The Staff Matched Giving Scheme supports individual colleagues who wish to raise money for, or give money to, UK registered charities or to exempt and excepted charities The Trustees have set an annual limit of £1,000 per person per year and £250,000 for the scheme in total

CORPORATE CHARITY
The Corporate Charity for 2009 was again Marie Curie Cancer Care, as fundraising during 2008 had been severely disrupted by the business restructure In 2009, a total of £250,000 was donated, including matching from The Northern Rock Foundation

A further £270,000 was also given to a wide range of national and local charities and organisations as a result of fundraising by colleagues over the year

OPERATING AND FINANCIAL REVIEW

INTRODUCTION/DESCRIPTION OF BUSINESS

Northern Rock (Asset Management) plc (the Company) changed its name from Northern Rock plc on 31 December 2009 as a result of the legal and capital restructure of the former Northern Rock into two companies Following the restructure, the Company holds a book of £49 7 billion of residential mortgages, as well as £3 9 billion of personal unsecured loans Following approval for State aid granted by the European Commission (the EC), the Company ceased to offer new lending at the end of 2009 As a result of the restructure the Company also transferred its entire book of retail savings, of £19 5 billion, to the new bank, Northern Rock plc, and no longer offers any retail savings products

OVERVIEW OF 2009

Northern Rock announced in February 2009 that it had concluded its strategic review, in close consultation with the Government, and agreed a revised business plan The key features of the revised plan are set out in the Chief Executive's Report on page 2 of this report

During 2009, the Company worked closely with the Government and the Financial Services Authority (the FSA) in preparation for the legal and capital restructure, which was central to its business plan This included supporting the Government in the submission of a revised State aid application to the EC as well as working with the FSA to demonstrate the robustness of the Company's future business plan

In October 2009, the EC announced that it had approved the Government's State aid package for Northern Rock This enabled the plan to restructure the business to proceed

Northern Rock (Asset Management) plc remains the borrower in respect of the Government loan and Northern Rock's existing outstanding wholesale and secured funding and subordinated debt

The structure offers the most capital efficient solution, with an additional capital requirement, for both companies, of no more than £3 billion, as previously announced in August 2008

The continued deterioration in economic conditions resulted in a significant increase in arrears on all loan books in the first half of 2009 Arrears levels stabilised in the second half of the year reflecting the Company's investment in its debt management capabilities and improved mortgage affordability resulting from the low Bank Base Rate

The Company incurred a statutory loss before tax of £257 5 million in 2009, a significant improvement on the £1,355 9 million loss incurred in 2008, despite incurring a loan loss impairment charge of £1,044 8 million in 2009 (2008 – £894 4 million) The Company recorded a statutory profit before tax of £466 7 million in the second half of 2009, compared to a loss of £724 2 million in the first half of 2009 This reflected improved net interest income, tight control of costs and a reduced loan impairment charge following a stabilisation in both UK house prices and the Company's mortgage arrears

Following the legal and capital restructure, all staff are employed by the new company, Northern Rock plc, who provide administrative and other services to Northern Rock (Asset Management) plc under service level agreements which are monitored by the independent Executive and Board structures of each entity Options for full separation will be evaluated and implemented throughout the course of 2010

LOANS TO CUSTOMERS

An analysis of lending and redemptions by portfolio is set out in the following table

	Residential £m	Commercial £m	Unsecured £m	Total £m
2009 Full Year				
Total lending	4,215	–	–	4,215
Redemptions	(10,518)	(2)	(1,300)	(11,820)
Net	(6,303)	(2)	(1,300)	(7,605)
Closing balances	60,068	288	3,912	64,268
2008 Full Year				
Total lending	2,925	2	95	3,022
Redemptions	(26,571)	(24)	(1,830)	(28,425)
Net	(23,646)	(22)	(1,735)	(25,403)
Closing balances	66,700	302	5,298	72,300

Note Lending flows represent cash flows excluding fair value adjustments Closing balances are stated including fair value adjustments Redemptions and net movements include asset disposals where appropriate

RESIDENTIAL LENDING

Northern Rock has maintained a presence in new mortgage lending markets throughout the period of public ownership, and increased the rate of new lending during the second half of 2009, reflecting its revised strategy During 2009, the Company's total residential lending was £4 2 billion, which included gross new residential lending of £3 1 billion and £1 1 billion of retention lending The Company reintroduced its policy of offering retention products to eligible existing customers as part of its revised strategy to support mortgage market capacity during 2009 All lending was made on commercial terms, in taxpayers best interests with affordability for customers a key consideration

The following is an analysis of the secured residential mortgage book at the relevant date

	2009	2008
Number of accounts (000s)	550	591
Product type (%)		
Standard	63	64
Together	30	29
Buy to Let	7	7
Geographic spread (%)		
North	17	16
Scotland/Northern Ireland	10	10
Midlands	27	27
South	46	47
Average indexed loan to value (%)	71	73

The average indexed Loan to Value (LTV) of the Company's mortgage book at the end of 2009 decreased to 71% (31 December 2008 – 73%) reflecting the slight improvement in house prices seen over the course of the year The average LTV of new lending in 2009 was 56% (2008 – 67%) reflecting the Company's appetite for high quality new lending The Company's loan book is geographically spread across the UK in line with the demographics of the population

The share of Together loans as a proportion of the residential book has increased to 30% at 31 December 2009 (31 December 2008 – 29%) While the Company no longer offers new Together products, Together customers on average have a higher LTV and, therefore, in current market conditions, can find it more challenging to move their mortgage to another lender

Northern Rock (Asset Management) plc ceased to offer new lending products from 1 January 2010 On 1 January 2010, £10 3 billion of residential loans were transferred to the new bank, Northern Rock plc, under the terms of the Northern Rock Transfer Order 2009

UNSECURED

The personal unsecured credit portfolios comprise the unsecured element of Together lending and standalone unsecured loans not linked to a residential mortgage The Company no longer offers new unsecured lending products and as a consequence, these unsecured loan portfolios will run-off over time

Balances of Together unsecured loans reduced to £2 5 billion at 31 December 2009, representing 63 9% of total unsecured loan balances (31 December 2008 – £2 7 billion, 51 3%) At 31 December 2009, standalone unsecured balances were £1 4 billion and represented 36 1% (31 December 2008 – £2 6 billion, 48 7%) of total unsecured loan balances

COMMERCIAL

Northern Rock (Asset Management) plc retains a small commercial loan portfolio which totalled £0 3 billion at 31 December 2009 (31 December 2008 – £0 3 billion) The Company no longer offers new commercial loans and the book will continue to run-off over time

CREDIT QUALITY AND LOAN LOSS IMPAIRMENT

ARREARS

The arrears position of each of our main personal lending portfolios, based upon numbers of accounts over three months in arrears, is set out in the table below

	CML residential average	Northern Rock residential	Non-Together residential	Together secured residential	Together unsecured	Standalone unsecured
31 December 2009	2 38%	4 28%	3 10%	6 93%	6 09%	3 63%
30 June 2009	2 40%	4 09%[1]	3 02%[1]	6 47%	5 46%	2 98%
31 December 2008	1 88%	2 92%	2 25%	4 53%	3 90%	2 87%

Source Northern Rock and Council of Mortgage Lenders (CML)

Note 1 Restated to reflect a revision to the basis of calculation of the CML industry average confirmed during 2009

Residential arrears cases and arrears as a percentage of the residential loan book are as follows

	Cases	31 December 2009 %	Cases	31 December 2008 %
Over 3 – 6 months	8,892	1 68	10,264	1 74
Over 6 – 12 months	8,521	1 62	6,259	1 06
Over 12 months	5,151	0 98	741	0 12
Total	22,564	4 28	17,264	2 92

The adverse economic background has led to an increase in defaults across the sector The Company's arrears increased during 2009 reflecting the external economic background as well as the nature of the Company's portfolio of mortgage loans The rate of increase in arrears slowed during the third quarter of 2009 and has now stabilised, reflecting the significant investment in the Company's debt management capabilities as well as improved affordability levels as a result of low interest rates

Arrears over 3 months increased to 4 28% at the end of December 2009, compared with 4 09% at the end of June 2009 and 2 92% at the end of 2008 The increase in arrears over 12 months reflects the Company's policy of forbearance wherever possible, reflecting its revised approach to debt management, including repossession being a last resort Within this total residential book number, Together arrears increased to 6 93% (31 December 2008 – 4 53%), while non-Together arrears increased to 3 10% (31 December 2008 – 2 25%)

£10 3 billion of residential loans were transferred to the new bank, Northern Rock plc on 1 January 2010 Following this transfer, residential arrears over 3 months were 5 32% on 1 January 2010

In the unsecured loan books, Together unsecured arrears rose to 6 09% at 31 December 2009 (31 December 2008 – 3 90%) Standalone unsecured arrears on a reported basis increased to 3 63% (31 December 2008 – 2 87%) Within the standalone unsecured portfolio there are a number of loans where the Company has agreed to a reduced payment compared with the original contractual payment in an attempt to alleviate payment difficulties for the customer If the customer maintains their payments in line with the agreed revised amount they are not considered to be in arrears and are not included within the reported figures If arrears were to be restated to compare against the original contractual amount then standalone unsecured arrears would be 9 44% (31 December 2008 - 7 26%)

Arrears over 3 months on commercial loans, including commercial buy to let loans, were 1 60% at 31 December 2009 (31 December 2008 – 1 70%)

The stock of unsold repossessed properties has halved from its peak in 2008 and was 2,061 at 31 December 2009, compared with 3,620 at the end of 2008

LOAN LOSS IMPAIRMENT

Loan loss impairment balances and coverage at the year end are set out in the following table

	Residential	Commercial	Unsecured	Total
2009				
Impairment provisions, £m	596 1	12 5	564 3	1,172 9
% of closing balances	0 98%	4 27%	12 60%	1 79%
2008				
Impairment provisions, £m	378 3	7 8	483 6	869 7
% of closing balances	0 56%	2 52%	8 36%	1 19%

The loan loss impairment charge on retail customer loans was £1,044 8 million in 2009 (2008 – £894 4 million), driven by increasing arrears, rising unemployment and falling house prices The loan loss impairment charge started to reduce in the second half of 2009, reflecting the improving economic trends notably the stabilisation in house prices, but is expected to remain above historic norms for the foreseeable future

TREASURY INVESTMENTS

Below is an analysis of treasury investments at 31 December 2009

	Nominal value £m	Carrying value £m	Impairment (charge)/credit in year £m	Share of portfolio %
Deposits with Bank of England	7,436 7	7,436 7	–	52 3
Loans and advances to banks	3,702 4	3,702 4	–	26 0
Unsecured investment loans	691 7	358 3	(22 9)	2 5
Reclassified available for sale securities	3,280 9	2,561 0	29 1	18 0
Available for sale securities	322 2	168 5	(5 5)	1 2
Held at fair value through the income statement	26 7	–	(10 7)	–
Total	15,460 6	14,226 9	(10 0)	100

Loans and advances to banks are cash deposits the Company has placed with other financial institutions and are carried at amortised cost, subject to a test for impairment No impairments have been made in 2009

Unsecured investment loans include holdings of structured investment vehicles (SIVs) and local authority loans Unsecured investment loans are carried at cost and are subject to a test for impairment An impairment charge of £22 9 million has been made in 2009 in relation to unsecured investment loans

Reclassified available for sale (AFS) securities include illiquid Floating Rate Notes and asset backed investments These investments have been assessed for impairment on a case by case basis, resulting in a credit of £29 1 million in 2009 reflecting improved market conditions

The remaining AFS investments include collateralised debt obligations (CDOs), Government bonds, certificates of deposit and certain structured investments An impairment charge of £5 5 million was made in 2009 In addition, a further £6 8 million was incurred as loss on disposal of AFS investments

The value of assets held at fair value through the income statement has reduced to nil following an impairment charge of £10 7 million in 2009

FUNDING

Northern Rock (Asset Management) plc's funding in 2009 was provided from five sources – in addition to its loan facilities from HM Treasury, the Company continued to be funded by wholesale funding, securitisation, covered bonds and retail deposits

Flows of each funding channel and closing balances are shown in the following table

	Retail £m	Wholesale £m	Securitisation £m	Covered Bonds £m	Government £m
2009 Full Year					
Net flow	(85)	(1,527)	(5,873)	(1,341)	1,864
Closing balances	19,478	10,457	28,802	9,866	10,725
2008 Full Year					
Net flow	9,044	(1,480)	(12,211)	–	(18,069)
Closing balances	19,623	12,924	37,987	12,550	8,861

Note Net flow represents net cash flows excluding fair value adjustments Closing balances are stated including fair value adjustments primarily related to exchange rate fluctuations Such fluctuations are protected by cross-currency swaps The Government loan balance is stated net of liquidity deposits held with the Bank of England, excluding deposits relating to swap collateral

RETAIL

Retail funding comprised a full year net outflow of funds of £0 1 billion, compared with a net inflow in 2008 of £9 0 billion

Closing retail balances comprised

	2009 £m	2008 £m
Branch accounts	4,461 8	4,312 8
Postal accounts	9,106 0	7,495 9
Internet accounts	3,774 2	5,397 7
Offshore accounts	1,831 9	2,023 2
Other accounts	304 3	393 2
Total retail balances	19,478 2	19,622 8

Retail funding balances were broadly stable in 2009, reflecting the Company's adherence to its self imposed competitive framework The framework included a set of principles and commitments to ensure that the Company did not take unfair advantage of Government support while in receipt of State aid This included a commitment to restrict the Company's share of retail deposits to no more than 1 5% in the UK and 0 8% in Ireland At the end of 2009, the Company's share of UK retail deposits was 1 42% and share of Ireland deposits was 0 57%

As a result of the legal and capital restructure, the entire retail deposit book was transferred to the new bank, Northern Rock plc, on 1 January 2010

WHOLESALE

Reported wholesale funding balances decreased from £12 9 billion to £10 5 billion during 2009 Wholesale funding balances included £3 8 billion of collateral placed with the Company in respect of interest and foreign exchange swaps (31 December 2008 – £2 6 billion) Excluding this collateral, wholesale balances have reduced reflecting contractual maturities

On 8 December 2009, HM Treasury announced replacement guarantee arrangements to safeguard certain wholesale liabilities of Northern Rock (Asset Management) plc following the legal and capital restructure Full details of these revised guarantees, which took effect from 1 January 2010, can be found on the HM Treasury website at www hm-treasury gov uk

As a result of the legal and capital restructure, £1 4 billion of wholesale deposits were transferred to the new bank, Northern Rock plc, on 1 January 2010

SECURITISATION

Securitisation is the process whereby the Company, through the Granite programme, has previously raised wholesale funding secured on a segregated pool of mortgage assets These assets are held in special purpose entities (SPEs) set up for this purpose, which are fully consolidated in the Company's financial statements The Company retains an economic interest in the SPEs through a combination of subordinated loans and profit retained in the SPEs

No new securitisation issues were completed during 2009

Granite remained in pass-through during 2009 Under pass-through, holders of Granite securities receive principal repayments based on principal received on the underlying mortgage assets within Granite, rather than receiving scheduled repayments The Company, as a beneficiary of the Granite mortgages trust, will not receive any distributions of principal in respect of the mortgage loans that have been securitised and are held in the Granite mortgages trust, until holders of Granite securities have been repaid in full

At 31 December 2009, securitised notes in the Group balance sheet amounted to £28 8 billion (31 December 2008 - £38 0 billion) Balances of securitised funding at the end of 2009 are affected by foreign currency movements, which increase both the reported funding balance and the value of the associated derivative financial instruments which hedge against these rate movements Excluding these fair value amounts, securitised note balances were £24 4 billion at 31 December 2009 (31 December 2008 - £30 7 billion)

COVERED BONDS

Covered bonds are secured by a pool of ring-fenced residential mortgages No additional funds were raised through the covered bond programme in 2009

At 31 December 2009, covered bonds in the Group balance sheet amounted to £9 9 billion (31 December 2008 - £12 6 billion) Balances of covered bonds at the end of 2009 are affected by foreign currency movements, which increase both the reported funding balance and the value of the associated derivative financial instruments which hedge against these rate movements Excluding these fair value amounts, covered bonds balances were £7 3 billion at 31 December 2009 (31 December 2008 - £8 5 billion)

GOVERNMENT LOAN

Borrowings provided by HM Treasury under the liquidity facility amounted to £14 3 billion at 31 December 2009 (31 December 2008 - £15 6 billion)

	31 December 2009 £bn	**31 December 2008 £bn**
Amount due to Government	14 3	15 6
Liquidity deposit accounts with Bank of England	(3 6)	(6 7)
	10 7	8 9

At the end of 2009, the net amount due to Government, after deducting liquidity deposits held with the Bank of England (excluding deposits relating to swap collateral), was £10 7 billion The gross loan balance reduced by £1 3 billion during 2009 reflecting the revised strategy to support mortgage market capacity, through a combination of increased mortgage lending and lower mortgage redemptions

The Government loan increased by £8 5 billion to £22 8 billion on completion of the legal and capital restructure This allowed additional cash resources to be provided by the Company to Northern Rock plc in connection with the transfer of its deposit liabilities to the new bank This will enable Northern Rock plc to continue to increase mortgage lending, supporting mortgage market capacity in a time of constrained market competition

The cost of the Government net funding and HM Treasury guarantees has been revised following approval for State aid by the EC in October 2009 This revision was back dated to 1 April 2008, resulting in a clawback of £472 4 million, of which £200 0 million related to 2008 Of the £472 4 million, £116 0 million was charged and clawed back during the second half of 2009, and therefore the resultant reversal in the second half of 2009 amounts to £356 4 million (see below)

2009 FINANCIAL PERFORMANCE

UNDERLYING LOSS BEFORE TAX

Statutory results include certain items which are not considered by management to represent part of the underlying performance of the Group in any one financial period A reconciliation of statutory and underlying loss before tax is set out in the following table

	Six months to		Full Year	
	30 Jun 2009 £m	31 Dec 2009 £m	2009 £m	2008 £m
Statutory (loss)/profit before taxation	(724 2)	466 7	(257 5)	(1,355 9)
Provision for customer redress	25 7	52 8	78 5	5 0
Accounting volatility on derivatives	298 2	(302 5)	(4 3)	(137 1)
Impact of State aid approval on the cost of Government funding and HM Treasury guarantees	156 4	(356 4)	(200 0)	200 0
Underlying loss before taxation	(243 9)	(139 4)	(383 3)	(1,288 0)

The underlying loss in 2009 has reduced by £904 7 million compared with 2008, reflecting increased underlying net interest income (see below), lower total costs and a reduced impairment charge on treasury assets The £200 0 million State aid impact comprises £223 9 million net interest income, less additional fees payable of £23 9 million

SUMMARY INCOME STATEMENT

The summary income statement for the six months to 30 June 2009 and 31 December 2009 as well as the 12 months to 31 December 2009 and 31 December 2008 is as follows

	Six months to		Full Year	
	30 Jun 2009 £m	31 Dec 2009 £m	2009 £m	2008 £m
Net interest income	74 2	1,083 2	1,157 4	50 9
Other income	(85 3)	34 9	(50 4)	203 5
Total income	(11 1)	1,118 1	1,107 0	254 4
Administrative expenses	(104 7)	(151 3)	(256 0)	(269 7)
Exceptional expenses	(5 7)	(34 2)	(39 9)	(163 6)
Donation to The Northern Rock Foundation	(7 5)	(22 5)	(30 0)	(15 0)
Total expenses	(117 9)	(208 0)	(325 9)	(448 3)
Impairment losses on loans and advances	(602 2)	(442 6)	(1,044 8)	(894 4)
Impairment credits/(losses) on investment securities reclassified as loans and receivables and unsecured investment loans	7 0	(0 8)	6 2	(267 6)
(Loss)/profit before taxation	(724 2)	466 7	(257 5)	(1,355 9)
Taxation	(15 8)	(3 3)	(19 1)	46 2
(Loss)/profit for the period	(740 0)	463 4	(276 6)	(1,309 7)

OPERATING AND FINANCIAL REVIEW (continued)

TOTAL INCOME AND INTEREST MARGIN AND SPREAD

The following table shows net interest income, total income and interest ratios for the six months to 30 June 2009 and 31 December 2009 as well as the 12 months to 31 December 2009 and 31 December 2008

	Six months to		Full Year	
	30 Jun 2009 £m	31 Dec 2009 £m	2009 £m	2008 £m
Statutory				
Net interest income	74 2	1,083 2	1,157 4	50 9
Other income	(85 3)	34 9	(50 4)	203 5
Total income	(11 1)	1,118 1	1,107 0	254 4
Underlying				
Net interest income	491 1	536 7	1,027 8	390 0
Other income	(21 9)	(24 7)	(46 6)	(67 7)
Total income	469 2	512 0	981 2	322 3
Interest margin (as reported)	0 15%	2 69%	1 39%	0 05%
Interest spread (as reported)	0 10%	2 70%	1 36%	(0 13)%
Interest margin (underlying)	1 12%	1 34%	1 23%	0 41%
Interest spread (underlying)	1 08%	1 32%	1 20%	0 23%

Underlying interest margin (which primarily excludes accounting volatility on derivatives and reflects the impact of State aid approval) at 1 23% and underlying interest spread at 1 20% for the 12 months to 31 December 2009 compare with 0 41% and 0 23% respectively for the 12 months to 31 December 2008 The increases primarily reflect the increasing proportion of customers paying standard variable rate as fewer customers remortgage to other mortgage lenders following the end of their product term and the interest rate environment

The table below shows an analysis of other income

	2009 £m	2008 £m
Fee and commission income	26 8	60 9
Fee and commission expense	(94 2)	(59 3)
Other operating income	12 5	4 2
Provision for customer redress	(78 5)	(5 0)
Losses on available for sale securities	(12 3)	(9 0)
Gains on disposal of loan books	-	49 1
Net trading income	95 3	162 6
Total other income	(50 4)	203 5

Fee and commission income comprises commission income generated on sales of third party products such as building and contents insurance and fees receivable on redemption of mortgages

Fee and commission expense represents third party administration fees not included in interest expense, as well as fees payable to HM Treasury in relation to Government guarantees provided to the Company In addition, in 2009 a provision of £3 9 million (2008 - £16 8 million) was made for an estimated levy from the Financial Services Compensation Scheme in relation to a number of retail deposit books

Provision for customer redress is in respect of potential customer complaints and is likely to be utilised over several years

The gains on disposal of loan books in 2008 represent the gains realised on the sale of the Lifetime mortgage portfolio to JP Morgan in January 2008 The book was sold at a premium of 2 25% to the balance sheet value, with proceeds of approximately £2 3 billion There were no equivalent transactions in 2009

Net trading income includes losses on fair value movements on derivatives not in designated hedge accounting relationships of £2,391 6 million (2008 – gain of £9,465 7 million), together with cross-currency exchange rate gains of £2,497 6 million (2008 – loss of £9,259 7 million) These are covered in more detail below within the narrative on accounting volatility on derivatives In addition, within net trading income is a negative movement in the fair value of treasury investment securities designated as "held at fair value through the income statement" amounting to £10 7 million (2008 – £43 4 million)

ACCOUNTING VOLATILITY ON DERIVATIVES

Volatility in reported results arises from accounting volatility on derivative instruments that hedge risk exposure on an economic basis Such accounting volatility, which will offset over time, arises due to fair value volatility on designated hedges or because hedge accounting has not been adopted or is not achievable on certain transactions The Company manages its risk exposures on an economic basis and does not include such accounting volatility in the assessment of its underlying performance or in assessing the effectiveness of its derivative positions in any one financial period

An analysis of volatility and other fair value gains and losses is set out below

	Six months to		**Full Year**	
	30 Jun 2009 £m	**31 Dec 2009 £m**	**2009 £m**	**2008 £m**
Fair value hedge volatility	(234 0)	173 1	(60 9)	(85 4)
Cash flow hedge volatility	(15 0)	(25 8)	(40 8)	16 5
Hedge volatility included within interest margin	(249 0)	147 3	(101 7)	(68 9)
Fair value movements on derivatives not in hedge accounting relationships	(3,366 2)	974 6	(2,391 6)	9,465 7
Translation gains/(losses) on associated instruments	3,317 0	(819 4)	2,497 6	(9,259 7)
	(49 2)	155 2	106 0	206 0
Total hedge ineffectiveness and other fair value gains and losses	(298 2)	302 5	4 3	137 1

Northern Rock enters into derivative financial instruments for economic hedging purposes Some of these are designated and accounted for as IAS 39 compliant fair value or cash flow hedge relationships Where effective fair value hedge relationships can be established, the movement in the fair value of the derivative instrument is offset in full or in part by opposite movements in the fair value of the instrument being hedged Any ineffectiveness arising from different movements in fair value will offset over time Ineffectiveness is included within interest income or expense, as appropriate

Where derivatives are economically effective for hedging purposes but cannot be included within effective IAS 39 compliant accounting hedge relationships, e g for instruments included in equity, the movement in their fair value is recorded within net trading income These are also excluded from management's view of operational performance as these fair value adjustments are not realised in the current accounting period The same treatment applies to the revaluation at each balance sheet date of economically hedged foreign currency assets and liabilities

During 2009, accounting volatility on derivative instruments resulted in a gain of £4 3 million compared with a gain of £137 1 million in 2008 The gain of £302 5 million in the second half of 2009 compares with a charge of £298 2 million in the first half of the year Of this reversal, over 60% represents the change in value of swaps on floating rate securitised notes issued in foreign currency due to changes in basis risk Such swaps do not qualify for hedge accounting treatment and consequently there is no offsetting fair value movement on the underlying notes The balance of the reversal reflects volatility in exchange rates and interest rates across a range of derivatives entered into to minimise risk

ADMINISTRATIVE EXPENSES

(Excluding exceptional expenses and the donation to The Northern Rock Foundation)

	2009 £m	2008 £m
Staff costs	142 1	163 4
Other expenses	89 6	84 4
Depreciation and amortisation	24 3	21 9
Total operating expenses	256 0	269 7

Total operating expenses amounted to £256 0 million, representing a decrease of 5 1% (2008 - £269 7 million) This primarily reflects a full year effect of the reduction in headcount in 2008, resulting in reduced staff costs in 2009

EXCEPTIONAL EXPENSES

The following table provides an analysis of exceptional expenses

	2009 £m	2008 £m
Staff costs	0 1	37 0
Professional fees incurred by the Company	1 2	29 8
Professional fees recharged by the Tripartite Authorities	2 7	10 7
Corporate advisory fees	-	4 2
Reimbursement of third party expenses	-	8 7
Accelerated charge on cancellation of share schemes	-	39 6
Company valuation	1 6	1 5
Other exceptional operating expenses	0 2	10 0
	5 8	141 5
Exceptional impairment credits on property, plant and equipment	(5 3)	(23 6)
Provision for onerous contracts	0 1	18 5
Exceptional impairment charges on intangible assets	-	27 2
Strategic project development	39 3	-
	39 9	163 6

Exceptional expenses of £39 9 million were incurred in 2009 (2008 - £163 6 million) primarily relating to professional fees associated with the development of the business plan and the restructuring process Further analysis of exceptional expenses is given in note 6 to the accounts

TAXATION

There has been a tax charge in the year of £19 1million (2008 credit of £46 2 million) The net tax charge for the year includes a tax credit of £26 7million and tax charges of £34 5million and £12 1million

The £26 7million credit arises due to a change in the timing of when certain Group profits are recognised for tax purposes allowing the utilisation of 2009 taxable losses

During 2009, the Group's securitisation special purpose entities elected into a new tax regime in order to eliminate future tax volatility This means that certain items which could previously be recognised as a deferred tax asset can no longer be recognised, resulting in a charge of £34 5million

Additionally there is a tax charge of £12 1million which arises from a write off of deferred tax assets through the income statement These assets may no longer be recognised because the matching deferred tax liability has been reversed through the pension reserve

OPERATING AND FINANCIAL REVIEW (continued)

CAPITAL

	2009 £m	2008 £m
Core tier 1 capital	(337 5)	(17 1)
Perpetual non-cumulative preference shares	630 2	648 3
Innovative tier 1 capital	299 3	299 3
Deductions from tier 1 capital	(101 6)	(146 4)
Tier 1 capital after deductions	490 4	784 1
Upper tier 2 capital	1,211 4	1,313 5
Lower tier 2 capital	935 0	940 5
Deductions from tier 2 capital	(42 5)	(76 3)
Tier 2 capital after deductions	2,103 9	2,177 7
Deductions from totals of tier 1 and tier 2 capital	(5 1)	(5 1)
Total available capital resources	2,589 2	2,956 7
Risk weighted assets	26,233 6	27,471 4

The Company's total available capital resources are shown in the table above The FSA's capital resources gearing rules require core tier 1 capital to account for at least 50% of total tier 1 capital and limit total tier 2 capital to 100% of tier 1 capital and lower tier 2 capital to 50% of tier 1 capital Certain elements of the total available capital resources shown above are therefore restricted for regulatory purposes The Company was granted a waiver from the restriction that total tier 2 capital must not exceed total tier 1 capital during the period 31 July 2008 to 30 June 2009 and from 28 October 2009 until 31 December 2009

As a result of State aid approval in October 2009 which requires the Company to withhold coupon payments on all subordinated instruments where possible, and the exercise of the general right of deferral of coupon payment contained within the terms and conditions of the instrument, certain subordinated debt has been reclassified as equity under the requirements of IAS 32

As previously described a legal and capital restructure of the former Northern Rock was completed on 1 January 2010 The Company remains authorised and regulated by the FSA However, it is now a regulated mortgage company rather than a bank and is therefore subject to significantly lower capital requirements than previously

Total capital resources of the Company are available without restriction in order to meet its capital requirement and are initially marginally higher than the total shown above

SOCIAL RESPONSIBILITY – THE NORTHERN ROCK FOUNDATION

Since demutualisation in 1997, the Company has supported The Northern Rock Foundation, which supports community and charitable causes mainly but not exclusively in the North East of England and Cumbria Following the Company entering into public ownership, a commitment has been made that the Foundation will receive at least £15 0 million per year in 2008, 2009 and 2010 The donation for 2009 amounts to £15 0 million (2008 – £15 0 million), with a further £15 million accrued in the accounts for 2009 reflecting the commitment for 2010 This results in £220 million having been paid since the Foundation's inception in 1997 Further information on The Northern Rock Foundation is available on the Company's website

EMPLOYEES

The Company has always valued its reputation as a caring employer, seeking to attract and retain high calibre employees Opportunities for training are given a high priority to ensure that all individuals can contribute to their own career development This approach extends itself to the fair treatment of people with disabilities in relation to their recruitment, training and development

All staff of Northern Rock (Asset Management) plc were transferred to the new bank, Northern Rock plc, following completion of the legal and capital restructure on 1 January 2010

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009

The Directors present their report and the audited financial statements for the year ended 31 December 2009

For the purposes of section 417 Companies Act 2006, the information set out under Corporate Governance (pages 5 to 9), the Corporate Social Responsibility Report (pages 16 to 18) and the Operating and Financial Review (pages 19 to 29) are incorporated by reference in this report

PRINCIPAL ACTIVITIES

The principal activities of the Group are discussed in the Operating and Financial Review on pages 19 to 29

REVIEW OF BUSINESS, FUTURE DEVELOPMENTS, PRINCIPAL RISKS AND UNCERTAINTIES

A review of the business, future developments, principal risks and uncertainties, objectives and associated KPIs are set out in the Operating and Financial Review on pages 19 to 29 and the Chief Executive's Report on pages 2 to 3 A review of the principal risks and uncertainties is set out in note 40 to the Accounts

DIVIDENDS

The Directors do not propose the payment of any dividends on the Ordinary shares in respect of the year ended 31 December 2009 (2008 – nil)

TANGIBLE FIXED ASSETS

Land and buildings, which are included in the balance sheet at cost less accumulated depreciation and impairment losses, amounted to £101 9 million at 31 December 2009 Based on valuations carried out by the Group's qualified chartered surveyors, it is the Directors' opinion that the market value of the properties on a vacant possession basis is £67 0 million

Details of changes to tangible fixed assets are included in note 24 to the Accounts

DIRECTORS

The current composition of the Board of Directors together with brief biographical details of each Director is shown on page 4 The following table shows details of Board appointments and retirements up to the date of this report

R A Sandler	Resigned 1 January 2010
L P Adams	Resigned 1 January 2010
J R Coates	Resigned 1 January 2010
J F Devaney	Resigned 1 January 2010
T W Scholar	Resigned 1 January 2010
R A Pym	Appointed 1 January 2010
A M Tate	Appointed 1 January 2010
S C Langley	Appointed 1 January 2010
K C W Morgan	Appointed 1 January 2010

Mr Remnant, Mr Atkinson, Mr Hoffman and Mr Davies were Directors of the Company for the full financial year ended 31 December 2009

Following public ownership taking effect on 22 February 2008, no Director had any interest in the shares of the Company

The powers of the Directors, along with provisions relating to their appointment and replacement, are set out in the Articles of Association and The Northern Rock plc Transfer Order 2008 and are also governed by UK company law Any alteration to the Articles of Association must be approved by shareholders

The Company's Articles of Association provide an indemnity to Directors against certain liabilities incurred as a result of their office The indemnities extend to defending any proceedings in which judgment is given in the Directors' favour or in which they are acquitted or in any proceedings in which relief is granted by a court from liability for negligence, default, breach of duty or breach of trust in relation to the affairs of the Company

The Company has also provided each Director with a Deed of Indemnity indemnifying them to the fullest extent permitted by law against all losses suffered or incurred in respect of acts and omissions arising as a result of holding office The indemnity also extends to reimbursing each Director with the costs of defending any proceedings, regulatory investigation or proposed action by a regulator brought in connection with any alleged negligence, default, misfeasance, breach of duty or breach of trust against the Director in relation to the Group Reimbursement is subject to the Director's obligation to repay the Company in accordance with the provisions of the Companies Act 2006 The payment obligations of the Company under each Deed of Indemnity are backed by a specific guarantee in favour of the Director entered into between the Company and HM Treasury

The Company has also arranged Director's and Officer's Insurance on behalf of the Directors in accordance with the provisions of the Companies Act 2006

POST BALANCE SHEET EVENTS

On 1 January 2010 a legal and capital restructuring of the Company took place, resulting in the transfer of certain assets and liabilities to Northern Rock plc Details of the post balance sheet events are given in note 44 to the Accounts

SHARES

Details of the structure of the Company's authorised and issued share capital as at the year end, as well as any movements in and changes to the authorised and issued share capital during the year, are provided in note 37 to the Accounts

Further details regarding the rights and obligations attaching to the current share classes are contained in the Company's Articles of Association

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009 (continued)

EMPLOYEES

Under the terms of The Northern Rock Transfer Order 2009, SI 2009/3226 all employees of Northern Rock (Asset Management) plc were transferred to Northern Rock plc on 1 January 2010

FINANCIAL INSTRUMENTS

The Group's financial risk management objectives and policies, including its governance framework and approach to the management of key risks including credit risk, market risk and liquidity risk, are discussed in note 40 to the Accounts

SIGNIFICANT SHAREHOLDINGS

As at the date of this report, all of the issued share capital is held by the Treasury Solicitor as nominee for HM Treasury

BRANCH OFFICES

As at 31 December 2009 the Company had a branch office in Ireland and a subsidiary through which it operated in Guernsey Under the terms of The Northern Rock Transfer Order these were transferred to Northern Rock plc on 1 January 2010

CREDITOR PAYMENT POLICY

The Company's policy with regard to the payment of suppliers is to negotiate and agree terms and conditions with all its suppliers, which include the giving of an undertaking to pay them within an agreed payment period

The average creditor payment period at 31 December 2009 was 39 days (2008 – 20 days)

SIGNIFICANT AGREEMENTS

The Company, or other members of the Group, are party to certain non-material agreements that contain change of control provisions in the event of the takeover of the Company but these are not considered to be significant on an individual basis

CHARITABLE CONTRIBUTIONS

Details of charitable contributions relating to 2009 are included within the Corporate Social Responsibility Report on pages 17 and 18

GOING CONCERN

As set out in note 1 to the Accounts on 28 October 2009, the European Commission approved State aid to the Company confirming the facilities provided by HM Treasury, thereby removing the material uncertainty over the Company's ability to continue as a going concern which previously existed Further, HM Treasury has confirmed that it is its intention to continue to fund the Company so as to maintain the Company as a going concern and enable the Company to meet its debts as and when they fall due for a period of not less than 18 months from 31 December 2009 It has also committed to convert up to £1 6bn of the Government loan to meet regulatory capital requirements if so required Therefore the Directors are satisfied at the time of approval of the financial statements that the Group has adequate resources to continue in business for the foreseeable future For this reason, they continue to adopt the going concern basis in preparing the accounts

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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 financial statements for each financial year Under that law the Directors have elected to prepare the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union 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 period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates that are resonable and prudent
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group 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 Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

The maintenance and integrity of the Northern Rock (Asset Management) plc website is the responsibility of the Directors, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

AUDITORS AND DISCLOSURE OF INFORMATION TO AUDITORS

So far as every Director at the date of this report is aware, there is no relevant audit information needed in preparation of the auditors' report of which the auditors are not aware The Directors have taken the steps they need to have taken as Directors to make themselves aware of any relevant audit information and to establish that the auditors are also aware of that information

By order of the Board

J Fitzpatrick
Company Secretary

23 March 2010

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDER OF NORTHERN ROCK (ASSET MANAGEMENT) PLC

We have audited the Group and Company financial statements (the "financial statements") of Northern Rock (Asset Management) plc for the year ended 31 December 2009 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements and the related notes The financial reporting framework that has been applied in their preparation is applicable law and international financial reporting standards (IFRSs) as adopted by the European Union and, as regards the Company financial statements, as applied in accordance with the provisions of the Companies Act 2006

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Statement of Directors' Responsibilities on page 31, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

This report, including the opinions, has been prepared for and only for the Company's member in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements

OPINION ON FINANCIAL STATEMENTS

In our opinion

- the financial statements give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2009 and of the Group's loss and the Group's and the Company's cash flows for the year then ended,
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the 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 and, as regards the Group financial statements, Article 4 of the IAS Regulation

OPINION ON OTHER MATTER PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the 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

Lindsay Gardiner (Senior Statutory Auditor) for and on behalf of
PricewaterhouseCoopers LLP
Chartered Accountants and
Statutory Auditors
Newcastle upon Tyne
23 March 2010

PRICEWATERHOUSECOOPERS

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2009

	Note	2009	2008
		£m	£m
Interest and similar income	4	**2,032 9**	5,706 9
Interest expense and similar charges	5	**(875 5)**	(5,656 0)
Net interest income		**1,157 4**	50 9
Fee and commission income		**26 8**	60 9
Fee and commission expense		**(94 2)**	(59 3)
Other operating income		**12 5**	4 2
Provision for customer redress	31	**(78 5)**	(5 0)
Losses on available for sale securities	21	**(12 3)**	(9 0)
Gain on disposal of loan books	10	**–**	49 1
Net trading income	11	**95 3**	162 6
		(50 4)	203 5
Total income		**1,107 0**	254 4
Analysed as			
Exceptional State aid clawback/(charge)	5	**200 0**	(200 0)
Recurring total income		**907 0**	454 4
Total income		**1,107 0**	254 4
Administrative expenses	6	**(231 7)**	(247 8)
Depreciation and amortisation		**(24 3)**	(21 9)
Donation to The Northern Rock Foundation		**(30 0)**	(15 0)
Exceptional operating expenses	6	**(39 9)**	(163 6)
Operating expenses		**(325 9)**	(448 3)
Impairment losses on loans and advances	9	**(1,044 8)**	(894 4)
Impairment credits/(losses) on investment securities reclassified as loans and receivables and unsecured investment loans	21	**6 2**	(267 6)
Loss before taxation		**(257.5)**	(1,355 9)
Income tax (expense)/credit	12	**(19.1)**	46 2
Loss for the year		**(276 6)**	(1,309 7)
Attributable to			
Appropriations	36	**32 5**	68 3
Loss attributable to equity shareholders		**(309 1)**	(1,378 0)
Total		**(276 6)**	(1,309 7)

The notes on pages 41 to 92 form an integral part of these accounts

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2009

	Note	2009	2008
		£m	£m
Loss for the year		**(276 6)**	(1,309 7)
Other comprehensive income			
Net movement in available for sale reserve		**216 0**	(531 5)
Net movement in cash flow hedge reserve		**143 9**	(240 5)
Actuarial gains and losses	8	**(45 9)**	25 5
Tax effects of the above		**11 3**	15 6
		325 3	(730 9)
Total comprehensive income for the year		**48 7**	(2,040 6)
Attributable to			
Appropriations		**32.5**	68 3
Comprehensive income attributable to equity		**16 2**	(2,108 9)
Total		**48 7**	(2,040 6)

The cumulative other comprehensive income in respect of assets classified as held for resale is £16 2m at 31 December 2009

CONSOLIDATED BALANCE SHEET

At 31 December 2009

	Note	Continuing operatings 2009	Held for resale 2009	Total 2009	2008
		£m	£m	£m	£m
Assets					
Cash and balances with central banks	15	7,500 5	9 9	7,510 4	9,336 8
Derivative financial instruments	16	7,473 8	-	7,473 8	13,314 4
Loans and advances to banks	17	2,836 8	865 6	3,702 4	3,384 4
Loans and advances to customers	18	53,924 9	10,343 3	64,268 2	72,299 4
Fair value adjustments of portfolio hedging	18	971 3	160 3	1,131 6	1,701 9
Investment securities and unsecured investment loans	21	2,663 8	424 0	3,087 8	3,809 2
Intangible assets	23	30 7	23 1	53 8	64 9
Property, plant and equipment	24	121 9	32 7	154 6	198 4
Current income tax asset		6 8	-	6 8	21 8
Deferred income tax asset	25	-	-	-	35 2
Retirement benefit asset	8	-	-	-	31 7
Other assets		24 5	4 4	28 9	32 9
Prepayments and accrued income		13 5	13 7	27 2	115 0
Total assets		75,568 5	11,877 0	87,445 5	104,346 0
Liabilities					
Loans from Government	26	14,315 5	-	14,315 5	15,583 4
Deposits by banks	27	5,787 0	235 3	6,022 3	4,625 1
Customer accounts	28	-	20,607 6	20,607 6	20,722 7
Derivative financial instruments	16	1,673 8	-	1,673 8	2,220 8
Debt securities in issue					
Securitised notes	19	28,801 9	-	28,801 9	37,986 9
Covered bonds	20	9,866 1	-	9,866 1	12,550 3
Other	29	3,305 7	-	3,305 7	7,199 1
Other liabilities		68 7	19 2	87 9	77 6
Accruals and deferred income	30	252 7	188 4	441 1	949 4
Deferred income tax liability	25	7 1	-	7 1	6 9
Retirement benefit obligations	8	4 9	-	4 9	-
Provisions for liabilities and charges	31	87 8	-	87 8	23 5
Subordinated liabilities	32	935 0	-	935 0	1,514 9
Tier one notes	33	233 7	-	233 7	251 8
		65,339 9	21,050 5	86,390.4	103,712 4
Equity					
Shareholders' funds					
Called up share capital					
Ordinary	37	123 9	-	123 9	123 9
Preference	37	0 1	-	0 1	0 1
Share premium account					
Ordinary	38	6 8	-	6 8	6 8
Preference	38	396 4	-	396 4	396 4
Capital redemption reserve	38	7 3	-	7 3	7 3
Other reserves	38	(495 9)	(16 2)	(512 1)	(872 2)
Retained earnings	39	(425 5)	17 1	(408 4)	(64 5)
Total equity attributable to equity shareholders		(386 9)	0 9	(386 0)	(402 2)
Non shareholders' funds					
Reserve capital instruments	34	299 3	-	299 3	299 3
Subordinated notes	35	1,141 8	-	1,141 8	736 5
Total non shareholders' funds		1,441 1	-	1,441 1	1,035 8
Total equity		1,054 2	0 9	1,055 1	633 6
Total equity and liabilities		66,394 1	21,051 4	87,445 5	104,346 0

Items held for resale are those transferred to Northern Rock plc on 1 January 2010 (see note 44)

The notes on pages 41 to 92 form an integral part of these accounts

Approved by the Board on 23 March 2010 and signed on its behalf by

R A Pym
Chairman

G A Hoffman
Chief Executive Officer

Northern Rock (Asset Management) plc is registered in England and Wales under Company Number 3273685

COMPANY BALANCE SHEET
At 31 December 2009

	Note	Continuing operatings 2009	Held for resale 2009	Total 2009	2008
		£m	£m	£m	£m
Assets					
Cash and balances with central banks	15	7,500 5	9 9	7,510 4	9,336 8
Derivative financial instruments	16	3,459 7	–	3,459 7	6,041 8
Loans and advances to banks	17	2,688 0	864 6	3,552 6	3,236 1
Loans and advances to customers	18	54,005 6	10,343 3	64,348 9	72 471 4
Fair value adjustments of portfolio hedging	18	971 3	160 3	1,131 6	1 701 9
Investment securities and unsecured investment loans	21	2,610 4	424 0	3,034 4	3,648 6
Shares in group undertakings	22	35 0	50 0	85 0	85 0
Intangible assets	23	-	23 1	23 1	34 2
Property, plant and equipment	24	130 7	32 7	163 4	187 1
Current income tax asset		8 0	–	8 0	22 1
Retirement benefit asset	8	-	-	–	31 7
Other assets		58 1	4 1	62 2	161 6
Prepayments and accrued income		14 2	13 7	27 9	118 9
Total assets		71,481 5	11,925 7	83,407 2	97,077 2
Liabilities					
Loans from Government	26	14,315 5	-	14,315 5	15,583 4
Deposits by banks	27	3,502 8	1,249 4	4,752 2	4,817 2
Customer accounts	28	26,819 4	19,671 6	46,491 0	51,180 4
Derivative financial instruments	16	1,668 8	–	1,668 8	2,209 7
Debt securities in issue					
Covered bonds	20	9,866 1	–	9,866 1	12,550 3
Other	29	3,305 7	–	3,305 7	7,199 1
Other liabilities		286 7	17 4	304 1	220 4
Accruals and deferred income	30	244 0	177 9	421 9	896 9
Deferred income tax liability	25	3 8	-	3.8	3 8
Retirement benefit obligations	8	4.9	–	4 9	-
Provisions for liabilities and charges	31	87.8	–	87 8	23 5
Subordinated liabilities	32	935 0	-	935 0	1,514 9
Tier one notes	33	233 7	–	233 7	251 8
		61,274 2	21,116 3	82,390 5	96 451 4
Equity					
Shareholders' funds					
Called up share capital					
Ordinary	37	123.9	-	123 9	123 9
Preference	37	0.1	-	0 1	0 1
Share premium account					
Ordinary	38	6 8	-	6 8	6 8
Preference	38	396 4	–	396 4	396 4
Capital redemption reserve	38	7 3	-	7 3	7 3
Other reserves	38	(495 2)	(16 2)	(511 4)	(869 5)
Retained earnings	39	(447 5)	-	(447 5)	(75 0)
Total equity attributable to equity shareholders		(408 2)	(16 2)	(424 4)	(410 0)
Non shareholders' funds					
Reserve capital instruments	34	299.3	-	299.3	299 3
Subordinated notes	35	1,141.8	–	1,141 8	736 5
Total non shareholders' funds		1,441 1	–	1,441 1	1,035 8
Total equity		1,032 9	(16 2)	1,016 7	625 8
Total equity and liabilities		62,307 1	21,100 1	83,407 2	97,077 2

Items held for resale are those transferred to Northern Rock plc on 1 January 2010 (see note 44)

The notes on pages 41 to 92 form an integral part of these accounts

Approved by the Board on 23 March 2010 and signed on its behalf by

R A Pym
Chairman

G A Hoffman
Chief Executive Officer

Northern Rock (Asset Management) plc is registered in England and Wales under Company Number 3273685

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2009

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders funds £m	Non shareholders' funds £m	Total equity £m
Balance at 31 December 2008		**124 0**	**403 2**	**7 3**	**(872 2)**	**(64 5)**	**(402 2)**	**1,035 8**	**633 6**
Loss for the year		–	–	–	–	(309 1)	(309 1)	32 5	(276 6)
Other comprehensive income									
Net movement in available for sale reserve	38	–	–	–	216 0	–	216 0	–	216 0
Net movement in cash flow hedge reserve	38	–	–	–	143 9	–	143 9	–	143 9
Actuarial gains and losses	8	–	–	–	–	(45 9)	(45 9)	–	(45 9)
Tax effects of the above		–	–	–	0 2	11 1	11 3	–	11 3
Total other comprehensive income		–	–	–	360 1	(34 8)	325 3	–	325 3
Appropriations	36	–	–	–	–	–	–	(32 5)	(32 5)
Reclassification of subordinated debt instrument	35	–	–	–	–	–	–	405 3	405 3
Balance at 31 December 2009		**124 0**	**403 2**	**7 3**	**(512 1)**	**(408 4)**	**(386 0)**	**1,441 1**	**1,055 1**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2008

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders funds £m	Non shareholders funds £m	Total equity £m
Balance at 31 December 2007		**124 0**	**403 2**	**7 3**	**(122 9)**	**1,251 9**	**1,663 5**	**1,035 8**	**2,699 3**
Loss for the year		–	–	–	–	(1,378 0)	(1 378 0)	68 3	(1 309 7)
Other comprehensive income									
Net movement in available for sale reserve	38	–	–	–	(531 5)	–	(531 5)	–	(531 5)
Net movement in cash flow hedge reserve	38	–	–	–	(240 5)	–	(240 5)	–	(240 5)
Actuarial gains and losses	8	–	–	–	–	25 5	25 5	–	25 5
Tax effects of the above		–	–	–	22 7	(7 1)	15 6	–	15 6
Total other comprehensive income		–	–	–	(749 3)	18 4	(730 9)	–	(730 9)
Appropriations	36	–	–	–	–	–	–	(68 3)	(68 3)
Movement in own shares	39	–	–	–	–	43 2	43 2	–	43 2
Balance at 31 December 2008		**124 0**	**403 2**	**7 3**	**(872 2)**	**(64 5)**	**(402 2)**	**1,035 8**	**633 6**

COMPANY STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2009

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders funds £m	Non shareholders' funds £m	Total equity £m
Balance at 31 December 2008		**124 0**	**403 2**	**7 3**	**(869 5)**	**(75 0)**	**(410 0)**	**1,035 8**	**625 8**
Loss for the year	13	–	–	–	–	(337 7)	(337 7)	32 5	(305 2)
Other comprehensive income									
Net movement in available for sale reserve	38	–	–	–	213 3	–	213 3	–	213 3
Net movement in cash flow hedge reserve	38	–	–	–	143 9	–	143 9	–	143 9
Actuarial gains and losses	8	–	–	–	–	(45 9)	(45 9)	–	(45 9)
Tax effects of the above		–	–	–	0 9	11 1	12 0	–	12 0
Total other comprehensive income		–	–	–	358 1	(34 8)	323 3	–	323 3
Appropriations	36	–	–	–	–	–	–	(32 5)	(32 5)
Reclassification of subordinated debt instrument	35	–	–	–	–	–	–	405 3	405 3
Balance at 31 December 2009		**124 0**	**403 2**	**7 3**	**(511 4)**	**(447 5)**	**(424 4)**	**1,441 1**	**1,016 7**

COMPANY STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2008

	Note	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total shareholders funds £m	Non shareholders' funds £m	Total equity £m
Balance at 31 December 2007		**124 0**	**403 2**	**7 3**	**(173 4)**	**1,109 0**	**1,470 1**	**1,035 8**	**2,505 9**
Loss for the year	13	–	–	–	–	(1,245 6)	(1,245 6)	68 3	(1,177 3)
Other comprehensive income									
Net movement in available for sale reserve	38	–	–	–	(457 9)	–	(457 9)	–	(457 9)
Net movement in cash flow hedge reserve	38	–	–	–	(240 5)	–	(240 5)	–	(240 5)
Actuarial gains and losses	8	–	–	–	–	25 5	25 5	–	25 5
Tax effects of the above		–	–	–	2 3	(7 1)	(4 8)	–	(4 8)
Total other comprehensive income		–	–	–	(696 1)	18 4	(677 7)	–	(677 7)
Appropriations	36	–	–	–	–	–	–	(68 3)	(68 3)
Movement in own shares	39	–	–	–	–	43 2	43 2	–	43 2
Balance at 31 December 2008		**124 0**	**403 2**	**7 3**	**(869 5)**	**(75 0)**	**(410 0)**	**1,035 8**	**625 8**

CONSOLIDATED CASH FLOW STATEMENT
For the year ended 31 December 2009

	Note	2009	2008
		£m	£m
Net cash (outflow)/inflow from operating activities			
Loss before taxation		**(257 5)**	(1,355 9)
Adjusted for			
Depreciation and amortisation		**24 3**	21 9
Exceptional impairment credits on property, plant and equipment	24	**(5 3)**	(23 6)
Exceptional impairment charges on intangible assets	23	**–**	27 2
Impairment losses on loans and advances	9	**1,044 8**	894 4
Impairment (credits)/losses on investment securities reclassified as loans and receivables and unsecured investment loans	21	**(6 2)**	267 6
Income taxes refunded		**39 4**	91 8
Fair value adjustments on financial instruments		**335 9**	(604 4)
Other non cash movements		**388 3**	333 5
Net cash inflow/(outflow) from operating losses before changes in operating assets and liabilities		**1,563 7**	(347 5)
Changes in operating assets and liabilities			
Net (increase)/decrease in deposits held for regulatory or monetary control purposes		**(12 4)**	16 9
Net decrease in loans and advances		**6,853 9**	24,852 0
Net decrease/(increase) in derivative financial instruments receivable		**5,840 6**	(11,073 4)
Net decrease/(increase) in other assets		**4 0**	(5 8)
Net decrease/(increase) in prepayments and accrued income		**87.8**	(72 5)
Net decrease in debt securities in issue		**(15,754.7)**	(4,728 9)
Net decrease in loans from Government		**(1,267 9)**	(12,889 6)
Net increase in deposits from other banks		**1,397 2**	3,881 0
Net (decrease)/increase in amounts due to customers		**(48 5)**	9,044 4
Net (decrease)/increase in derivative financial instruments payable		**(547 0)**	477 4
Net increase in other liabilities		**10.3**	16 3
Net decrease in accruals and deferred income		**(508.3)**	(13 5)
Net cash (outflow)/inflow from operating activities		**(2,381 3)**	9 156 8
Net cash inflow from investing activities			
Net investment in intangible assets		**(0 4)**	(14 7)
Net investment in property, plant and equipment		**36 3**	5 7
Purchase of investment securities		**(42.6)**	(126 7)
Proceeds from sale and redemption of investment securities		**764.1**	2,424 9
		757.4	2 289 2
Net cash outflow from financing activities			
Appropriations (including tax of £nil, 2008 £3 2m)		**(32 5)**	(71 5)
		(32 5)	(71 5)
Net (decrease)/increase in cash and cash equivalents		**(1,656 4)**	11,374 5
Opening cash and cash equivalents		**12,810.4**	1,435 9
Closing cash and cash equivalents	43	**11,154.0**	12 810 4

COMPANY CASH FLOW STATEMENT

For the year ended 31 December 2009

	Note	2009	2008
		£m	£m
Net cash (outflow)/inflow from operating activities			
Loss before taxation		**(323 1)**	(1,186 7)
Adjusted for			
Depreciation and amortisation		**26 6**	21 3
Exceptional impairment credits on property, plant and equipment	24	**(5 3)**	(23 6)
Exceptional impairment charges on intangible assets	23	**-**	27 2
Impairment losses on loans and advances	9	**1,044 8**	894 4
Impairment (credits)/losses on investment securities reclassified as loans and receivables and unsecured investment loans	21	**(6 2)**	267 6
Income taxes refunded		**39 5**	92 1
Fair value adjustments on financial instruments		**339 4**	(602 6)
Other non cash movements		**383 5**	402 0
Net cash inflow/(outflow) from operating losses before changes in operating assets and liabilities		**1,499 2**	(108 3)
Changes in operating assets and liabilities			
Net (increase)/decrease in deposits held for regulatory or monetary control purposes		**(12 4)**	16 9
Net decrease in loans and advances		**6,945 2**	25,131 8
Net decrease/(increase) in derivative financial instruments receivable		**2,582 1**	(5,003 1)
Net decrease/(increase) in other assets		**99 4**	(52 3)
Net decrease/(increase) in prepayments and accrued income		**91 0**	(69 9)
Net (decrease)/increase in debt securities in issue		**(6,573 2)**	351 9
Net decrease in loans from Government		**(1,267 9)**	(12,889 6)
Net (decrease)/increase in deposits from other banks		**(65 0)**	3,522 5
Net decrease in amounts due to customers		**(4,622 8)**	(8,245 1)
Net (decrease)/increase in derivative financial instruments payable		**(540 9)**	1,373 9
Net increase in other liabilities		**83 7**	91 8
Net (decrease)/increase in accruals and deferred income		**(475 0)**	184 4
Net cash (outflow)/inflow from operating activities		**(2,256 6)**	4,304 9
Net cash inflow from investing activities			
Net investment in intangible assets		**(0 4)**	(14 7)
Net investment in property, plant and equipment		**13 9**	5 7
Purchase of investment securities		**(0 2)**	(0 1)
Proceeds from sale and redemption of investment securities		**612 9**	7,283 8
		626.2	7,274 7
Net cash outflow from financing activities			
Appropriations (including tax of £nil, 2008 £3 2m)		**(32 5)**	(71 5)
		(32 5)	(71 5)
Net (decrease)/increase in cash and cash equivalents		**(1,662 9)**	11,508 1
Opening cash and cash equivalents		**12,662 1**	1,154 0
Closing cash and cash equivalents	43	**10,999 2**	12,662 1

1. Basis of preparation

The financial statements have been prepared on a going concern basis

Northern Rock (Asset Management) plc, formerly Northern Rock plc, (Northern Rock, the Company, the Group) was taken into public ownership on 22 February 2008 During 2007 and 2008 loan facilities to the Company were put in place by the Bank of England all of which were novated to HM Treasury on 28 August 2008

On 28 October 2009, the European Commission approved State aid to the Company confirming the facilities provided by HM Treasury, thereby removing the material uncertainty over the Company's ability to continue as a going concern which previously existed

Following the completion of a legal and capital restructuring on 1 January 2010, the Company no longer operates as a deposit taking institution under the supervision of the Financial Services Authority (FSA) It is now regulated by the FSA as a mortgage administration company and the Directors believe it has appropriate and adequate levels of capital to support these activities

Further, HM Treasury has confirmed that it is its intention to continue to fund the Company so as to maintain the Company as a going concern and enable the Company to meet its debts as and when they fall due for a period of not less than 18 months from 31 December 2009 It has also committed to convert up to £1 6bn of the Government loan to meet regulatory capital requirements if so required

2. Principal accounting policies

a) Accounting convention

These financial statements have been prepared in accordance with EU endorsed International Financial Reporting Standards ("IFRS"), IFRIC interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS The financial statements have been prepared under the historical cost convention as modified by the revaluation of available for sale investments, financial assets and liabilities held at fair value A summary of the more important group accounting policies is set out below The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates (see note 3)

The Directors consider the business to comprise one operating and geographical segment due to the similarity of risks faced within its UK based residential, commercial and unsecured lending portfolios

b) Basis of consolidation

The financial information of the Group incorporates the assets, liabilities and results of Northern Rock (Asset Management) plc and its subsidiary undertakings (including Special Purpose Entities) Entities are regarded as subsidiaries where the Group has the power to govern financial and operating policies so as to obtain benefits from their activities Inter-company transactions and balances are eliminated upon consolidation

The purchase method of accounting is used to account for the purchase of subsidiaries which are held at cost in the Company balance sheet

c) Interest income and expense

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost using the effective interest method

The effective interest method calculates the amortised cost of a financial asset or a financial liability, and allocates the interest income or interest expense over the relevant period The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss

d) Fees and commissions

Where they are not included in the effective interest calculation, fees and commissions are generally recognised on an accruals basis when the service has been provided Loan commitment fees for loans that are likely to be drawn down are deferred (together with related incremental direct costs) and recognised as an adjustment to the effective interest rate on the loan Insurance commissions are recognised in the period in which they are earned

e) Financial instruments

Financial assets can be classified in the following categories loans and receivables, available for sale, held to maturity or financial assets at fair value through profit and loss Management determines the classification of its financial instruments at initial recognition The Group measures all of its financial liabilities at amortised cost, other than derivatives and those instruments which have been designated as part of a hedging relationship (see below) Regular way purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on trade date – the date on which the Group commits to purchase or sell the asset

i) Loans and receivables and financial liabilities at amortised cost

The Group's loans and advances to banks and customers, unsecured investment loans including certain investment securities, and investments in Structured Investment Vehicles ('SIVs') are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, whose recoverability is based solely on the credit risk of the customer and where the Group has no intention of trading the loan Both loans and receivables and financial liabilities are initially recognised at fair value including direct and incremental transaction costs Subsequent recognition is at amortised cost using the effective interest method

ii) Available for sale financial assets

Available for sale financial assets are assets that are either designated as available for sale or are assets that do not meet the definition of loans and receivables and are not derivatives or assets held at fair value through profit and loss These are principally but not exclusively investment securities intended to be held for an indefinite period of time which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices They are initially measured at fair value including direct and incremental transaction costs Subsequent measurement is at fair value, with changes in fair value being recognised in equity except for impairment losses and translation differences, which are recognised in the income statement. Upon derecognition of the asset, or where there is objective evidence that the investment security is impaired, the cumulative gains and losses recognised in equity are removed from equity and recycled to the income statement

2. Principal accounting policies (continued)

In October 2008 IAS 39 was amended to allow the reclassification of available for sale securities to loans and receivables where such securities would now meet the definition of loans and receivables Northern Rock elected to make such reclassifications, and full details are contained in note 21 to the accounts Reclassifications are made at fair value on the date of reclassification Fair value becomes the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before the reclassification date are subsequently made unless the assets are subsequently impaired Effective interest rates for financial assets reclassified to loans and receivables are determined at the reclassification date Further changes in estimates of cash flows adjust effective interest rates prospectively If reclassified assets are impaired after reclassification, any fair value gains or losses recorded before classification in the available for sale reserve are charged as appropriate to the income statement.

iii) Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity They are initially measured at fair value including direct and incremental transaction costs Subsequent measurement is at amortised cost using the effective interest method No financial assets were classified as held to maturity during either 2009 or 2008

iv) Financial assets and liabilities at fair value through profit or loss

A financial asset or liability is classified in this category if it is held for trading or is so designated by management on initial recognition A financial asset or liability is classified as held for trading if it is a derivative not in an IAS 39 compliant accounting hedge relationship, or if it is acquired for the purpose of selling or repurchasing in the near term In certain circumstances other assets and liabilities may be designated as held at fair value through profit or loss on initial recognition These are when

a) Doing so significantly reduces measurement inconsistencies that would arise if the asset or liability were carried at amortised cost but a related derivative was treated as held for trading,

b) Certain investments are managed and evaluated on a fair value basis in accordance with a documented risk management strategy and are reported to management on that basis,

c) Financial instruments contain significant embedded derivatives that significantly modify the cash flows from the instruments

The Group holds certain investment securities, such as Collateralised Debt Obligations ('CDOs') that contain a significant embedded derivative that is not clearly and closely related These fall under the description c) above and are therefore measured at fair value through profit and loss

The assets are initially measured at fair value, with transaction costs taken directly to the income statement Subsequent measurement is at fair value including interest cash flows and accruals, with changes in fair value included directly in the income statement within other income, except for derivative instruments where interest cash flows and accruals are recorded within net interest income

The fair values of quoted investments in active markets are based on current bid prices If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value using valuation techniques These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants

f) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously

g) Derivative financial instruments and hedge accounting

The Group undertakes transactions in derivative financial instruments, which include cross currency swaps, interest rate swaps, equity swaps, interest rate caps, forward rate agreements, options, foreign exchange contracts and similar instruments, for non-trading purposes

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest and foreign exchange rates inherent in the Group's assets, liabilities and positions All derivative transactions are for economic hedging purposes and so it is therefore decided at the outset which position the derivative will be hedging Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate Derivatives are measured initially at fair value and subsequently remeasured to fair value Fair values are obtained from quoted market prices in active markets and, where these are not available, from valuation techniques including discounted cash flow models and option pricing models Where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement Where derivatives are designated within hedging relationships, the treatment of the changes in fair value depends on the nature of the hedging relationship as explained below

Hedge accounting is used for derivatives designated in this way provided certain criteria are met The Group documents at inception of the hedge relationship the link between the hedging instrument and the hedged item as well as its risk management objective and strategy for undertaking various hedge transactions The Group also documents its assessment both at hedge inception and on an ongoing basis of whether the derivatives used in hedging transactions are highly effective in offsetting changes in the fair values or cash flows of hedged items

i) Cash flow hedges
A cash flow hedge is used to hedge exposures to variability in cash flows, such as variable rate financial assets and liabilities The effective portion of changes in the derivative fair value is recognised in equity, and recycled to the income statement in the periods when the hedged item will affect profit and loss The fair value gain or loss relating to the ineffective portion is recognised immediately in the income statement

ii) Fair value hedges
A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity

If derivatives are not designated as hedges then changes in fair values are recognised immediately in the income statement

iii) Embedded derivatives
Certain derivatives are embedded within other non-derivative host instruments to create a hybrid instrument Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risk of the host instrument, and where the hybrid instrument is not measured at fair value, the Group separates the embedded derivative from the host instrument and measures it at fair value with the changes in fair value recognised in the income statement

2. Principal accounting policies (continued)

h) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral, the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits or deposits due to customers, as appropriate Securities purchased under agreements to resell, ('reverse repos'), are recorded as loans and advances to banks or customers as appropriate The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method Securities lent to counterparties are also retained in the financial statements

i) Impairment losses

The Group assesses its financial assets or groups of financial assets for objective evidence of impairment at each balance sheet date An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the balance sheet date and has a reliably measurable impact on the estimated future cash flows of the financial assets or groups of financial assets Losses that are incurred as a result of events occurring after the balance sheet date are not recognised in these accounts

i) Assets held at amortised cost

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant Objective evidence that a financial asset is impaired includes observable data that comes to the attention of the Group about the following loss events

a) significant financial difficulty of the issuer or obligor,

b) a breach of contract, such as a default or delinquency in interest or principal repayments,

c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider,

d) it becomes probable that the borrower will enter bankruptcy or other financial reorganisation,

e) the disappearance of an active market for that financial asset because of financial difficulties, or

f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including

i adverse changes in the payment status of borrowers in the portfolio,

ii national or local economic conditions that correlate with defaults on the assets in the portfolio

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment Assets that are individually assessed and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate The carrying amount of the asset is reduced through the use of an impairment allowance and the amount of the loss is recognised in the income statement In future periods the unwind of the discount is recognised within interest income

When a loan is uncollectible, it is written off against the related provision for loan impairment Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment allowance The amount of the reversal is recognised in the income statement

ii) Available for sale financial assets

For available for sale financial assets, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset, or group of financial assets are impaired The amount of the loss is measured as the difference between the asset's acquisition cost less principal repayments and amortisation and the current fair value The amount of the impairment loss is recognised in the income statement This includes cumulative gains and losses previously recognised in equity which are recycled from equity to the 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 recognised in profit or loss, the impairment loss is reversed through the income statement

iii) Renegotiated loans

Loans to customers whose terms have been renegotiated are no longer considered past due but are treated as fully performing loans only after at least three monthly payments under the new arrangements have been received In subsequent years, the asset is considered to be past due and disclosed only if renegotiated again within that year

j) Derecognition of financial assets and liabilities

Derecognition is the point at which the Group removes an asset or liability from its balance sheet The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial asset expires The Group also derecognises financial assets that it transfers to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset or where the Group has transferred substantially all the risks and rewards of ownership Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised

The Group derecognises financial liabilities only when the obligation specified in the contract is discharged, cancelled or has expired

k) Securitisation transactions

Certain Group companies have issued debt securities in order to finance specific loans and advances to customers Both the debt securities in issue and the loans and advances to customers remain on the Group balance sheet within the appropriate balance sheet headings unless

i) a fully proportional share of all or of specifically identified cash flows have been transferred to the holders of the debt securities, in which case that proportion of the assets are derecognised,

ii) substantially all the risks and rewards associated with the assets have been transferred, in which case the assets are fully derecognised, or

iii) a significant proportion of the risks and rewards have been transferred, in which case the assets are recognised only to the extent of the Group's continuing involvement

2 Principal accounting policies (continued)

l) Debt and equity securities in issue

Issued securities are classified as liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder, or to exchange financial instruments under conditions that are potentially unfavourable to the Group Issued securities are classified as equity where they meet the definition of equity and confer a residual interest in the Group's assets on the holder of the securities

Financial liabilities are carried at amortised cost using the effective interest rate (see "interest income and expense") Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax Appropriations to holders of equity securities are deducted from equity, net of any related income tax, as they become irrevocably due to the holders of the securities

m) Foreign currency translation

The Group's financial statements are presented in sterling, which is the functional currency of the parent company Items included in the financial statements of each of the Group's entities are measured using their functional currency, which is the currency of the primary economic environment in which they operate

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the dates of the transactions Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the income statement. Non-monetary items measured at amortised cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation Where these are held at fair value through the income statement, exchange differences are reported as part of the fair value gain or loss

n) Share-based payments

The Group has no share based payment schemes The costs in relation to such schemes in 2008 represent the costs calculated under IFRS 2 for the termination of all schemes then in existence following the acquisition of all shares in the Company by HM Treasury in February 2008

o) Intangible assets

i) Goodwill

Goodwill arising on the acquisition of subsidiary companies, which is represented by the excess of fair value of the purchase consideration over the fair value of the assets acquired, is capitalised and shown as an asset in the balance sheet It is reviewed for impairment annually Any impairment is recognised immediately in the income statement and is not subsequently reversed

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amount, having been tested for impairment at 31 December 2003

ii) Computer software

Costs incurred in acquiring and developing computer software for internal use are capitalised as intangible assets where the software leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group from its use for a period of over one year The software is classified as an intangible asset where it is not an integral part of the related hardware and amortised over its estimated useful life on a straight line basis which is generally 3 to 5 years

Costs associated with maintaining software are expensed as they are incurred

p) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks

q) Taxation

i) Current income tax

Income tax payable/(receivable) is calculated on taxable profits/(losses) based on the applicable tax law in each jurisdiction where the Company's subsidiaries operate and is recognised as an expense/(income) for the period except to the extent that it relates to items that are charged or credited to other comprehensive income or to equity

Where the Group has tax losses that can be relieved against a tax liability for a previous year, it recognises those losses as an asset, because the tax relief is recoverable by refund of tax previously paid This asset is offset against an existing current tax balance

Where tax losses can be relieved only by carry forward against taxable profits of future periods, a deductible temporary difference arises Those losses carried forward, if provided for, are set off against deferred tax liabilities carried in the consolidated balance sheet

Current income tax assets and liabilities are only offset when they arise in the same reporting tax group and where there is both a legal right to offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously

ii) Deferred income tax

Deferred income tax is calculated using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the date of the consolidated balance sheet and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled

The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and carry forwards, rolled over gains on disposal of property, plant and equipment, unremitted earnings from overseas subsidiaries, and change in accounting basis on adoption of IFRS

Deferred income tax assets are recognised when it is probable that future taxable profits will be available against which these temporary differences can be utilised

Deferred income tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future

The tax effects of carry forwards of unused losses or unused tax credits are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised

Deferred income tax related to fair value re-measurement of available for sale investments and cash flow hedges, which are recognised in other comprehensive income, is also recognised in other comprehensive income and subsequently in the consolidated income statement together with the deferred gain or loss.

Deferred income tax assets and liabilities are only offset when they arise in the same reporting tax group and where there is both a legal right to offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously

2. Principal accounting policies (continued)

r) Pensions and employee benefits

The Company operates the Northern Rock Pension Scheme (the "Scheme") to provide retirement benefits for staff Staff who joined the Scheme before 1 July 1999 participate in the funded, contracted out, defined benefit section of the Scheme unless they opt out Other staff, including those employed at 1 July 1999 but not members of the defined benefit section of the Scheme at that date, together with staff employed from 1 July 1999, participate in the defined contribution section of the scheme unless they opt out The assets of both sections of the Scheme are held in a trustee-administered fund separate from the assets of Northern Rock (Asset Management) plc

A full actuarial valuation of the Group's defined benefit section of the Scheme is undertaken every three years with interim reviews in the intervening years, these valuations are updated to 31 December each year by qualified independent actuaries For the purpose of these annual updates, Scheme assets are included at their fair value and Scheme liabilities are measured on an actuarial basis using the projected unit credit method Liabilities in the defined benefit section of the scheme are discounted using rates equivalent to the market yields at the balance sheet date on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability The resulting net surplus or deficit is included in the Group's balance sheet Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the Scheme

The Group's income statement includes the current service cost of providing pension benefits, the expected return on the Scheme's assets, net of administration costs, and the interest cost on the Scheme's liabilities Cumulative actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately through other comprehensive income

Past service costs are recognised immediately in the income statement, unless the changes to the Scheme are conditional on the employees remaining in service for a specified period of time (the vesting period) In this case, the past service costs are amortised on a straight line basis over the average vesting period

For defined contribution plans, the Company has no further payment obligations once the contributions have been paid The contributions are recognised as an employee benefit expense when they are due Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available

s) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, as appropriate Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset All other repairs and maintenance are charged to the income statement in the period in which they are incurred

Depreciation is provided using the straight line method to allocate costs less residual values over estimated useful lives, as follows

Freehold property	100 years
Leasehold property	Unexpired period of the lease
Plant, equipment, fixtures and fittings	
– plant	30 years
– furniture	10 years
– other	5 years
Computer equipment	
– PCs	3 years
– other	5 years
Motor vehicles	4 years

Assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date

Where the cost of freehold land can be identified separately from buildings, the land value is not depreciated Fixed assets are subject to impairment testing, if deemed appropriate

Assets in the course of construction are not depreciated until they have been completed and transferred to the appropriate category of property, plant and equipment. The costs of financing assets in the course of construction are not included in the costs of the assets Assets in the course of construction are included within the impairment test referred to above where appropriate

t) Impairment of property, plant and equipment and intangible assets

Property, plant and equipment and intangible assets are assessed for indications of impairment at each balance sheet date, or more frequently where required by events or changes in circumstances Goodwill is reviewed for impairment annually at the balance sheet date If indications of impairment are found, these assets are subject to an impairment review The impairment review compares the carrying value of the assets with their recoverable amounts, which are defined as the higher of the net selling price and their value in use Net selling price is the amount at which the asset could be sold in a binding agreement in an arm's length transaction Value in use is calculated as the discounted cash flows generated as a result of the asset's continued use including those generated by its ultimate disposal, discounted at a market rate of interest on a pre tax basis

Where impairments are indicated, the carrying values of fixed assets and goodwill are written down by the amount of the impairment and the charge is recognised in the income statement in the period in which it occurs A previously recognised impairment charge on a fixed asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount The carrying value of the fixed asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised Any impairment charges on goodwill are not reversed

u) Leases

If the lease agreement, in which the Group is a lessee, transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised At inception, the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life The lease obligations are recorded as borrowings

If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease

Operating lease payments are charged to the income statement on a straight line basis unless a different systematic basis is more appropriate Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the income statement in the period in which termination is made

2. Principal accounting policies (continued)

v) Provisions

Provisions are recognised for present obligations arising from past events where it is more likely than not that outflows of resources will be required to settle the obligations and they can be reliably estimated

The Group recognises provisions for vacant leasehold premises where the unavoidable costs of the present obligations exceed anticipated rental incomes

Contingent liabilities are possible obligations whose existence depends upon the outcome of uncertain future events or are present obligations where the outflows of resources are uncertain or cannot be reliably measured Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote

w) Share capital

i) Share issue costs

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds

ii) Dividends on shares

Dividends on shares are recognised in equity in the period in which they are approved by the Company's shareholders or paid

iii) Treasury shares

Where any Group company purchases the Company's equity share capital, the consideration paid is deducted from total shareholders' equity as treasury shares until they are cancelled Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity

x) Disposal groups held for sale

A group of assets to be disposed of by sale, and liabilities directly associated with those assets that will be transferred in the transaction, are classified as a disposal group Disposal groups are classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than through continuing use Disposal groups are measured at the lower of their carrying amount and fair value less costs to sell

y) Implementation of new standards and amendments to published standards and interpretations effective during 2009

The following new standards, amendments to standards or interpretations are mandatory for the first time for financial years beginning on 1 January 2009 and have been endorsed for adoption by the EU and are relevant to the Group

- IAS 1 (revised) – Presentation of financial statements This standard has resulted in changes to the Statement of Recognised Income and Expense This has been split into two statements, one showing changes in equity resulting from transactions not reflected in the income statement and the other showing changes in equity resulting from transactions with shareholders
- Amendment to IFRS 7 Improving Disclosures about Financial Instruments This amendment has changed the IFRS 7 disclosure requirements in the statutory accounts The main impact has been the classification of fair value assets and liabities against a fair value hierarchy

The following new standards, amendments to standards or interpretations are also mandatory for the first time for financial years during 2009 and have been endorsed for adoption by the EU, but have no material financial impact on the Group These are applicable from 1 January 2009 unless otherwise stated

- IFRS 8 – Operating segments
- IAS 23 (revised) – Borrowing costs
- IFRIC 13 – Customer loyalty programmes
- Amendment to IFRS 2 Share-Based Payment Vesting Conditions and Cancellations
- IAS 32 (amendment) – Financial instruments presentation, and consequential amendments to IAS 1
- Revised IFRS 3 Business Combinations This is effective for annual periods beginning on or after 1 July 2009
- Revised IAS 27 Consolidated and separate financial statements This is effective for annual periods beginning on or after 1 July 2009
- IFRIC 14 – IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirement and their Interaction
- IFRIC 16 – Hedges of a net investment in a foreign operation This is effective for annual periods beginning on or after 1 October 2008
- Improvements to IFRSs
- IFRS 1 (revised) 'First time adoption of IFRS'
- Amendment to IFRS 1 'First time adoption of IFRS' and IAS 27 'Consolidated and separate financial statements' on the 'Cost of an investment in a subsidiary, jointly controlled entity or associate'
- IFRIC 18 – Transfer of Assets from Customers This is effective for annual periods beginning on or after 1 July 2009
- Amendment to IAS 32 Financial Instruments Presentation and IAS 1 Presentation of financial statements on Puttable financial instruments and obligations arising on liquidation
- Amendments to IFRIC 9 and IAS 39 regarding embedded derivatives This is effective for annual periods beginning on or after 1 July 2008
- Amendment to IAS 39, 'Financial Instruments Recognition and Measurement' and IFRS 7, 'Financial Instruments Disclosures' on the 'Reclassification of Financial Assets' This is effective for annual periods beginning on or after 1 July 2008
- Amendment to IAS 39 Financial Instruments Recognition and Measurement Eligible Hedged Items This is effective for annual periods beginning on or after 1 July 2009
- IFRIC 15 – Agreements for the construction of real estate
- IFRIC 17 – Distribution of Non-cash assets to Owners This is effective for annual periods beginning on or after 1 July 2009

z) Standards, interpretations and amendments to published standards that are not yet effective and the early adoption of standards

The Group has not early adopted any standards or interpretations during 2009

The following new standards, amendments to standards or interpretations that are relevant to the Group have been issued but are not effective for financial years beginning 1 January 2009 and have not been endorsed by the EU

Amendment to IAS 24 Related party disclosures Management is assessing the impact of this amendment on its financial statements, to ensure it meets the revised disclosure requirements introduced by this amendment

2. Principal accounting policies (continued)

- IFRS 9 Financial Instruments Management is assessing the impact of this amendment on its financial statements, to ensure it meets the revised disclosure requirements introduced by this amendment

The following new standards, amendments to standards or interpretations are not effective for financial years beginning 1 January 2009 and have been endorsed by the EU, but have no material impact on the Group

- Amendments to IAS 32 Financial Instruments Presentation on classification or rights issues The Group believes the application of this amendment will have no material impact on the financial statements in the period of initial application

The following new standards, amendments to standards or interpretations are not effective for financial years beginning 1 January 2009, have not been endorsed by the EU and have no material financial impact on the Group

- IFRIC 19 – Extinguishing financial liabilities with equity instruments
- Amendment to IFRIC 14, IAS 19 – Prepayments of a minimum funding requirement
- Amendments to IFRS 1, on first time adoption of IFRS additional exemption
- Amendments to IFRS 1, First time adoption of IFRS
- IFRS 2 Share-based payment – Group cash-settled share-based payment transactions

3. Critical accounting estimates

a) Impairment losses on loans and advances

Individual impairment losses on loans and advances are calculated based on an individual valuation of the underlying asset Collective impairment losses on loans and advances are calculated using a statistical model The key assumptions used in the model are the probability of any balance entering into default in the next twelve months as a result of an event that had occurred prior to the balance sheet date, the probability of this default resulting in possession or write off, and the subsequent loss incurred These key assumptions are based on observed data trends and are updated on a monthly basis within agreed methodology to ensure the impairment allowance is entirely reflective of the current portfolio The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes To the extent that the loss given default differs by +/- 10%, the impairment allowance would be an estimated £105 3m higher (2008 £60 0m) or £123 1m lower (2008 £70 8m) respectively

b) Fair value calculations

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in a transaction with a willing and knowledgeable counterparty For the majority of instruments carried at fair value, these are determined by reference to quoted market prices Where these are not available, fair value is based upon cash flow models, which use wherever possible independently sourced market parameters such as interest rate yield curves, currency rates and option volatilities Other factors are also considered, such as counterparty credit quality and liquidity Management must use judgement and estimates where not all necessary data can be externally sourced or where factors specific to Northern Rock's holdings need to be considered The accuracy of the fair value calculations would therefore be affected by unexpected market movements, inaccuracies within the models used compared to actual outcomes and incorrect assumptions For example, if management were to use a tightening in the credit spread of 10 basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £52 5m (2008 £77 2m)

c) Average life of secured lending

IAS 39 requires interest earned from mortgage lending to be measured under the effective interest method The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset

Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it The accuracy of the effective interest rate would therefore be affected by unexpected market movements resulting in altered customer behaviour, inaccuracies in the models used compared to actual outcomes and incorrect assumptions If the estimated average life of secured loans were increased or reduced by one month, the value of such loans on the balance sheet would be increased or decreased by £26 5m (2008 £20 2m) and £23 3m (2008 £21 2m) respectively

d) Pension benefits

The present value of the pension obligations is dependent upon an actuarial calculation which includes a number of assumptions These assumptions include the discount rate, which is used to determine the present value of the estimated future cash outflows that will be required to meet the pension obligation In determining the appropriate discount rate to use, the Group considers market yields of high quality corporate bonds denominated in sterling that have terms to maturity approximating the terms of the pension liability Were this discount rate to reduce by 0 1% or increase by 0 1% from the current management estimate, the carrying value of the pension obligations would be an estimated £9 0m higher (2008 £7 8m) or £8 6m lower (2008 £7 5m) respectively

Other key assumptions for pensions benefits including mortality tables are based in part upon current market conditions or published data Additional information is included in note 8

e) Unrecognised deferred tax assets

Significant management judgement is required to determine the amount of deferred tax assets that can be recognised Management reassesses unrecognised deferred tax assets at each balance sheet date Based upon the likely timing and level of future taxable profits together with future tax planning strategies, management has concluded that deferred tax assets should only be recognised to the extent that the Group will realise taxable profits arising from the reversal of existing taxable temporary differences The amount of unrecognised deferred tax assets at 31 December 2009 was £595 9m (2008 £604 9m) in both the Group and Company

Management will closely monitor the opportunities for the recoverability of these deferred tax assets and will reassess the need to recognise them at subsequent balance sheet dates

4. Interest and similar income

	2009 £m	2008 £m
On secured advances	**1,699 0**	4,684 0
On other lending	**170 1**	446 7
On investment securities and deposits	**163 8**	576 2
	2,032 9	5,706 9

Interest accrued on individually impaired assets was £81 5m (2008 £42 7m)

5. Interest expense and similar charges

	2009 £m	2008 £m
On retail customer accounts	**287 8**	956 6
On other deposits including loans from Government	**96 8**	1,399 6
Other	**490 9**	3,299 8
	875 5	5,656 0

As a result of State aid approval in October 2009, net interest income includes a net interest clawback of £223 9m in 2009 Offsetting this are additional fees payable of £23 9m resulting in a total income clawback of £200 0m The 2008 figures include corresponding charges of the same amount

6. Administrative expenses

	2009 £m	2008 £m
Administrative expenses		
Wages and salaries	**117 6**	140 3
Social security costs	**11 6**	12 7
Other pension costs	**12 9**	10 4
Total staff costs	**142.1**	163 4
Other administrative expenses	**89 6**	84 4
	231 7	247 8
Other administrative expenses include		
Hire of equipment	**3 7**	4 8
Property rentals	**4 3**	5 3
Remuneration of auditors (see below)	**1 7**	1 9

Exceptional operating expenses

Exceptional operating expenses are those incurred as a result of the restructuring and strategic review of the Group's activities prior to and following Northern Rock being brought into public ownership

	2009 £m	2008 £m
Redundancy and other staff costs	**0 1**	37 0
Professional fees incurred by the Company	**1 2**	29 8
Professional fees recharged by the Tripartite Authorities	**2 7**	10 7
Corporate advisory fees	**-**	4 2
Reimbursement of third party expenses	**-**	8 7
Accelerated charge on cancellation of share schemes (see note 7)	**-**	39 6
Company valuation	**1 6**	1 5
Other exceptional operating expenses	**0.2**	10 0
	5 8	141 5
Exceptional impairment credits on property, plant and equipment	**(5 3)**	(23 6)
Provision for onerous contracts	**0 1**	18 5
Exceptional impairment charges on intangible assets	**-**	27 2
Strategic project development	**39.3**	-
	39 9	163 6

Exceptional staff costs of £0 1m (2008 £37 0m) mainly represent the costs of redundancy, payments in lieu of notice and outplacement services associated with the reduction in the workforce as part of the restructuring of the business

The reimbursement of third party expenses in 2008 represented costs incurred by third parties as part of the strategic review process

6. Administrative expenses (continued)

The accelerated charge on cancellation of share schemes in 2008 represented the charge to the income statement of all previously unexpensed costs required by IFRS 2 – Share-based Payment on cancellation of staff share schemes after the acquisition of all shares in the Company by HM Treasury on 22 February 2008

Company valuation costs of £1 6m (2008 £1 5m) relate to work done by BDO Stoy Hayward to value the Company's shares before the Company was taken into public ownership

The exceptional impairment credits of £5 3m (2008 £23 6m) have arisen primarily due to reversals of impairments made in 2007 in respect of properties in the course of construction (see note 24)

The provisions for onerous contracts of £0 1m (2008 £18 5m) represent the costs associated with properties no longer required after the restructuring of the business (see note 31)

The exceptional impairment charges on intangible assets of £nil (2008 £27 2m) represent the costs associated with the accelerated amortisation of software no longer required after the restructuring of the business (see note 23)

The strategic project development costs represent the costs associated with the legal and capital restructuring and positioning of the Company to increase lending in a prudent and sustainable way

The monthly average number of persons (including Directors) employed by the Group and Company was as follows

	2009	2008
Full time	**3,555**	4,231
Part time	**991**	1,045

The aggregate Directors' emoluments and the emoluments of the highest paid Director are given in the Directors' Remuneration Report on pages 10 to 15

Services provided by the Group's auditor and network firms
During the year the Group obtained the following services from the Group's auditor, as detailed below

	2009 £m	2008 £m
Administrative expenses		
Fees payable to Company auditor for the audit of parent Company and consolidated accounts	**1 0**	1 2
Fees payable to Company auditor and its associates for other services		
– The audit of Company's subsidiaries pursuant to legislation	**0 4**	0 4
– Other services pursuant to legislation (including review of half year Interim Statement)	**0 1**	0 1
– Reporting Accountant services (see note i)	**0 1**	0 2
– Taxation services	**0 1**	–
	1 7	1 9
Exceptional operating expenses		
Fees payable to Company auditor and its associates for other services		
– Other assurance services (see note ii)	**0 2**	–
– Other services (see note iii)	**–**	3 3
	0 2	3 3

i) Reporting accountant services comprise objective review of the verification of historical financial information and the performance of certain agreed upon assurance procedures for securitisation transactions

ii) Other assurance services comprise project assurance work in respect of the legal and capital restructure

iii) Other services comprise services provided in respect of the Company's forecasts, proposed restructuring plans (as developed by the Company), its options to manage liquidity and regulatory capital, its obligations to key financial stakeholders and its reporting and other obligations to the Tripartite authorities under various agreements all of which were incurred prior to public ownership

7 Share based payment

As a result of The Northern Rock plc Transfer Order 2008 all share schemes were extinguished on 22 February 2008 The charge in 2008 in relation to share schemes was £39 6m arising from the acceleration through the income statement of all previously unexpensed charges for all share schemes

The following table summarises the movement in the number of share options and rights for all share schemes between those outstanding at the beginning and end of 2008

	Options/ Rights at the beginning of the year	**Options/ Rights lapsed during the year**	**Options/ Rights extinguished during the year**	**Options/ Rights outstanding at the end of the year**	**Options/ Rights exercisable at the end of the year**
2008					
Employee Sharesave and Share Option Schemes	7,670,205	(298,619)	(7,371,586)	–	–
Long Term Incentive Plans	1,105,466	–	(1,105,466)	–	–
Share Matching Schemes	1,390,343	(2,223)	(1,388,120)	–	–
Deferred Share Schemes	474,858	–	(474,858)	–	–

8. Retirement benefit obligations

The Company operates one main employee benefit scheme ("the Scheme") with both defined benefit and defined contribution sections

The defined benefit section of the Scheme provides benefits based on final salary for certain employees The assets of the Scheme are held in a separate trustee-administered fund Contributions to the defined benefit section are assessed in accordance with the advice of an independent qualified actuary using the projected unit method The defined benefit section was closed to new entrants in July 1999

The Company's policy for recognising actuarial gains and losses is to recognise them immediately on the balance sheet through the statement of comprehensive income

The overall costs of the Scheme have been recognised in the Company's accounts in accordance with IAS19

Summary of assumptions

	2009 %	2008 %
Price inflation	**3.85**	3 10
Rate of increase in salaries	**4 35**	4 35
Rate of increase for pre 6 April 2006 pensions in payment (in excess of any Guaranteed Minimum Pension (GMP) element)	**3 90**	3 60
Rate of increase for post 6 April 2006 pensions in payment	**3 65**	3 10
Rate of increase for deferred pensions	**3 85**	3 10
Discount rate	**5 65**	6 00
Expected rate of return on assets	**4 92**	4 60

The most significant non financial assumption is the assumed rate of longevity The table below shows the life expectancy assumptions used in the accounting assessments based on the life expectancy of a member aged 60

	2009		2008	
	Pensioner	**Non-pensioner**	Pensioner	Non-pensioner
Male	**27 3 years**	**28 4 years**	27 2 years	28 4 years
Female	**29 9 years**	**30 7 years**	29 7 years	30 8 years

The expected return on assets has been derived as the weighted average of the expected returns from each of the main asset classes The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of the financial markets (as suggested by the yields available), and the views of investment organisations

Categories of assets held

	2009 %	2008 %
Equities	**2**	3
Government and other corporate bonds	**94**	93
Property	**3**	3
Cash/other	**1**	1
Total	**100**	100

Funded status

	2009 £m	2008 £m
Present value of defined benefit obligation	**(391 4)**	(335 8)
Assets at fair value	**386 5**	367 5
Defined benefit (liability)/asset	**(4 9)**	31 7

Disclosed pension expense for year

a) Components of defined benefit pension expense

	2009 £m	2008 £m
Current service cost	**5 7**	8 3
Interest cost	**20 0**	20 4
Expected return on assets	**(17.2)**	(17 5)
Curtailments	**-**	(4 1)
Total pension expense	**8 5**	7 1

8. Retirement benefit obligations (continued)

b) Statement of comprehensive income

	2009 £m	2008 £m
Actuarial (loss)/gain recognised in statement of comprehensive income	**(45 9)**	25 5
Cumulative actuarial gains/(losses) recognised at 1 January	**17 2**	(8 3)
Cumulative actuarial (losses)/gains recognised at 31 December	**(28.7)**	17 2

Movements in present value of defined benefit obligation during the year

	2009 £m	2008 £m
Present value of defined benefit obligation at 1 January	**335.8**	354 6
Defined benefit service cost	**5 7**	8 3
Interest cost	**20 0**	20 4
Defined benefit employee contributions	**1 3**	1 7
Actuarial loss/(gain)	**39 6**	(27 4)
Defined benefit actual benefits paid	**(11 0)**	(17 7)
Curtailments	**-**	(4 1)
Present value of defined benefit obligation at 31 December	**391 4**	335 8

Movements in fair value of defined benefit assets during the year

	2009 £m	2008 £m
Fair value of assets at 1 January	**367 5**	360 3
Expected return on assets	**17 2**	17 5
Actuarial loss	**(6 3)**	(1 9)
Defined benefit actual company contributions	**17 8**	7 6
Defined benefit employee contributions	**1.3**	1 7
Defined benefit actual benefits paid	**(11 0)**	(17 7)
Fair value of assets at 31 December	**386 5**	367 5

The actual return on plan assets in 2009 was £10 9m (2008 £15 6m)

Experience gains and losses

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Defined benefit obligation	**391 4**	335 8	354 6	350 7	311 0
Fair value of assets	**386 5**	367 5	360 3	329 0	256 6
(Deficit)/surplus	**(4 9)**	31 7	5 7	(21 7)	(54 4)
Actuarial (loss)/gain on defined benefit obligation	**(39 6)**	27 4	23 3	(21 1)	(39 4)
Experience (loss)/gain on assets	**(6 3)**	(1 9)	6 2	4 6	20 8

Estimated contributions for year ending 31 December 2010

	2010 £m
Estimated employer contributions for 2010	**12 2**
Estimated employee contributions for 2010	**-**
Estimated total contributions for 2010	**12 2**

Pension costs for the defined contribution section of the Scheme were

	2009 £m	2008 £m
Total included in staff costs	**3 6**	4 1

The Scheme is now closed and members accrue no further benefits within it as a consequence of The Northern Rock Transfer Order 2009, SI 2009/3226, under which all employees transferred to Northern Rock plc and became members of the Northern Rock (2010) Pension Scheme The Company has agreed with the Trustees to fund the deficit in the defined benefit section of the Scheme by making contributions of £12 2m per annum

9 Impairment losses on loans and advances

	On advances secured on residential property £m	On advances secured on residential buy to let property £m	On other secured advances £m	On unsecured loans £m	Total £m
2009					
Group					
At 1 January 2009	335 4	42 9	7 8	483 6	869 7
Increase in allowance during the year net of recoveries	458 9	83 4	4 4	498 1	1,044 8
Amounts written off during the year	(303 3)	(26 3)	-	(423 3)	(752 9)
Discount unwind	4 8	0 3	0 3	5 9	11 3
At 31 December 2009	495 8	100 3	12 5	564 3	1,172 9
Company					
At 1 January 2009	335 4	42 9	7 8	483 7	869 8
At 31 December 2009	495 8	100 3	12 5	564 4	1,173 0

	On advances secured on residential property £m	On advances secured on residential buy to let property £m	On other secured advances £m	On unsecured loans £m	Total £m
2008					
Group					
At 1 January 2008	58 4	5 3	0 7	178 6	243 0
Increase in allowance during the year net of recoveries	364 0	48 9	8 2	473 3	894 4
Amounts written off during the year	(87 8)	(11 8)	(1 3)	(170 1)	(271 0)
Discount unwind	0 8	0 5	0 2	1 8	3 3
At 31 December 2008	335 4	42 9	7 8	483 6	869 7
Company					
At 1 January 2008	58 4	5 3	0 7	178 7	243 1
At 31 December 2008	335 4	42 9	7 8	483 7	869 8

10. Gain on disposal of loan books

During the first half of 2008 the Group sold £2,240 7m (net of provisions) of its residential equity release mortgage portfolio to JP Morgan Limited Total proceeds (net of costs) amounted to £2,289 8m The surplus on disposal amounted to £49 1m Included in the reported results for the year ended 31 December 2008 is net interest income of £0 9m in relation to those assets to the date of disposal

11. Net trading income

	2009 £m	2008 £m
Net losses on changes in fair value of assets held at fair value	**(10 7)**	(46 4)
Net income from financial assets designated at fair value	**-**	3 0
Fair value movements of future cash flows, excluding accruals, on derivatives not in hedge accounting relationships	**(2,391.6)**	9,465 7
Translation gains/(losses) on underlying instruments	**2,497 6**	(9,259 7)
	95.3	162 6

12. Income tax (expense)/credit

	2009 £m	2008 £m
The income tax (expense)/credit for the year comprises		
Current tax		
– on loss for the year	**(0 1)**	(0 4)
– adjustments in respect of prior years	**28 6**	(8 4)
Total current tax	**28 5**	(8 8)
Deferred tax (see note 25)		
– origination and reversal of temporary differences	**(13 0)**	75 8
– effect of UK tax rate change on deferred tax items	**–**	(1 2)
– write off of deferred income tax asset previously recognised	**(34 6)**	(19 6)
Total deferred tax	**(47 6)**	55 0
	(19 1)	46 2

The tax on the Group's loss before tax differs from the theoretical amount that would arise using the standard weighted average rate of UK corporation tax of 28% (2008 28 49%) as follows

	2009 £m	2008 £m
Loss before taxation	**(257 5)**	(1,355 9)
Tax calculated at rate of 28% (2008 28 49%)	**72 1**	386 3
Deferred income tax asset arising not recognised	**(95 7)**	(319 4)
Deferred income tax asset write off	**(34 6)**	(19 6)
Income not subject to tax	**44 6**	9 7
Expenses not deductible for tax purposes	**(5 5)**	(9 6)
Effect of UK tax rate change on deferred tax items	**–**	(1 2)
Income tax (expense) / credit	**(19 1)**	46 2

As detailed in notes 38 and 39, current and deferred income tax have also been credited direct to equity The deferred income tax credited amounts to £12 2m for the Group (2008 credit of £15 6m) and £13 0m for the Company (2008 charge of £4 8m) The current income tax charge amounts to £1 0m for both the Group and the Company (2008 credit of £3 6m)

13. Loss attributable to equity shareholders

Of the loss attributable to equity shareholders, £337 7m (2008 £1,245 6m) has been dealt with in the accounts of the Company As permitted by section 408 of the Companies Act 2006, the Company's income statement has not been presented separately

14 Analysis of financial assets and financial liabilities by measurement basis

2009

	Financial liabilities at amortised cost £m	Loans and receivables £m	Available for sale securities £m	Designated as held at fair value £m	Investment securities held as loans and receivables £m	Unsecured investment loans £m	IAS 39 held for trading £m	Fair value hedge £m	Cash flow hedge £m	Total £m
Financial assets										
Cash and balances with central banks	–	7,510 4	–	–	–	–	–	–	–	7,510 4
Derivative financial instruments	–	–	–	–	–	–	4,531 8	2,938 8	3 2	7,473 8
Loans and advances to banks	–	3,702 4	–	–	–	–	–	–	–	3,702 4
Loans and advances to customers	–	65,399 8	–	–	–	–	–	–	–	65,399 8
Investment securities and unsecured investment loans	–	–	168 5	–	2,561 0	358 3	–	–	–	3,087 8
Accrued income	–	15 1	–	–	–	–	–	–	–	15 1
	–	76,627 7	168 5	–	2,561 0	358 3	4,531 8	2,938 8	3 2	87,189 3
Non financial assets										256 2
										87,445 5
Financial liabilities										
Loans from Government	14,315 5	–	–	–	–	–	–	–	–	14,315 5
Deposits by banks	6,022 3	–	–	–	–	–	–	–	–	6,022 3
Customer accounts	20,607 6	–	–	–	–	–	–	–	–	20,607 6
Derivative financial instruments	–	–	–	–	–	–	139 8	1,377 8	156 2	1,673 8
Debt securities in issue	41,973 7	–	–	–	–	–	–	–	–	41,973 7
Accruals	385 0	–	–	–	–	–	–	–	–	385 0
Subordinated liabilities	935 0	–	–	–	–	–	–	–	–	935 0
Tier one notes	233 7	–	–	–	–	–	–	–	–	233 7
	84,472 8	–	–	–	–	–	139 8	1,377 8	156 2	86,146 6
Non financial liabilities										243 8
Total liabilities										86,390 4
Equity										1,055 1
										87,445 5

14. Analysis of financial assets and financial liabilities by measurement basis (continued)

2008

	Financial liabilities at amortised cost £m	Loans and receivables £m	Available for sale securities £m	Designated as held at fair value £m	Investment securities held as loans and receivables £m	Unsecured investment loans £m	IAS 39 held for trading £m	Fair value hedge £m	Cash flow hedge £m	Total £m
Financial assets										
Cash and balances with central banks	-	9,336 8	-	-	-	-	-	-	-	9,336 8
Derivative financial instruments	-	-	-	-	-	-	8,669 7	4,644 6	0 1	13,314 4
Loans and advances to banks	-	3,384 4	-	-	-	-	-	-	-	3,384 4
Loans and advances to customers	-	74,001 3	-	-	-	-	-	-	-	74,001 3
Investment securities and unsecured investment loans	-	-	422 5	11 5	2,952 8	422 4	-	-	-	3,809 2
Accrued income	-	99 3	-	-	-	-	-	-	-	99 3
	-	86,821 8	422 5	11 5	2,952 8	422 4	8,669 7	4,644 6	0 1	103,945 4
Non financial assets										400 6
										104,346 0
Financial liabilities										
Loans from Government	15,583 4	-	-	-	-	-	-	-	-	15,583 4
Deposits by banks	4,625 1	-	-	-	-	-	-	-	-	4,625 1
Customer accounts	20,722 7	-	-	-	-	-	-	-	-	20,722 7
Derivative financial instruments	-	-	-	-	-	-	194 6	1,757 1	269 1	2,220 8
Debt securities in issue	57,736 3	-	-	-	-	-	-	-	-	57,736 3
Accruals	908 5	-	-	-	-	-	-	-	-	908 5
Subordinated liabilities	1,514 9	-	-	-	-	-	-	-	-	1,514 9
Tier one notes	251 8	-	-	-	-	-	-	-	-	251 8
	101,342 7	-	-	-	-	-	194 6	1,757 1	269 1	103,563 5
Non financial liabilities										148 9
Total liabilities										103,712 4
Equity										633 6
										104,346 0

15. Cash and balances with central banks

	Group and Company	
	2009 £m	2008 £m
Cash in hand	**9 9**	9 4
Balances with Bank of England for liquidity purposes	**3,590 2**	6,611 9
Collateral balances with Bank of England	**3,846 5**	2,551 7
Other balances with central banks	**-**	112 4
Included in cash and cash equivalents	**7,446 6**	9,285 4
Mandatory reserve deposits with central banks	**63 8**	51 4
	7,510 4	9,336 8

Mandatory reserve deposits with central banks are not available for use in day to day operations

At 31 December 2009 £9 9m was held for resale

16. Derivative financial instruments

Strategy in using derivative financial instruments

The Board has authorised the use of derivative instruments for the purpose of supporting the strategic and operational business activities of the Group and reducing the risk of loss arising from changes in interest rates and exchange rates All use of derivative instruments within the Group is to hedge risk exposure, and the Group takes no trading positions in derivatives

The objective, when using any derivative instrument, is to ensure that the risk to reward profile of any transaction is optimised The intention is to only use derivatives to create economically effective hedges However, because of the specific requirements of IAS 39 to obtain hedge accounting, not all economic hedges are designated as accounting hedges, either because natural accounting offsets are expected or because obtaining hedge accounting would be especially onerous

16. Derivative financial instruments (continued)

a) Fair value hedges
The Group designates a number of derivatives as fair value hedges In particular the Group has three approaches establishing relationships for

i) Hedging the interest rate and foreign currency exchange rate risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps

ii) Hedging of interest rate risk of a single currency portfolio of sterling, US Dollar or Euro non-prepayable fixed rate assets/liabilities on a one-for-one basis with vanilla fixed/floating or floating/fixed interest rate swaps

iii) Hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages The Group believes this solution is the most appropriate as it is consistent with its policy for hedging fixed rate mortgages on an economic basis

The total fair value of derivatives included within fair value hedges at 31 December 2009 was a net asset of £1,561 0m (2008 net asset of £2,887 5m)

b) Cash flow hedges
The Group designates a number of derivatives as cash flow hedges In particular, the Group adopts an approach of using fixed interest rate swaps in a cash flow hedge strategy to economically hedge the interest rate risk associated with the mortgage pipeline The accounting hedge relationship is to hedge floating rate sterling liabilities The total fair value of derivatives included within cash flow hedges at 31 December 2009 was a net liability of £153 0m (2008 net liability of £269 0m)

c) Net investment hedges
The Group has not designated any derivatives as net investment hedges in 2009 or 2008

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 analysis below therefore splits derivatives between those in accounting hedge relationships and those in economic hedge relationships but not in accounting hedge relationships

	2009			2008		
	Contract/ notional amount	**Fair values**		Contract/ notional amount	Fair values	
Group	**£m**	**Assets £m**	**Liabilities £m**	£m	Assets £m	Liabilities £m
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges						
Interest rate swaps	**35,812 6**	**217 5**	**(1,377 8)**	42,289 4	272 1	(1,757 1)
Cross currency interest rate swaps	**7,149 6**	**2,721 3**	**-**	8,858 2	4,372 5	-
	42,962.2	**2,938 8**	**(1,377 8)**	51,147 6	4,644 6	(1,757 1)
Derivatives designated as cashflow hedges						
Interest rate swaps	**4,468 5**	**3 2**	**(156 2)**	7,299 5	0 1	(269 1)
	4,468 5	**3 2**	**(156 2)**	7,299 5	0 1	(269 1)
	47,430 7	**2,942 0**	**(1,534 0)**	58,447 1	4,644 7	(2,026 2)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives						
Interest rate swaps	**38,335 6**	**102 9**	**(58 9)**	7,446 0	190 5	(39 4)
Caps, floors and options	**40 0**	**2 2**	**-**	240 0	9 4	-
Equity index swaps	**4 2**	**-**	**-**	4 2	-	(0 1)
Embedded derivatives	**4 2**	**-**	**-**	4 4	-	-
	38,384 0	**105 1**	**(58 9)**	7,694 6	199 9	(39 5)
Currency derivatives						
Cross currency swaps	**19,581 3**	**4,426 7**	**(76 7)**	25,741 6	8,466 2	(144 0)
Forward foreign exchange	**818 2**	**-**	**(4 2)**	86 0	3 6	(11 1)
	20,399 5	**4,426 7**	**(80 9)**	25,827 6	8,469 8	(155 1)
Total derivatives in economic hedging relationships	**58,783 5**	**4,531 8**	**(139 8)**	33,522 2	8,669 7	(194 6)
Total recognised derivative assets/(liabilities)	**106,214 2**	**7,473 8**	**(1,673.8)**	91,969 3	13,314 4	(2,220 8)

16. Derivative financial instruments (continued)

Company	2009 Contract/ notional amount £m	2009 Fair values Assets £m	2009 Fair values Liabilities £m	2008 Contract/ notional amount £m	2008 Fair values Assets £m	2008 Fair values Liabilities £m
Derivatives in accounting hedge relationships						
Derivatives designated as fair value hedges						
Interest rate swaps	**35,564 1**	**211 1**	**(1,377 8)**	41,937 2	261 5	(1,757 1)
Cross currency interest rate swaps	**7,149 6**	**2,721 3**	**-**	8,858 2	4,372 5	–
	42,713 7	**2,932 4**	**(1,377 8)**	50,795 4	4,634 0	(1,757 1)
Derivatives designated as cashflow hedges						
Interest rate swaps	**4,468 5**	**3 2**	**(156 2)**	7,299 5	0 1	(269 1)
	4,468 5	**3 2**	**(156 2)**	7,299 5	0 1	(269 1)
	47,182 2	**2,935 6**	**(1,534 0)**	58,094 9	4,634 1	(2,026 2)
Derivatives in economic hedging relationships but not in accounting hedge relationships						
Interest rate derivatives						
Interest rate swaps	**38,335 6**	**102 9**	**(58 9)**	7,446 0	190 5	(39 4)
Caps, floors and options	**40 0**	**2 2**	**-**	240 0	9 4	–
Equity index swaps	**4 2**	**-**	**-**	4 2	–	(0 1)
Embedded derivatives	**4 2**	**-**	**-**	4 4	–	–
	38,384 0	**105 1**	**(58 9)**	7,694 6	199 9	(39 5)
Currency derivatives						
Cross currency swaps	**2,749 2**	**419 0**	**(71 7)**	5,041 9	1,207 8	(144 0)
Forward foreign exchange	**818 2**	**-**	**(4 2)**	–	–	–
	3,567 4	**419 0**	**(75 9)**	5,041 9	1,207 8	(144 0)
Total derivatives in economic hedging relationships	**41,951 4**	**524 1**	**(134 8)**	12,736 5	1,407 7	(183 5)
Total recognised derivative assets/(liabilities)	**89,133 6**	**3,459 7**	**(1,668 8)**	70,831 4	6,041 8	(2,209 7)

(Losses)/gains on fair value hedges

	2009 £m	2008 £m
On hedging instruments	**(693 2)**	2,494 2
On the hedged items attributable to the hedged risk	**632 3**	(2,579 6)
Fair value hedge ineffectiveness	**(60 9)**	(85 4)

Fair value hedge ineffectiveness recorded within interest income in the income statement amounted to a charge of £216 3m (2008 charge of £64 0m) Fair value hedge ineffectiveness recorded within interest expense in the income statement amounted to a credit of £155 4m (2008 charge of £21 4m)

Cash flow hedges

Periods when cash flows are expected to occur and affect the income statement

	2009 £m	2008 £m
Within one year	**(95 4)**	(175 9)
In one to five years	**(32 8)**	(94 0)
Over five years	**2.2**	-
	(126 0)	(269 9)

Cash flow hedge ineffectiveness recorded within interest expense in the income statement amounted to a charge of £40 8m in 2009 (2008 credit of £16 5m)

17. Loans and advances to banks

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Fixed rate	**1,692 7**	2,335 1	**1,679 3**	2,326 7
Variable rate	**2,009 7**	1,049 3	**1,873 3**	909 4
	3,702 4	3,384 4	**3,552 6**	3,236 1

At 31 December 2009 £865 6m was held for sale in the Group and £864 6m in the Company

18. Loans and advances to customers

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Advances secured on residential property not subject to securitisation	**27,336 0**	28,679 0	**27,336.0**	28,679 0
Advances secured on residential property subject to securitisation	**27,254 4**	32,325 0	**27,254 4**	32,325 0
	54,590 4	61,004 0	**54,590 4**	61,004 0
Residential buy to let loans not subject to securitisation	**5,477 3**	5,695 7	**5,477 3**	5,695 7
Total advances secured on residential property	**60,067 7**	66,699 7	**60,067 7**	66,699 7
Commercial secured advances not subject to securitisation	**287 9**	301 7	**287 9**	301 7
Unsecured loans not subject to securitisation	**3,912 6**	5,298 0	**3,912.6**	5,298 0
Amounts due from subsidiary undertakings	**–**	–	**80 7**	172 0
	64,268 2	72,299 4	**64,348 9**	72,471 4
Fixed rate	**29,987.4**	47,575 5	**29,987 4**	47,575 5
Variable rate	**34,280 8**	24,723 9	**34,361.5**	24,895 9
	64,268 2	72,299 4	**64,348 9**	72,471 4

At 31 December 2009 £10,343 3m was held for resale in both Group and Company

Fair value adjustments of portfolio hedging amounting to £1,131 6m (2008 £1,701 9m) relate to fair value adjustments of loans and advances to customers in relation to interest rate risk as a result of their inclusion in a fair value portfolio hedge relationship At 31 December 2009 £160 3m of this balance was held for resale in both Group and Company

19. Securitisation

The Group's results include the results and assets and liabilities of securitisation Special Purpose Entities ("SPEs"), none of which qualify for derecognition under IAS 39, on a line by line basis Securitised advances are subject to non-recourse finance arrangements These loans have been purchased at par from Northern Rock (Asset Management) plc, and have been funded through the issue of mortgage-backed bonds by the SPEs The balances of assets subject to securitisation notes in issue at 31 December 2009 are as follows

2009

	Gross assets securitised £m	**Notes in issue £m**
Granite Finance Funding Limited	4,461 8	4,536 8
Granite Finance Funding 2 Limited	20,988 9	23,816 7
	25,450 7	28,353 5
Retained interest in Granite Finance Trustees Limited	3,709 2	
Less cash deposits held with Northern Rock (Asset Management) plc	(1,777 1)	
Total	27,382 8	28,353 5

The retained interest in Granite Finance Trustees Limited represents Northern Rock (Asset Management) plc's share of the assets held by Granite Finance Trustees Limited

19 Securitisation (continued)

Gross assets securitised and notes in issue as presented above reconcile to amounts included in the consolidated balance sheet within loans and advances to customers and debt securities in issue as follows

	Gross assets securitised £m	Notes in issue £m
Total as above	27,382 8	28,353 5
Less cash deposits with third parties included within loans and advances to banks	(128 4)	
Less accrued interest on loan notes included within accruals and deferred income		(9 6)
Add loan notes issued by Whinstone Limited (see below)		458 0
Total advances subject to securitisation (see note 18)	27,254 4	
Total securitised notes as per consolidated balance sheet		28,801 9

2008

	Gross assets securitised £m	Notes in issue £m
Granite Finance Funding Limited	5,557 9	5,980 3
Granite Finance Funding 2 Limited	25,824 3	31,566 0
	31,382 2	37,546 3
Retained interest in Granite Finance Trustees Limited	3,253 8	
Less cash deposits held with Northern Rock (Asset Management) plc	(2,182 6)	
Total	32,453 4	37,546 3

The retained interest in Granite Finance Trustees Limited represents Northern Rock (Asset Management) plc's share of the assets held by Granite Finance Trustees Limited

Gross assets securitised and notes in issue as presented above reconcile to amounts included in the consolidated balance sheet within loans and advances to customers and debt securities in issue as follows

	Gross assets securitised £m	Notes in issue £m
Total as above	32,453 4	37,546 3
Less cash deposits with third parties included within loans and advances to banks	(128 4)	
Less accrued interest on loan notes included within accruals and deferred income		(45 1)
Add loan notes issued by Whinstone Limited (see below)		485 7
Total advances subject to securitisation (see note 18)	32,325 0	
Total securitised notes as per consolidated balance sheet		37,986 9

At 31 December 2009 the SPEs had cash deposits with Northern Rock (Asset Management) plc amounting to £4,061 3m, including collateral deposits of £2,284 2m (31 December 2008 £3,146 7m including collateral deposits of £964 1m) This balance (excluding the collateral deposits) is restricted in use to the repayment of the debt securities issued by the SPEs and other legal obligations

Many of the securitised notes are issued in foreign currency and are translated into sterling at exchange rates prevailing at 31 December All issuance in foreign currency is subject to cross currency swaps that provide the amounts of foreign currency required to repay the notes in exchange for an amount of sterling fixed at the outset of the securitisation, thereby protecting against foreign exchange risk. At 31 December 2009 there is a gross derivative asset on derivatives economically hedging the foreign currency notes of £4,014 1m (31 December 2008 £7,269 0m) The value of the loans assigned to the bankruptcy remote special purpose vehicles exceed the value of sterling required under the foreign exchange swaps, and therefore the debt securities in issue are more than covered by loan assets allocated for this purpose

On 11 November 2008, as a result of a breach of a non asset trigger, the Granite Master Trust ("the Trust") moved into pass through The main consequence of this is that the repayments of the loan notes no longer adhere to the controlled amortisation schedules detailed in the SPEs' offering circulars All principal cash received by the Trust is allocated between Granite Finance Funding Limited and Granite Finance Funding 2 Limited in accordance with their respective shares of the Trust's property as at 1 November 2008, this being the last determination date prior to the breach of the non asset trigger The principal cash allocated to Granite Finance Funding Limited is then distributed pro-rata between the relevant issuers in the Granite Finance Funding Limited group by reference to the size of their inter-company loans outstanding with Granite Finance Funding Limited at each determination date The principal cash received by the issuers is utilised in full on each quarterly payment date to make repayments in respect of the loan notes The priority of loan note repayment is by reference to their original credit ratings on issue, with AAA notes repaid first, then AA notes, then A notes and finally BBB notes The principal cash allocated to Granite Finance Funding 2 Limited is used to repay the loan from Granite Master Issuer plc, which in turn uses the cash to repay the loan notes in issue by reference to their original credit ratings on issue in the same manner as detailed above The average time taken to repay the loan notes is now expected to be significantly extended beyond the maturity profiles envisaged by the original controlled amortisation schedules It is therefore highly unlikely that the loan notes will be called on their step up and call dates

19. Securitisation (continued)

On 15 November 2005, Northern Rock entered into a financial guarantee contract with Whinstone Capital Management Limited, a special purpose entity, in respect of £423 0m of the first loss reserve funds held by the Granite securitisation entities repayable to Northern Rock only after repayment of all other liabilities Whinstone Capital Management Limited simultaneously issued credit linked notes to the value of £423 0m in respect of which there were no repayments during 2009 (2008 £104 0m) The remaining credit linked notes of £221 2m are included within debt securities in issue at year end exchange rates where issued in currencies other than sterling As a consequence of the Granite Master Trust entering pass through in 2008 the expected maturity of the notes issued by Whinstone Capital Management Limited has been significantly extended It is highly likely that the notes will not be called on their step up and call dates

On 20 June 2006, Northern Rock entered into a financial guarantee contract with Whinstone Capital Management 2 Limited, a special purpose entity, in respect of £168 5m of the first loss reserve funds held by the Granite securitisation entities repayable to Northern Rock only after repayment of all other liabilities Whinstone Capital Management 2 Limited simultaneously issued credit linked notes to the value of £168 5m which are included within debt securities in issue at year end exchange rates where issued in currencies other than sterling As a consequence of the Granite Master Trust entering pass through in 2008 the expected maturity of the notes issued by Whinstone Capital Management 2 Limited has been significantly extended It is highly likely that the notes will not be called on their step up and call dates

20. Covered bonds

Included within loans and advances to customers not subject to securitisation are £11,953 2m (2008 £9,686 5m) of mortgage advances assigned to a bankruptcy remote special purpose vehicle The value of loans assigned has increased mainly as a consequence of changes in rating agency methodologies that have demanded greater over-collateralisation to allow the asset coverage test, required by the transaction documentation, to be passed These loans provide security to issues of covered bonds made by the Company, which are included within debt securities in issue amounting to £9,866 1m (2008 £12,550 3m) The Company retains substantially all the risks and rewards associated with these loans and therefore these transactions do not qualify for derecognition under IAS 39 Most of the covered bonds are issued in foreign currency and are translated into sterling at exchange rates prevailing at 31 December The decrease in the value in issuance in 2009 is due to the redemption of covered bond 04-1 and changes in foreign exchange rates No new notes were issued during 2009 or 2008 All issuance in foreign currency is subject to cross currency swaps that provide the amounts of foreign currency required to repay the notes in exchange for an amount of sterling fixed at the issue of the bond, thereby protecting against foreign exchange risk. At 31 December 2009 there is a gross derivative asset on derivatives economically hedging the foreign currency notes of £2,689 2m (2008 £4,071 2m) The value of the loans assigned to the bankruptcy remote special purpose vehicle exceed the value of sterling required under the foreign exchange swaps, and therefore the debt securities in issue are more than covered by loan assets allocated for this purpose

21. Investment securities and unsecured investment loans

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Available for sale securities	**168 5**	422 5	**115 1**	261 9
Assets held at fair value through the income statement	**-**	11 5	**-**	11 5
Investment securities held as loans and receivables	**2,561 0**	2,952 8	**2,561 0**	2,952 8
Unsecured investment loans	**358 3**	422 4	**358 3**	422 4
	3,087 8	3,809 2	**3,034 4**	3,648 6

a) Available for sale securities

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
At fair value				
Listed	**85.6**	216 3	**78 9**	100 8
Unlisted	**82 9**	206 2	**36 2**	161 1
	168 5	422 5	**115 1**	261 9
Fixed rate	**125 5**	281 9	**78 8**	224 9
Variable rate	**43 0**	140 6	**36.3**	37 0
	168 5	422 5	**115 1**	261 9

21. Investment securities and unsecured investment loans (continued)

The movement in available for sale securities was as follows

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
At 1 January	**422 5**	6,002 7	**261.9**	10,786 6
Additions	**311 0**	326 8	**204 6**	120 4
Disposals (sales and redemptions)	**(549 8)**	(2,569 9)	**(339 6)**	(7,313 5)
Exchange differences	**(11 4)**	183 7	**(11 4)**	183 8
Net losses on changes in fair value	**(3 8)**	(607 4)	**(0 4)**	(602 0)
Assets reclassified from available for sale to loans and receivables	**-**	(2,913 4)	**-**	(2,913 4)
At 31 December	**168 5**	422 5	**115 1**	261 9

Losses on available for sale securities are analysed as follows

	2009	2008
	£m	£m
(Losses)/gains on disposal of available for sale securities	**(6 8)**	44 4
Impairment losses on available for sale securities	**(5 5)**	(53 4)
	(12 3)	(9 0)

Losses of £6 8m (2008 gains of £44 4m) previously recognised in reserves have been transferred to the income statement on the disposal of available for sale securities

b) Assets held at fair value through the income statement

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
At fair value				
Listed	**-**	11 5	**-**	11 5
Unlisted	**-**	-	**-**	-
	-	11 5	**-**	11 5
Fixed rate	**-**	-	**-**	-
Variable rate	**-**	11 5	**-**	11 5
	-	11 5	**-**	11 5

The movement in assets held at fair value through the income statement was as follows

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
At 1 January	**11 5**	106 0	**11 5**	106 0
Disposals	**-**	(60 1)	**-**	(60 1)
Exchange differences	**(0 8)**	12 2	**(0.8)**	12 2
Net losses on changes in fair value	**(10.7)**	(46 6)	**(10.7)**	(46 6)
At 31 December	**-**	11 5	**-**	11 5

Certain securities which contain an embedded derivative are classified as held at fair value through the income statement Fair value is based on quoted prices in an active market The Group has not reclassified any financial assets between those held at amortised cost and those held at fair value during the year (2008 £nil)

21. Investment securities and unsecured investment loans (continued)

c) Investment securities held as loans and receivables

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Carrying value	**2,561 0**	2,952 8	**2,561 0**	2,952 8
Fair value	**2,312 4**	2,693 2	**2,312 4**	2,693 2
Listed	**2,521 8**	2,896 1	**2,521 8**	2,896 1
Unlisted	**39 2**	56 7	**39 2**	56 7
	2,561 0	2,952 8	**2,561 0**	2,952 8
Fixed rate	**65 9**	75 9	**65 9**	75 9
Variable rate	**2,495 1**	2,876 9	**2,495 1**	2,876 9
	2,561 0	2,952 8	**2,561 0**	2,952 8

In 2008, a pool of asset backed securities and floating rate notes were reclassified from available for sale to loans and receivables under the terms of IAS 39 paragraph 50E If the financial assets had not been reclassified, fair value gains recognised in the available for sale reserve in 2009 would have been £271 2m (2008 losses of £(994 9)m)

d) Unsecured investment loans

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Fixed rate	**-**	16 5	**-**	16 5
Variable rate	**358 3**	405 9	**358 3**	405 9
	358 3	422 4	**358 3**	422 4

Unsecured investment loans were previously reported in loans and advances to customers but have been reclassified to investment securities and unsecured investment loans to facilitate improved presentation

	2009	2008
	£m	£m
Impairment allowance on unsecured investment loans	**333 5**	423 2

Impairment credits on investments securities reclassified as loans and receivables and unsecured investment loans are £6 2m (2008 losses of £267 6m)

At 31 December 2009 £424 0m in respect of available for sale securities and investment securities held as loans and receivables was held for resale in both the Group and Company

22 Shares in group undertakings

	Company
	£m
Cost	
At 1 January 2009 and 31 December 2009	85 0

The Company's interests in subsidiary undertakings are analysed as follows

	2009	2008
	£m	£m
Credit institutions	**50 0**	50 0
Other	**35 0**	35 0
	85 0	85 0

The Directors consider the value of investments to be supported by their underlying assets

At 31 December 2009 £50 0m was held for resale

22. Shares in group undertakings (continued)

The principal subsidiaries of Northern Rock (Asset Management) plc at 31 December 2009 are listed below, all of which operate in their country of incorporation or registration

The following subsidiaries are directly held and wholly owned by the Company

	Nature of business	Country of incorporation
Northern Rock Mortgage Indemnity Company Limited	Provision of mortgage indemnity insurance	Guernsey
Northern Rock (Guernsey) Limited	Retail deposit taker	Guernsey

The following companies are SPEs established in connection with the Group's securitisation programme (see note 19) Although the Company has no direct or indirect ownership interest in these companies, they are regarded as legal subsidiaries under UK companies legislation This is because they are principally engaged in providing a source of long term funding to the Group, which in substance has the rights to all benefits from the activities of the SPEs They are therefore effectively controlled by the Group

	Nature of business	Country of incorporation
Granite Mortgages 03-2 plc	Issue of securitised notes	England & Wales
Granite Mortgages 03-3 plc	Issue of securitised notes	England & Wales
Granite Mortgages 04-1 plc	Issue of securitised notes	England & Wales
Granite Mortgages 04-2 plc	Issue of securitised notes	England & Wales
Granite Mortgages 04-3 plc	Issue of securitised notes	England & Wales
Granite Master Issuer plc	Issue of securitised notes	England & Wales
Granite Finance Trustees Limited	Holding of interests in securitisations	Jersey
Granite Finance Funding Limited	Holding company	Jersey
Granite Finance Funding No 2 Limited	Holding company	England & Wales
Whinstone Capital Management Limited	Issue of credit linked notes	Jersey
Whinstone Capital Management 2 Limited	Issue of credit linked notes	Jersey

The Directors consider that to give full particulars of all subsidiary undertakings would lead to a statement of excessive length A full list of subsidiary undertakings at 31 December 2009 will be annexed to the Company's next Annual Return to be filed at Companies House

23 Intangible assets

Group	Goodwill £m	Software £m	Total £m
2009			
Cost			
At 1 January 2009	30 7	159 8	190 5
Additions	-	1 5	1 5
Disposals	-	(0 2)	(0 2)
At 31 December 2009	30 7	161 1	191 8
Impairment and amortisation			
At 1 January 2009	-	125 6	125 6
Amortisation charged in year	-	12 5	12 5
Adjustment arising on disposals	-	(0 1)	(0 1)
At 31 December 2009	-	138 0	138 0
Net book amount			
At 31 December 2009	30 7	23 1	53 8

	Goodwill £m	Software £m	Total £m
2008			
Cost			
At 1 January 2008	30 7	152 2	182 9
Additions	-	7 6	7 6
At 31 December 2008	30 7	159 8	190 5
Impairment and amortisation			
At 1 January 2008	-	87 1	87 1
Amortisation charged in year	-	11 3	11 3
Impairment charged in year	-	27 2	27 2
At 31 December 2008	-	125 6	125 6
Net book amount			
At 31 December 2008	30 7	34 2	64 9

23. Intangible assets (continued)

Company	Software £m	Total £m
2009		
Cost		
At 1 January 2009	159 8	159 8
Additions	1 5	1 5
Disposals	(0 2)	(0 2)
At 31 December 2009	161 1	161 1
Impairment and amortisation		
At 1 January 2009	125 6	125 6
Amortisation charged in year	12 5	12 5
Adjustment arising on disposals	(0 1)	(0 1)
At 31 December 2009	138 0	138 0
Net book amount		
At 31 December 2009	23 1	23 1

	Software £m	Total £m
2008		
Cost		
At 1 January 2008	152 2	152 2
Additions	7 6	7 6
At 31 December 2008	159 8	159 8
Impairment and amortisation		
At 1 January 2008	87 1	87 1
Amortisation charged in year	11 3	11 3
Impairment charged in year	27 2	27 2
At 31 December 2008	125 6	125 6
Net book amount		
At 31 December 2008	34 2	34 2

Impairment losses of £nil have arisen in 2009 (2008 £27 2m) in both the Group and Company representing the costs associated with the accelerated amortisation of software no longer required after the restructuring of the business

At 31 December 2009 £23 1m was held for resale in both the Group and Company

24. Property, plant and equipment

Group **2009**	Land and buildings Freehold £m	 Long leasehold £m	 Short leasehold £m	Plant, equipment, fixtures, fittings and vehicles £m	Assets in the course of construction £m	Total £m
Cost						
At 1 January 2009	90 3	19 2	7 6	171 2	59 3	347 6
Additions	0 2	0 3	0 1	5 0	0 2	5 8
Disposals	(3 4)	(0 3)	(0 2)	(10 1)	(59 5)	(73 5)
At 31 December 2009	87 1	19 2	7 5	166 1	-	279 9
Depreciation						
At 1 January 2009	7 6	2 5	4 2	109 4	25 5	149 2
Charged in year	0 2	0 1	0 5	10 6	–	11 4
Impairment reversals	–	–	–	–	(5 3)	(5 3)
Adjustment arising on disposals	(2 9)	–	(0 3)	(6 6)	(20 2)	(30 0)
At 31 December 2009	4 9	2 6	4 4	113 4	–	125 3
Net book amount						
At 31 December 2009	82 2	16 6	3 1	52 7	–	154 6

2008	Land and buildings Freehold £m	 Long leasehold £m	 Short leasehold £m	Plant, equipment, fixtures, fittings and vehicles £m	Assets in the course of construction £m	Total £m
Cost						
At 1 January 2008	91 9	19 9	7 8	171 4	56 3	347 3
Additions	0 2	-	–	1 7	3 0	4 9
Transfers	(1 6)	–	–	1 6	–	–
Disposals	(0 2)	(0 7)	(0 2)	(3 5)	–	(4 6)
At 31 December 2008	90 3	19 2	7 6	171 2	59 3	347 6
Depreciation						
At 1 January 2008	6 8	2 2	3 8	94 2	56 3	163 3
Charged in year	1 0	0 3	0 5	10 0	–	11 8
Impairment losses/(reversals)	–	–	-	7 2	(30 8)	(23 6)
Adjustment arising on disposals	(0 2)	–	(0 1)	(2 0)	–	(2 3)
At 31 December 2008	7 6	2 5	4 2	109 4	25 5	149 2
Net book amount						
At 31 December 2008	82 7	16 7	3 4	61 8	33 8	198 4

24. Property, plant and equipment (continued)

Company 2009	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Plant, equipment, fixtures, fittings and vehicles £m	Assets in the course of construction £m	Total £m
Cost						
At 1 January 2009	50 9	67 7	7 6	147 2	59 3	332 7
Additions	48 9	0 3	0 1	28 7	0 2	78 2
Disposals	(3 4)	(50 6)	(0 2)	(10 1)	(59 5)	(123 8)
At 31 December 2009	96 4	17 4	7 5	165 8	–	287 1
Depreciation						
At 1 January 2009	5 8	6 4	4 2	103 7	25 5	145 6
Charged in year	1 5	0 6	0 5	15 2	–	17 8
Impairment reversals	–	–	–	–	(5 3)	(5 3)
Adjustment arising on disposals	(2 9)	(4 4)	(0 3)	(6 6)	(20 2)	(34 4)
At 31 December 2009	4 4	2 6	4 4	112 3	–	123 7
Net book amount						
At 31 December 2009	92 0	14 8	3 1	53 5	–	163 4

2008	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Plant, equipment, fixtures, fittings and vehicles £m	Assets in the course of construction £m	Total £m
Cost						
At 1 January 2008	52 5	68 4	7 8	147 4	56 3	332 4
Additions	0 2	–	–	1 7	3 0	4 9
Transfers	(1 6)	–	–	1 6	–	–
Disposals	(0 2)	(0 7)	(0 2)	(3 5)	–	(4 6)
At 31 December 2008	50 9	67 7	7 6	147 2	59 3	332 7
Depreciation						
At 1 January 2008	5 4	5 5	3 8	89 3	56 3	160 3
Charged in year	0 6	0 9	0 5	9 2	–	11 2
Impairment losses/(reversals)	–	–	–	7 2	(30 8)	(23 6)
Adjustment arising on disposals	(0 2)	–	(0 1)	(2 0)	–	(2 3)
At 31 December 2008	5 8	6 4	4 2	103 7	25 5	145 6
Net book amount						
At 31 December 2008	45 1	61 3	3 4	43 5	33 8	187 1

Impairment credits of £5 3m have arisen in 2009 (2008 £23 6m) in both the Group and Company due primarily to reversals of impairments made in 2007 in respect of properties in the course of construction

At 31 December 2009 £32 7m was held for resale in both the Group and Company

25. Deferred income tax assets and liabilities

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deferred income tax assets	**-**	35 2	**-**	-
Deferred income tax liabilities	**(7 1)**	(6 9)	**(3 8)**	(3 8)
	(7 1)	28 3	**(3 8)**	(3 8)

The full movement in deferred income tax (payable)/recoverable was as follows

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
At 1 January	**28 3**	(45 5)	**(3 8)**	(19 7)
Income statement (charge)/credit	**(47 6)**	55 0	**(13 0)**	17 5
Appropriations credit	**-**	3 2	**-**	3 2
Deferred tax impact charged direct to equity				
– revaluation reserve – available for sale investments	**0 1**	22 7	**0 9**	2 3
– actuarial losses recognised in other comprehensive income	**12 1**	(7 1)	**12 1**	(7 1)
At 31 December	**(7 1)**	28 3	**(3 8)**	(3 8)

Deferred income tax assets and liabilities are attributable to the following items

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deferred income tax assets				
Derivative financial instruments	**-**	34 6	**-**	-
Pensions and other retirement benefits	**0 8**	-	**0 8**	-
Other temporary differences	**0 1**	0 1	**0 1**	0 1
Tax losses	**10 9**	23 5	**10.9**	23 5
	11 8	58 2	**11 8**	23 6
Deferred income tax liabilities				
Pensions and other retirement benefits	**-**	(9 1)	**-**	(9 1)
Excess of capital allowances over depreciation	**(0 1)**	(1 2)	**-**	(1 1)
Available for sale securities	**(1 7)**	(1 0)	**(1.9)**	(1 9)
Unremitted earnings from overseas subsidiary	**(3 4)**	(3 3)	**-**	-
Rolled over gains	**(3 8)**	(3 8)	**(3 8)**	(3 8)
Change in accounting basis on adoption of IFRS	**(9 9)**	(11 5)	**(9 9)**	(11 5)
	(18 9)	(29 9)	**(15 6)**	(27 4)
Net deferred income tax (liability)/asset	**(7 1)**	28 3	**(3 8)**	(3 8)
Disclosed as deferred income tax assets	**-**	35 2	**-**	-
Disclosed as deferred income tax liabilities	**(7 1)**	(6 9)	**(3 8)**	(3 8)
	(7 1)	28 3	**(3 8)**	(3 8)

Deferred tax assets and liabilities are offset only to the extent that there is a legally enforceable right to set off and the balances relate to income tax payable to the same taxation authority by either the same taxable entity or different taxable entities within the same tax group where there is the intention and ability to settle on a net basis or realise the assets and liabilities simultaneously

The amount of deferred tax asset expected to be recovered after more than twelve months for the Group is £nil (2008 £35 2m)

The amount of deferred tax liability expected to be settled after more than twelve months is £7 1m (2008 £6 9m) for the Group and £3 8m (2008 £3 8m) for the Company

IAS 12 requires that deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised Where the entity has a history of recent losses, deferred tax is only recognised to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profits will be available A deferred tax asset should only be recognised to the extent that the Group will realise taxable profits arising from the reversal of existing taxable temporary differences Accordingly, deferred tax assets have not been recognised in respect of the following items

25. Deferred income tax assets and liabilities (continued)

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Deductible temporary differences (gross)	**427 9**	544 6	**427 9**	544 6
Unused tax losses (gross)	**1,700 3**	1,615 9	**1,700 3**	1,615 9
	2,128 2	2,160 5	**2,128 2**	2,160 5

Under current tax legislation these unprovided deductible temporary differences and unused tax losses do not have an expiry date and can therefore be recognised in future as taxable profits arise

Deferred income tax liabilities have not been established for tax that would be payable if earnings of the Group's overseas subsidiaries were remitted to the UK Such amounts are either reinvested for the foreseeable future or are expected to be remitted free of tax Unremitted earnings at 31 December 2009 totalled £39 6m (2008 £42 7m)

The deferred tax charge/(credit) in the income statement comprises the following temporary differences

	2009 £m	2008 £m
Pensions and other employee benefits	**2 6**	-
Derivative financial instruments	**34 6**	(10 3)
Excess of capital allowances over depreciation	**(1 1)**	(6 4)
Change in accounting basis on adoption of IFRS	–	21 3
Tax losses	**11.4**	(20 6)
Dividend from overseas subsidiary	–	(15 1)
Unremitted earnings from overseas subsidiary	**0 1**	(27 1)
Rolled over gains	-	1 8
Other temporary differences	-	1 4
	47 6	(55 0)

26. Loans from Government

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Amount due to HM Treasury	**14,315 5**	15,583 4	**14,315 5**	15,583 4

The amount due to HM Treasury was novated from the Bank of England on 28 August 2008 with unchanged terms and conditions On 28 October 2009 on receipt of State aid, the loan remains repayable on demand and the interest payable changed from a margin above the Bank Base Rate to a margin above LIBOR

27. Deposits by banks

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Amounts due to subsidiaries	–	–	**1,014 1**	1,156 1
Other deposits	**6,022 3**	4,625 1	**3,738 1**	3,661 1
	6,022 3	4,625 1	**4,752 2**	4,817 2
Fixed rate	**235 3**	145 0	**235 3**	145 0
Variable rate	**5,787 0**	4,480 1	**4,516 9**	4,672 2
	6,022 3	4,625 1	**4,752 2**	4,817 2

At 31 December 2009 £235 3m was held for resale within the Group and £1,249 4m within the Company

28. Customer accounts

	Group		Company	
	2009 **£m**	2008 £m	**2009** **£m**	2008 £m
Retail funds and deposits	**19,478 2**	19,622 8	**18,542 2**	18,553 8
Amounts due to securitisation special purpose entities	**-**	-	**26,819 4**	31,526 7
Other customer accounts	**1,129 4**	1,099 9	**1,129 4**	1,099 9
	20,607 6	20,722 7	**46,491 0**	51,180 4
Fixed rate	**12,383 8**	9,992 5	**11,698 2**	9,336 3
Variable rate	**8,223 8**	10,730 2	**34,792 8**	41,844 1
	20,607 6	20,722 7	**46,491 0**	51,180 4

Amounts due to securitisation special purpose entities represent the beneficial interests held in mortgage portfolios by securitisation special purpose entities (see note 19) Because the mortgage loans do not qualify for derecognition from Northern Rock's balance sheet, the securitisation special purpose entities' beneficial interests in the mortgage portfolios are represented by a deemed loan to Northern Rock. This is equivalent in value to the beneficial interest in the mortage portfolios plus associated inter group balances directly relating to the beneficial interests in the mortgage portfolios

At 31 December 2009 £20,607 6m was held for resale within the Group and £19,671 6m within the Company

29 Other debt securities in issue

	Group		Company	
	2009 **£m**	2008 £m	**2009** **£m**	2008 £m
Bonds and medium term notes	**3,305 7**	6,752 6	**3,305.7**	6,752 6
Other debt securities in issue	**-**	446 5	**-**	446 5
	3,305 7	7,199 1	**3,305 7**	7,199 1
Fixed rate	**332 5**	894 7	**332 5**	894 7
Variable rate	**2,973 2**	6,304 4	**2,973 2**	6,304 4
	3,305 7	7,199 1	**3,305 7**	7,199 1

30. Accruals and deferred income

	Group		Company	
	2009 **£m**	2008 £m	**2009** **£m**	2008 £m
Accrued interest	**382 2**	885 6	**363 2**	833 4
Deferred income	**0 6**	1 0	**0 6**	1 0
Other accruals	**58 3**	62 8	**58 1**	62 5
	441 1	949 4	**421 9**	896 9

At 31 December 2009 £188 4m was held for resale within the Group and £177 9m within the Company

31. Provisions for liabilities and charges

	Group and Company					
	Provision for customer redress		Onerous contracts provision		Total	
	2009	2008	**2009**	2008	**2009**	2008
	£m	£m	**£m**	£m	**£m**	£m
The movement in provisions was as follows						
At 1 January	**5 0**	-	**18 5**	12 9	**23.5**	12 9
Utilised in the year	**(11 1)**	-	**(5 5)**	(12 9)	**(16 6)**	(12 9)
Charged in the year	**78 5**	5 0	**0 1**	18 5	**78 6**	23 5
Adjustment on disposal of property, plant and equipment	**-**	-	**2.3**	-	**2 3**	-
At 31 December	**72 4**	5 0	**15 4**	18 5	**87.8**	23 5

Provision for customer redress is in respect of potential customer complaints and is likely to be utilised over several years

The onerous contracts provision is in respect of leasehold properties no longer required as a result of changes to the Group's business plan in 2008

32 Subordinated liabilities

	Group and Company	
	2009	2008
	£m	£m
5 625% Subordinated bonds due 2015	**295 1**	304 7
11 734% Subordinated loan 2016	**25 8**	27 1
5 75% Subordinated bonds due 2017	**263 9**	265 9
10⅛% Subordinated bonds due 2018	**50 5**	50 5
9⅛% Subordinated bonds due 2021	**149 1**	149 0
6 594% Perpetual fixed to floating rate subordinated notes	**-**	574 4
HM Government PIK interest	**150 6**	143 3
	935 0	1,514 9

The 5 625% subordinated bonds due 2015 were not redeemable in the ordinary course of business before 13 January 2010 and have yet to be redeemed

The 11 734% subordinated loan 2016 is repayable in five equal annual instalments from 2012 to 2016

The 5 75% subordinated bonds due 2017 are not redeemable in the ordinary course of business before 28 February 2012

The 10⅛% subordinated bonds due 2018 are not redeemable in the ordinary course of business before 25 March 2018

The 9⅛% subordinated bonds due 2021 are not redeemable in the ordinary course of business before 17 October 2021

As a result of State aid approval in October 2009 which requires the Company to withhold coupon payments on all subordinated instruments where possible, and the exercise of the general right of deferral of coupon payment contained within the terms and conditions of the instrument, the 6 594% perpetual fixed to floating rate subordinated notes have been reclassified as equity under the requirements of IAS 32 (see note 35)

The HM Government PIK interest represents the amount of the margin payable to HM Government which was subordinated under the terms of the facility (see note 26) Repayment of this amount is not due until five years after repayment of the other HM Government facilities Interest is rolled up and capitalised until all other facilities are repaid, after which it becomes repayable in cash Interest is payable on this loan at a floating rate above the Bank Base Rate

All subordinated liabilities other than the 6 594% perpetual fixed to floating rate notes (which are denominated in US dollars) are denominated in sterling

Redemptions of any subordinated liabilities prior to their final maturity date are subject to obtaining prior consent of the Financial Services Authority

The rights of repayment of holders of subordinated liabilities are subordinated to the claims of other creditors

33 Tier one notes

The tier one notes were issued for a value of £200m on 21 August 2002 and are undated They carry a coupon of 7 053% payable annually in arrears on 21 September each year At each payment date Northern Rock will decide whether to declare or defer the coupon, only if payment of the coupon would lead to breaches of regulatory capital requirements If Northern Rock decides to defer the coupon, this can then only be satisfied upon the date on which the issue is redeemed No interest will accrue on any deferred coupon If Northern Rock defers the coupon, it may not pay a dividend on any share or pay any coupon on the reserve capital instruments, nor redeem or repurchase any of its share capital or reserve capital instruments until it next makes a coupon payment for the tier one notes While Northern Rock is in public ownership, deferred coupons can only be satisfied in accordance with the terms of Article 5 of The Northern Rock Transfer Order 2008 which was made on 21 February 2008 pursuant to the Banking (Special Provisions) Act 2008

Northern Rock has a call option after 25 years, which it can only exercise with the consent of the Financial Services Authority If the issue is not called, the coupon resets to yield 1 835% above 6-month LIBOR

The full amount of tier one notes is permitted for inclusion within Tier 1 for regulatory capital purposes

The carrying value of tier one notes at 31 December 2009 is £233 7m (2008 £251 8m)

34. Reserve capital instruments

Reserve capital instruments were issued for a value of £200m in September 2000 and £100m in May 2001 and are undated They carry a coupon of 8 399% payable annually in arrears on 21 September each year At each payment date Northern Rock will decide whether to declare or defer the coupon If Northern Rock decides to declare the coupon, the holder will receive a cash payment equivalent to the coupon which will be achieved either by the payment of cash directly, or while Northern Rock is in public ownership, as per the terms of Article 5 of The Northern Rock Transfer Order 2008 (the "Transfer Order") which was made on 21 February 2008 pursuant to the Banking (Special Provisions) Act 2008 If Northern Rock elects to defer the coupon, it may not declare or pay a dividend on any share until the deferred coupons are satisfied While Northern Rock is in public ownership, deferred coupons and any interest accruing thereon can only be satisfied in accordance with the terms of Article 5 of the Transfer Order

Northern Rock has a call option after 15 years, which it can only exercise with the consent of the Financial Services Authority If the issue is not called, the coupon resets to yield 4 725% above the prevailing 5 year benchmark Gilt rate

The maximum amount of reserve capital instruments permitted to be included in Tier 1 for regulatory capital purposes is 15% of overall Tier 1 capital, as defined by the Financial Services Authority Any excess is allocated to Upper Tier 2 capital

In accordance with the requirements of IAS 32, reserve capital instruments are classified as non shareholders' equity Coupons on these notes are treated as appropriations and amounted to £nil (2008 £24 1m) after a tax credit of £nil (2008 £1 1m)

35. Subordinated notes

	Group and Company	
	2009	2008
	£m	£m
12⅝% Perpetual subordinated notes	**19 8**	19 8
8% Undated subordinated notes	**62 1**	62 1
6.594% Perpetual fixed to floating rate subordinated notes	**405 3**	-
6 75% Fixed rate step-up undated subordinated notes	**195 4**	195 4
Floating rate undated subordinated notes	**66 0**	66 0
5 6% Undated subordinated notes	**393 2**	393 2
	1,141 8	736 5

In accordance with the requirements of IAS 32, undated subordinated liabilities are classified as non shareholders' equity, as there is no contractual obligation to pay the interest coupon Coupons on these notes are treated as appropriations and amounted to £32 5m (2008 £44 2m) after a tax credit of £nil (2008 £2 1m)

The 12⅝% perpetual subordinated notes were created in 1997 on the transfer of business from Northern Rock Building Society and were issued to holders of Permanent Interest Bearing Shares of the Society

The 8% undated subordinated notes are denominated in US dollars, the proceeds and coupon payments have been swapped into sterling The notes became redeemable on 15 June 2004 and may be subsequently redeemed in the ordinary course of business on coupon dates which fall on 15 March, 15 June, 15 September and 15 December

The 6 594% Perpetual fixed to floating rate subordinated notes are denominated in US dollars, the proceeds and coupon payments have been swapped into sterling These notes have been reclassified from subordinated liabilities in 2009 (see note 32) and are not redeemable in the ordinary course of business before 28 June 2017

The 6 75% fixed rate step-up undated subordinated notes are not redeemable in the ordinary course of business before 17 June 2024

The floating rate undated subordinated notes are denominated in US dollars, the proceeds and coupon payments have been swapped into sterling They are not redeemable in the ordinary course of business before 23 February 2011 Interest is payable at 1% above 3 month US$ LIBOR

The 5 6% undated subordinated notes are denominated in US dollars, the proceeds and coupon payments have been swapped into sterling The notes are not redeemable in the ordinary course of business before 30 April 2014

With the exception of notes denominated in US dollars as referred to above, all other subordinated notes are denominated in sterling

Redemptions of any subordinated notes are at the issuer's option only and are subject to obtaining prior consent of the Financial Services Authority

The rights of repayment of holders of subordinated notes are subordinated to the claims of other creditors

36. Appropriations

	2009	2008
	£m	£m
Reserve capital instruments	-	25 2
Subordinated notes	**32 5**	46 3
Tax on appropriations	-	(3 2)
	32 5	68 3

37. Called up share capital

	2009 Number	2009 £m	2009 €m	2008 Number	2008 £m	2008 €m
Authorised share capital						
Ordinary shares of 25p each	**718 5m**	**179 6**	**-**	718 5m	179 6	-
Perpetual non-cumulative callable Preference shares of 25p each	**100 0m**	**25 0**	**-**	100 0m	25 0	-
Perpetual non-cumulative callable Preference shares of 25c each	**100 0m**	**-**	**25 0**	100 0m	-	25 0
	918 5m	**204 6**	**25 0**	918 5m	204 6	25 0

	2009 Number	2009 £m	2008 Number	2008 £m
Issued and fully paid share capital				
Ordinary shares of 25p each	**495 6m**	**123 9**	495 6m	123 9
Perpetual non-cumulative callable Preference shares of 25p each	**0 4m**	**0 1**	0 4m	0 1
	496 0m	**124 0**	496 0m	124 0

On 22 February 2008, under the terms of The Northern Rock plc Transfer Order 2008 (SI 2008 No 432), all shares in the Company were transferred to the Treasury Solicitor as nominee of the Treasury Each Foundation share was converted into and redesignated as one Ordinary share in the Company

Dividends on Preference shares are discretionary and, subject to Board approval, are payable annually on 4 July at a rate of 6 8509% No dividends were paid in 2009 or 2008

38. Reserves

Share premium account

	Group and Company Ordinary £m	Group and Company Preference £m
At 1 January 2009 and 31 December 2009	6 8	396 4

Capital redemption reserve

	Group and Company £m
At 1 January 2009 and 31 December 2009	7 3

Other reserves

a) Revaluation reserve – available for sale investments

	Group 2009 £m	Group 2008 £m	Company 2009 £m	Company 2008 £m
Balance at 1 January	**(602 5)**	(93 7)	**(599 8)**	(144 2)
Net (losses)/gains from changes in fair value	**(3 3)**	(562 0)	**0 5**	(488 3)
Losses transferred to net income due to impairment	**5 5**	53 4	**5 5**	53 4
Net losses/(profits) on disposal transferred to net income	**6 8**	(44 4)	**0.3**	(44 5)
Amortisation of fair value differences in respect of securities transferred to loans and receivables	**236 2**	(21 8)	**236 2**	(21 8)
Losses transferred (from)/to net income due to impairment of securities transferred to loans and receivables	**(29 2)**	43 3	**(29 2)**	43 3
Deferred income taxes	**0.2**	23 1	**0 9**	2 4
Effect of UK tax rate change on deferred tax items	**-**	(0 4)	**-**	(0 1)
Balance at 31 December	**(386 3)**	(602 5)	**(385 6)**	(599 8)

38 Reserves (continued)

b) Hedging reserve – cash flow hedges

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Balance at 1 January	**(269 7)**	(29 2)	**(269 7)**	(29 2)
Amounts recognised in equity	**164 8**	(218 5)	**164 8**	(218 5)
Amounts transferred to interest payable	**(20 9)**	(22 0)	**(20 9)**	(22 0)
Balance at 31 December	**(125 8)**	(269 7)	**(125 8)**	(269 7)
Total other reserves				
At 31 December	**(512 1)**	(872 2)	**(511 4)**	(869 5)

At 31 December 2009 £16 2m was held for resale in both Group and Company

39. Retained earnings

	Group		Company	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Balance at 1 January	**(64 5)**	1,251 9	**(75 0)**	1,109 0
Loss for the year	**(309 1)**	(1,378 0)	**(337.7)**	(1,245 6)
Adjustment in respect of own shares	**-**	43 2	**-**	43 2
Net actuarial (losses)/gains from changes in fair value of pension scheme assets and liabilities	**(45 9)**	25 5	**(45 9)**	25 5
Current income taxes on actuarial gains	**(1 0)**	-	**(1 0)**	-
Deferred income taxes on actuarial losses/(gains)	**12.1**	(7 2)	**12 1**	(7 2)
Deferred income taxes on actuarial gains – effect of UK tax rate change on deferred tax items	**-**	0 1	**-**	0 1
Balance at 31 December	**(408 4)**	(64 5)	**(447 5)**	(75 0)

At 31 December 2009 £17 1m was held for resale within the Group and £nil within the Company

The amounts deducted from the retained earnings in respect of own shares, which are held at cost, are as follows

	Group and Company	
	2009 £m	2008 £m
Own shares in relation to employee share schemes	-	-

Movements in the amount deducted from retained earnings in respect of own shares are as follows

	2009 £m	2008 £m
At 1 January	-	94 2
Transfer of shares to Treasury Solicitor	-	(94 2)
At 31 December	-	-

As a result of The Northern Rock plc Transfer Order 2008, all shares were transferred to the Treasury Solicitor as nominee for the Treasury on 22 February 2008 Consequently, the Company no longer owns any of its shares The consideration it will receive for these shares has not yet been determined and therefore no asset has been recognised for the proceeds in these accounts

The credit to retained earnings in 2008 was as follows

	2009 £m	2008 £m
Accelerated charge on cancellation of share schemes	-	39 6
Current income tax impact of share based payments	-	3 6
	-	43 2

40. Financial risk management

A) Financial Risk Management

Governance

The Board of Directors is responsible for determining strategies and policies for the Group The Group maintains a risk governance structure that strengthens risk evaluation and management, in addition to positioning the Group to manage the changing regulatory environment in an efficient and effective manner

The Group works within the terms of the Shareholder Framework, and has the primary responsibilities of

- Developing and recommending a business plan aligned to the objectives of the Shareholder, and,
- Delivering the plan

The diagram below shows the governance structure that was operational at Northern Rock in 2009

It should be noted that, subsequent to the Company's legal and capital restructure on 1 January 2010, the governance structure has been revised below Executive Committee to three sub committees (ALCO, RCRC and ORCC)

Board Level Governance

BOARD

NOMINATION COMMITTEE

AUDIT COMMITTEE

REMUNERATION COMMITTEE

RISK COMMITTEE

Management Level Governance

EXECUTIVE COMMITTEE

MAJOR PROJECTS COMMITTEE

CAPITAL MANAGEMENT COMMITTEE

RETAIL PRODUCTS AND LIMITS COMMITTEE

ASSET AND LIABILITY COMMITTEE

RETAIL CREDIT RISK COMMITTEE

OPERATIONAL RISK AND COMPLIANCE COMMITTEE

OFFSHORE MANAGEMENT COMMITTEE

Details of the operation of Board Level Governance and its committees are set out in the Corporate Governance report on pages 5 to 9

Details of the operation of Management Level Governance and its committees are set out below

Executive Committee (ExCo) is the most senior management operating committee, chaired by the Chief Executive Officer (CEO) ExCo is responsible for developing and delivering against a Board approved strategy, and for ensuring the effective and smooth running of the business within Board approved risk appetites It is responsible for putting in place effective monitoring and control mechanisms, which enable it to have appropriate oversight of business activities ExCo has seen several membership changes with a number of new and external appointments The new team has reviewed and refined its governance and operating framework to ensure that there are effective relationships with the Board and strong management oversight and control of all operations As part of this new framework, ExCo has established seven sub committees which provide for greater focus in respect of business change (Retail Products and Limits and Major Projects Committees), capital management (Capital Management Committee), risk management (Asset and Liability Committee, Retail Credit Risk Committee and Operational Risk and Compliance Committee) and offshore management (Offshore Management Committee)

Major Projects Committee (MPC) ensures all major project decisions are aligned to the corporate strategy, and that the appropriate resource is aligned to deliver It maximises and tracks value and benefit from its investment, engages with stakeholders to ensure ongoing support and ensures that needs of customers are reflected as appropriate within the Northern Rock Treating Customers Fairly (TCF) framework. MPC also has oversight of the change portfolio Group-wide in order to prevent conflicting change agendas and overload

Capital Management Committee (CMC) is the Executive level Committee through which all aspects of capital management are monitored, reported and controlled It is responsible for overseeing the adequacy of capital resources to meet internal, rating agency and regulatory requirements It is ultimately responsible for recommending to the Board for its approval, policies and strategies to ensure that capital management is optimised to meet internal and external stakeholder requirements

Retail Products and Limits Committee (RPLC) is responsible for establishing and maintaining an effective framework within which new products are reviewed and approved This includes conformance with the New Product Approval policy and the Delegated Authorities Framework for product development It is also responsible for establishing limits and boundaries within which new products are sold and monitoring actual performance against these limits

Asset & Liability Committee (ALCO) is responsible for overseeing the asset, liquidity, liability and other solvency risks, specifically market risk, wholesale credit risk and liquidity risk (referred to as 'financial risk') ALCO is ultimately responsible for recommending to the Risk Committee for its approval, policies and frameworks that ensure optimal risk processes and outcomes for the Group and that liquidity positions are optimised to meet internal and external stakeholder requirements ALCO manages the Group's liquidity resources to meet the responsibilities under the loan agreement with the Government, and it monitors the Group's secured funding activities and vehicles.

Retail Credit Risk Committee (RCRC) is the principal body through which all aspects of Retail Credit Risk are monitored, reported and controlled It is the most senior retail credit decision making authority below the Board It primarily acts as the formal designated Committee to manage all retail credit related aspects of Basel II – Capital Requirement Directive RCRC develops and recommends a Retail Credit Risk Appetite for approval by ExCo and the Board (via Risk Committee) It also reviews and approves Credit Risk Strategy and Policy In addition, RCRC ensures the Company has policies and processes which support Responsible Lending and the fair treatment of customers at all times

40. Financial risk management (continued)

RCRC reviews detailed portfolio monitoring reports to ensure the performance and quality of credit risk portfolios remains within agreed risk appetite, submitting appropriate summary information to the Risk Committee RCRC reviews and recommends any necessary changes to credit risk models and established a credit sanctioning and approval framework, within which formal lending authorities are delegated and controlled through the organisation It establishes lower level working groups to ensure suitably skilled cross functional experts have the opportunity to review specific matters in detail before submission to RCRC

Operational Risk and Compliance Committee (ORCC) is the executive level committee through which all aspects of the high level operational risk and control environment are monitored ORCC develops and recommends the Operational Risk Policies and Risk Appetite for approval by ExCo and the Board ORCC regularly reviews all operational losses in line with risk appetite and budgets It also reviews other significant risk events and failures in order to enhance Operational Risk management ORCC develops and recommends all compliance policies, considers new/revised regulatory requirements and reviews regulated product complaint trends

Offshore Management Committee (OMC) ensures that offshore subsidiaries are first and foremost effectively run and well controlled by offshore management within the local regulatory regimes It ensures that offshore subsidiaries also comply with the same governance principles, ethical values, and policies, procedures and guidelines that are applied by the Company where they are not restricted from doing so by local regulation It assures the Board and Executive Management of the Company that effective corporate governance is implemented in the Guernsey subsidiary and Irish branch, with the appropriate processes, structures, accountability and communication in place

Risk Management

Definitions

The principal risks that the Group manages are as follows

- Credit risk the current or prospective loss to earnings and capital (expected and unexpected loss) arising from lending as a result of debtors or counterparties defaulting on their obligations due to the Group
- Market risk the risk that changes in the level of interest rates, the rate of exchange between currencies or the price of securities or other financial contracts, including derivatives, will have an adverse impact on the results of operations or financial condition of the Group
- Liquidity risk the risk that the Group is unable to meet its obligations as they fall due
- Operational risk the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events including legal risk
- Regulatory risk the risk of failing to comply with the legal and regulatory requirements applying to Northern Rock's arrangements and activities, with the potential consequences of
  - Customers being unfairly treated or suffering financial or other detriment
  - Legal or regulatory sanctions
  - Reputational loss and the associated financial and business impacts
  - Risks to market confidence or stability, and
  - Northern Rock being used for the purposes of financial crime

Developments in Risk Management

During 2009, the Company has continued to make significant progress in its Risk Management capabilities The Chief Risk Officer has an independent reporting line directly to the CEO and also reports to the Chair of the Risk Committee As the independent second line of defence, the Risk function takes an integrated, holistic view of risks and ensures that a consistent approach to the aggregation and management of risks is in place, and integrated into business management and decision making

Key developments in 2009 include

- Enhancing the Governance Framework and Policies
- Recruitment of additional Risk specialists and development of existing colleagues
- Continued development of Internal Ratings Basis (IRB) models
- Enhancing Operational Risk processes and reporting
- Improving Liquidity Risk monitoring processes, systems and controls
- Improving Compliance and Prudential capability

Each of the major risk categories is listed below together with a brief description of the risk management framework

i) Credit risk

Risk appetite

Credit risk appetite is an expression of boundaries (qualitative and quantitative) that provide clear guidance on the level of risk exposure that the Board considers acceptable and in line with the corporate strategy A revised credit risk appetite aligned to the current business strategy and external environment was approved by the Board in November 2008 Risk appetite is subject to an annual review process and limits are regularly monitored and reported to the Risk Committee

The Board's high level expression of a desired credit risk appetite is also translated into specific maximum risk limits in relation to product and lending policy parameters within which management must operate The Risk Appetite Statement is developed by the Chief Risk Officer, and owned and approved by the Executive and the Board It is based upon a consolidation of the Risk function's enterprise wide analysis of current and potential future risk exposures, with due regard to the most practical and relevant level of appetite, limits and delegated authorities The Board is responsible for approving the Risk Appetite Statement (and any material changes proposed to it) on an annual basis The statement may be reviewed more frequently if appropriate Material changes to the Risk Appetite Statement must gain Board approval prior to implementation Monitoring and reporting against the risk appetite and the associated limits and triggers were in place for both new lending and whole book during 2009

Lending policy criteria

New lending is tightly controlled using an appropriate mix of statistical and experiential analysis It should be noted that, subsequent to the Company's split on 1 January 2010, new lending is not permitted New business quality is constantly monitored and controlled by the Credit Decisioning team using sophisticated scoring techniques and a number of other core control components as follows

- Credit scoring Automated statistically-based credit scoring methods are used in the decision making process for new and existing customers These are subject to regular monitoring, review and approval
- Affordability, underwriting and mandates To lend responsibly, the Group employs experienced underwriters to determine customers' overall financial situation and ability to repay credit. The ability to agree a credit agreement with a customer is prescribed in Board delegated authority levels to specific individuals who have been proven to have the requisite credit skills

40. Financial risk management (continued)

- Valuations Property assets are independently valued at mortgage inception. Where a revaluation is required, this is led by a specialist Property Risk function using a range of valuation methods
- Monitoring and performance The credit portfolios are monitored regularly, with a range of prescribed reports distributed to key stakeholders. Detailed management information is provided to the Retail Credit Risk Committee, Executive Committee and Risk Committee
- Collections and recoveries The Group's debt management process is led by the Director of Debt Management A team of specialists manage all aspects of collections and recoveries with the aim of helping customers who encounter financial difficulties to achieve a positive outcome for the customer and the Group
- Stress testing and scenario analysis, to stimulate outcomes and calculate the risk impact

Credit Risk Measurement
The credit risk of lending to customers is a factor of three components

- The probability of default (PD) by the customer on contractual obligations
- The exposure at default by the customer on contractual obligations
- The likely recovery of defaulted obligations (loss given default (LGD))

Internal rating models are used to assess customer probability of default, exposure at default and loss given default The rating models use statistical analysis combined with external data and are subject to rigorous internal monitoring and change control

These credit risk models are used throughout the Group to support the analytical elements of the credit risk management framework, in particular the quantitative risk assessment part of the credit approval process, ongoing credit monitoring as well as portfolio level analysis and reporting

Credit risk models used by the Group can be grouped broadly into two categories

- PD/customer credit grade – these models assess the probability that a customer will fail to make full and timely repayment of credit obligations over a time horizon Each customer is assigned a score which corresponds to a probability of default There are a number of different credit grading models in use across the Group, each of which considers particular customer characteristics The credit grading models use a combination of quantitative inputs, such as recent financial performance, credit bureau data and customer behaviour
- LGD – these models estimate the expected loss that may be suffered by the Group on a credit facility in the event of default The Group's LGD models take into account the type of borrower and any security held

The Group does not operate internal risk assessment models for commercial mortgage loans due to the very small scale of its commercial lending (now in run off) Details of the risk profiles of commercial mortgage loans neither past due nor impaired can be found in the tables on pages 76 to 81 relating to loan to value ratios and loan sizes

Corporate and Wholesale Credit Risk
Corporate Credit Counterparty risk arises through Treasury hedging and investment activities and related balance sheet management requirements

Credit risk can be broken down into two elements

- Counterparty risk (the risk of default or migration of derivative counterparties)
- Wholesale credit risk (the risk of default or rating migration of issuers in the Treasury investment portfolio)

The Board has approved a framework for maximum credit counterparty limits against which total exposures are continually monitored and controlled The credit limit structure adopts a risk based matrix whereby lower rated counterparties are afforded lower overall levels of limit Although publicly available ratings produced by rating agencies provide a useful guide to the creditworthiness of counterparties, an internal rating is also used in the limit assignment process Single counterparties are assigned maximum limits in accordance with the ratings matrix, based on the lowest rating afforded to any part of the counterparty group

Maximum credit risk exposure at 31 December before collateral and other credit enhancements

	2009 £m	2008 £m
On balance sheet		
Cash and balances with central banks	**7,510 4**	9,336 8
Derivative financial instruments	**7,473 8**	13,314 4
Loans and advances to banks	**3,702 4**	3,384 4
Loans and advances to customers	**64,268 2**	72,299 4
Investment securities and unsecured investment loans	**3,087 8**	3,809 2
	86,042 6	102,144 2
Off balance sheet		
Loan commitments	**4,173.1**	4,265 2

Loans and advances by credit quality

2009	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m	Unsecured investment loans £m
Neither past due nor impaired	3,702 4	54,783 3	279 2	3,716 8	358 0
Past due but not impaired	–	3,781 3	0 2	116 0	–
Impaired	–	1,503 1	8 5	79 8	0 3
	3,702 4	60,067 7	287 9	3,912 6	358 3

40. Financial risk management (continued)

2008	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m	Unsecured investment loans £m
Neither past due nor impaired	3,384 4	61,455 9	290 4	5,046 9	404 6
Past due but not impaired	–	4,325 5	4 5	151 7	–
Impaired	–	918 3	6 8	99 4	17 8
	3,384 4	66,699 7	301 7	5,298 0	422 4

The credit quality of loans neither past due nor impaired may be assessed by reference to the internal ratings and probability of default bandings allocated to loans by the Company's internal credit assessment models as set out in the tables below

	2009		2008	
	Loans and advances to banks £m	**Unsecured investment loans £m**	Loans and advances to banks £m	Unsecured investment loans £m
AAA	**364 3**	–	–	16 5
AA+	–	–	182 6	–
AA	**400 5**	–	896 2	–
AA-	**926 7**	–	549 9	–
A+	**1,715 5**	–	1,069 7	–
A	**294 7**	–	559 4	–
A-	**0 7**	–	92 8	–
BBB+	–	–	9 0	–
BBB	–	**104 9**	18 0	113 4
BBB-	–	**253 1**	4 9	274 7
BB+	–	–	1 9	–
	3,702 4	**358 0**	3,384 4	404 6

	2009		2008	
	Residential mortgage loans £m	**Unsecured personal loans £m**	Residential mortgage loans £m	Unsecured personal loans £m
PD band				
Risk 1 – very low risk	**45,537 0**	**1,748 4**	52,029 2	2,390 2
Risk 2 – low risk	**3,275 6**	**895 7**	3,666 4	1,343 1
Risk 3 – medium risk	**2,820 8**	**762 3**	2,960 0	1,041 9
Risk 4 – high risk	**3,149 9**	**310 4**	2,800 3	271 7
	54,783 3	**3,716 8**	61,455 9	5,046 9

Available for sale securities and investment securities held as loans and receivables by credit quality

	2009		2008	
	Available for sale securities £m	**Investment securities held as loans and receivables £m**	Available for sale securities £m	Investment securities held as loans and receivables £m
Neither past due nor impaired	**144 7**	**2,521 7**	412 3	2,905 9
Past due but not impaired	–	–	–	–
Impaired	**23 8**	**39 3**	10 2	46 9
	168 5	**2,561 0**	422 5	2,952 8

40. Financial risk management (continued)

The credit quality of available for sale securities and investment securities held as loans and receivables by reference to credit ratings is set out in the table below

	2009		2008	
	Available for sale securities £m	**Investment securities held as loans and receivables £m**	Available for sale securities £m	Investment securities held as loans and receivables £m
AAA	**81 6**	**762 6**	120 7	1,368 3
AA+	**-**	**127 5**	-	2 1
AA	**-**	**220 3**	49 4	220 4
AA-	**5 0**	**249 4**	45 0	211 1
A+	**31 6**	**121 7**	18 0	174 4
A	**10 0**	**280 0**	57 1	510 8
A-	**-**	**209 5**	-	158 7
BBB+	**-**	**160 7**	3 3	92 5
BBB	**3 8**	**168 5**	-	130 2
BBB-	**-**	**27 6**	-	45 9
BB+	**-**	**63 3**	-	12 8
BB	**-**	**49 5**	-	1 1
BB-	**-**	**34 0**	-	-
B+	**-**	**35 0**	-	-
B	**0 1**	**9 5**	-	1 7
B-	**-**	**10 5**	-	0 5
CCC	**-**	**25 9**	-	-
CCC-	**-**	**3 6**	-	-
CC	**-**	**0 8**	0 1	-
C	**0 1**	**1 1**	0 1	-
Not rated	**36 3**	**-**	128 8	22 3
Total	**168 5**	**2,561 0**	422 5	2,952 8

Past due not impaired loans

2009	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m
Up to one month	-	-	-	-
In one to three months	-	1,986 6	0 2	98 0
In three to six months	-	1,071 2	-	7 0
Over six months	-	723 5	-	11 0
	-	3,781 3	0 2	116 0

2008	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m
Up to one month	-	-	-	-
In one to three months	-	2,531 3	3 6	139 4
In three to six months	-	1,351 6	-	6 5
Over six months	-	442 6	0 9	5 8
	-	4,325 5	4 5	151 7

No loans were renegotiated that would otherwise be past due or impaired at 31 December 2009 (2008 £2 1m) All renegotiated loans in 2008 were included within residential mortgage loans and did not include any loans which prior to renegotiation were included within unsecured personal loans.

40 Financial risk management (continued)

Collateral

Due to the nature of the Group's exposures (comprising primarily residential mortgages), the only collateral held against credit risk was that in respect of the counterparty risk arising on derivative transactions (in the form of cash) and in respect of residential and commercial lending (in the form of mortgage charges over residential and commercial property) Valuations on residential and commercial property are carried out on a quarterly basis Cash collateral held against counterparty credit risk at 31 December 2009 amounted to £5,564 9m (2008 £4,239 9m), residential and commercial property held amounted to £93,143 1m (2008 £99,661 1m) The table below shows an estimate of the fair value of collateral held against financial assets

2009	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Derivative financial instruments £m
Neither past due nor impaired				
Property	–	86,609 1	384 8	–
Cash	–	–	–	5,564 9
Other	–	–	–	–
Past due but not impaired				
Property	–	4,612 9	0 3	–
Cash	–	–	–	–
Other	–	–	–	–
Impaired				
Property	–	1,527 5	8 5	–
Cash	–	–	–	–
Other	–	–	0 5	–
Total	–	92,749 5	394 1	5,564 9

2008	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Derivative financial instruments £m
Neither past due nor impaired				
Property	–	93,210 9	386 1	–
Cash	–	–	–	4,239 9
Other	–	–	–	–
Past due but not impaired				
Property	–	5,126 6	6 4	–
Cash	–	–	–	–
Other	–	–	–	–
Impaired				
Property	–	924 1	7 0	–
Cash	–	–	–	–
Other	–	–	0 5	–
Total	–	99,261 6	400 0	4,239 9

Impairment

All credit portfolios are regularly reviewed to assess for impairment. A loan or portfolio of loans is considered to be impaired if there is any observable data indicating that there has been a measurable decrease in the estimated future cash flow or their timings This will include identification of

- Significant financial difficulty of the customer,
- Default or delinquency in interest or principal payments,
- The borrower entering bankruptcy or other financial reorganisation, and
- Adverse changes in the payment status of borrowers

In the retail mortgage portfolio, individual impairments may occur where the Group has taken possession of the property or where specific circumstances indicate that a loss is likely to be incurred In addition, collective impairment allowances across the retail credit portfolios are calculated on a portfolio basis using formulae which take into account the probability of default, the roll to write-off or possession and the loss given default, less the value of any security held These parameters are kept under regular review to ensure that, as far as possible, they reflect current economic circumstances and risk profile

Concentration risk

Concentration risk is managed at portfolio, product, and counterparty levels This is carried out through the application of limits relating to geographical spread, the size of loan relative to property value (at counterparty and portfolio levels) and the concentration of borrowers in each risk band

40. Financial risk management (continued)

The following table breaks down the Group's main credit exposures by geographical region at their carrying amounts Exposures are allocated to regions based on the country of domicile of the counterparty

2009	UK £m	Europe £m	US £m	Other countries £m	Total £m
Derivative financial instruments	1,991 7	4,256 3	1,160 1	65 7	7,473 8
Loans and advances to banks	1,800 9	1,388 6	113 3	399 6	3,702 4
Loans and advances to customer					
Residential mortgage lending	60,067 7	-	-	-	60,067 7
Other secured lending	287 9	-	-	-	287 9
Unsecured lending	3,912 6	-	-	-	3,912 6
Available for sale debt securities	53 3	78 8	-	36 4	168 5
Investment securities held as loans and receivables	1,163 3	643 1	166 8	587 8	2,561 0
Unsecured investment loans	-	-	-	358 3	358 3
As at 31 December 2009	69,277 4	6,366 8	1,440 2	1,447 8	78,532 2

2008	UK £m	Europe £m	US £m	Other countries £m	Total £m
Derivative financial instruments	4,520 0	6,678 6	2,053 9	61 9	13,314 4
Loans and advances to banks	1,519 8	1,370 5	277 0	217 1	3,384 4
Loans and advances to customer					
Residential mortgage lending	66,699 7	-	-	-	66,699 7
Other secured lending	301 7	-	-	-	301 7
Unsecured lending	5,298 0	-	-	-	5,298 0
Available for sale debt securities	284 7	100 7	-	37 1	422 5
Investment securities held as loans and receivables	1,217 1	829 8	236 1	669 8	2,952 8
Financial assets designated at fair value	-	-	-	11 5	11 5
Unsecured investment loans	16 5	-	-	405 9	422 4
As at 31 December 2008	79,857 5	8,979 6	2,567 0	1,403 3	92,807 4

LTV (%) - Indexed value as of financial year end	Residential mortgage loans 2009 £m	Residential mortgage loans 2008 £m	Commercial mortgage loans 2009 £m	Commercial mortgage loans 2008 £m
<70%	**15,411 1**	15,746 0	**86 4**	66 0
70%-75%	**3,343 4**	3,147 4	**40 4**	53 4
75%-80%	**4,045 5**	3,670 0	**118 0**	123 6
80%-85%	**4,412 9**	4,366 6	**40 0**	43 6
85%-90%	**4,902 1**	4,993 3	**1.2**	1 2
90%-95%	**5,438 1**	5,841 0	**1 8**	-
95%-100%	**5,561 2**	6,832 9	**-**	-
>100%	**16,953.4**	22,102 5	**0 1**	13 9
	60,067 7	66,699 7	**287 9**	301 7

Loan size by outstanding balance

Outstanding balance	Residential mortgage loans 2009 £m	Residential mortgage loans 2008 £m
£0-£100k	**15,840 6**	17,196 5
£100-£250k	**32,668 6**	35,737 4
£250-£500k	**7,685 4**	8,862 9
£500k-£1m	**2,525 7**	3,174 1
£1m-£2 5m	**1,096 1**	1,224 8
>£2 5m	**251 3**	504 0
	60,067 7	66,699 7

40. Financial risk management (continued)

Outstanding balance	Commercial mortgage loans 2009 £m	2008 £m
£0-£500k	**8 5**	8 9
£500k-£1m	**10 4**	9 6
£1m-£5m	**68 6**	76 2
£5m-£10m	**68 0**	70 4
£10m-£25m	**44 1**	70 5
>£25m	**88 3**	66 1
	287 9	301 7

ii) Market Risk

Market risk is the risk that changes in the level of interest rates, the rate of exchange between currencies or the price of securities or other financial contracts, including derivatives, will have an adverse impact on the results of operations or financial condition of the company Northern Rock does not trade or make markets in any areas and market risk arises only as a consequence of carrying out and supporting core business activities

Market risk within the Group can be subdivided into the following risks

- Mismatch The effect that variations in the relationship between different points on the yield curve indices have on the value of fixed rate assets and liabilities
- Curve The effect that variations in the relationship between different points on the yield curve indices have on the value of fixed rate assets and liabilities
- Prepayment. The effect that variations in early repayment have on expected run off profiles of fixed rate loans and therefore on the effectiveness of hedging transactions
- Basis Created where balance sheet assets and liabilities are sensitive to different underlying indices Basis risk arises for example where mortgage interest rates are linked to Bank Base Rate but the liabilities funding them are linked to LIBOR
- Reset Exposure to the timing of repricing of assets and liabilities or to a sudden spike in a key underlying index on a particular day
- Foreign Exchange Volatility in earnings resulting from movements in exchange rates altering the sterling value of unmatched foreign currency income streams, assets and liabilities (principally US$ and Euro positions)

The Group offers numerous banking, mortgage and savings products with varying interest rate features and maturities which create potential interest rate risk exposures Primary risks arise as a result of timing differences on the repricing of assets and liabilities, unexpected changes in yield curves and changes in the correlation of interest rates between different financial instruments. In addition, structural interest rate risk arises in the Group's consolidated balance sheet as a result of fixed rate, variable rate and non interest bearing assets and liabilities

Risk exposures are controlled using gross risk position limits and net 'earnings at risk' volatility limits which require Treasury to manage proactively expected interest margins to within pre-defined limits In addition, the impact of specific stress scenarios on portfolio exposures are analysed to ensure that unexpected events do not carry unacceptable risk levels

Interest Rate Risk

Interest rate sensitivity arises from the relationship between interest rates and net interest income resulting from the periodic repricing of assets and liabilities The Group also offers fixed rate residential mortgages and savings products on which the interest rate paid by or to the customer is fixed for an agreed period of time at the start of the contract The Group closely monitors mortgage redemption and repayment patterns and reduces the mismatch of the expected maturity profiles of its interest earning assets and interest bearing liabilities through the use of derivatives

The Group uses a number of measures to monitor and control interest rate risk and sensitivity One such measure evaluates the difference in principal value between assets and liabilities repricing in various gap periods Risk weights are assigned to each gap period which reflect potential losses for a given change in rates, and based on these an economic value impact of a positive 200bp interest rate shock is calculated for each period on the total balance sheet The economic impact of this shock on the income statement was a reduction of net interest income of £83 6m as at 31 December 2009 (2008 reduction of net interest income of £30 6m)

40. Financial risk management (continued)

The following table gives an analysis of the repricing periods of assets and liabilities on the Group balance sheet at 31 December

Items are allocated to time bands in the table below by reference to the earlier of the next contractual interest rate repricing date and the residual maturity date Amounts shown in respect of loans and advances to customers include fair value adjustments of portfolio hedging

2009	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non interest bearing funds £m	Total £m
Assets							
Cash and balances with central banks	7,454 3	-	-	-	-	56 1	7,510 4
Loans and advances to banks	3,687 7	-	-	-	-	14 7	3,702 4
Loans and advances to customers	36,570 7	2,248 3	4,617 2	19,627 6	2,161 2	174 8	65,399 8
Investment securities and unsecured investment loans	3,280 1	207 5	21 5	122 5	22 2	(566 0)	3,087 8
Other assets	-	-	-	-	-	7,745 1	7,745 1
Total assets	50,992 8	2,455 8	4,638 7	19,750 1	2,183 4	7,424 7	87,445 5
Liabilities							
Loans from Government	14,315 5	-	-	-	-	-	14,315 5
Deposits by banks	5,906 0	88 9	-	-	-	27 4	6,022 3
Customer accounts	11,029 8	1,585 8	4,415 2	3,486 3	39 7	50 8	20,607 6
Debt securities in issue	27,540 1	33 2	250 6	2,767 0	4,549 3	6,833 5	41,973 7
Subordinated liabilities	450 7	-	-	250 0	220 0	14 3	935 0
Tier one notes	-	-	-	-	200 0	33 7	233 7
Other liabilities	-	-	-	-	-	2,302 6	2,302 6
Shareholders' equity	-	-	-	-	-	(386 0)	(386 0)
Non shareholders' equity	69 0	-	-	422 7	909 6	39 8	1,441 1
Total liabilities	59,311 1	1,707 9	4,665 8	6,926 0	5,918 6	8,916 1	87,445 5
Notional values of derivatives affecting interest rate sensitivity	(10,846 9)	913 5	200 4	12,941 2	(3,208 2)	-	-
	48,464 2	2,621 4	4,866 2	19,867 2	2,710 4	8,916 1	87,445 5
Total interest rate sensitivity gap	2,528 6	(165 6)	(227 5)	(117 1)	(527 0)	(1,491 4)	-
Cumulative interest rate sensitivity gap	2,528 6	2,363 0	2,135 5	2,018 4	1,491 4	-	-

40 Financial risk management (continued)

2008	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Non interest bearing funds £m	Total £m
Assets							
Cash and balances with central banks	9,292 3	-	-	-	-	44 5	9,336 8
Loans and advances to banks	3,180 4	-	-	-	-	204 0	3,384 4
Loans and advances to customers	31,543 5	4,920 1	8,122 4	25,794 9	2,409 5	1,210 9	74,001 3
Investment securities and unsecured investment loans	4,242 0	262 8	21 0	150 7	35 2	(902 5)	3,809 2
Other assets	-	-	-	-	-	13,814 3	13,814 3
Total assets	48,258 2	5,182 9	8,143 4	25,945 6	2,444 7	14,371 2	104,346 0
Liabilities							
Loans from Government	15,583 4	-	-	-	-	-	15,583 4
Deposits by banks	4,494 4	82 3	-	-	-	48 4	4,625 1
Customer accounts	14,113 6	1,442 2	3,359 9	1,689 8	-	117 2	20,722 7
Debt securities in issue	36,131 6	1,386 8	113 0	3,154 7	4,549 3	12,400 9	57,736 3
Subordinated liabilities	143 3	-	-	550 0	547 8	273 8	1,514 9
Tier one notes	-	-	-	-	200 0	51 8	251 8
Other liabilities	-	-	-	-	-	3,278 2	3,278 2
Shareholders' equity	-	-	-	-	-	(402 2)	(402 2)
Non shareholders' equity	69 0	-	-	-	739 6	227 2	1,035 8
Total liabilities	70,535 3	2,911 3	3,472 9	5,394 5	6,036 7	15,995 3	104,346 0
Notional values of derivatives affecting interest rate sensitivity	(23,484 3)	2,739 7	5,032 4	19,662 8	(3,950 6)	-	-
	47,051 0	5,651 0	8,505 3	25,057 3	2,086 1	15,995 3	104,346 0
Total interest rate sensitivity gap	1,207 2	(468 1)	(361 9)	888 3	358 6	(1,624 1)	-
Cumulative interest rate sensitivity gap	1,207 2	739 1	377 2	1,265 5	1,624 1	-	-

In addition to the calculation of the sensitivity of the total balance sheet to a positive 200bp interest rate shock, a separate sensitivity calculation is carried out for the fixed rate mortgage book The calculation measures the sensitivity of each portfolio to a 200bp parallel shift in rates The economic impact of this shift on the income statement was a reduction of net interest income of £7 1m as at 31 December 2009 (2008 reduction of net interest income of £48 0m)

Use of Derivatives

The Board has authorised the use of derivative instruments where their use is appropriate in reducing the risk of loss arising from changes in interest rates and exchange rates All use of derivative instruments within the Group is to hedge economic risk exposure, and the Group takes no trading positions in derivatives

The Group uses a number of derivative instruments to reduce interest rate risk and currency risk. These have, from time to time, included interest rate swaps, interest rate options, forward rate agreements, interest rate and bond futures, currency swaps and forward foreign exchange contracts Where either a balance sheet derivative instrument or an alternative balance sheet asset or liability could be used for a specific purpose, or where more than one derivative instrument could be used, the Group will select the instrument that optimises the following conditions

- Minimise capital utilisation
- Maximise income or minimise cost
- Maximise liquidity
- Minimise administrative and accounting complexity
- Minimise the Group's tax liability

The benefit of using derivative instruments is measured by examining the anticipated consequences of not hedging the perceived risk in terms of revenue or capital loss The vast majority of the Group's derivatives activity is contracted with major banks and financial institutions

Derivative instruments will be used by the Group for the following purposes

- To reduce the interest rate risk and foreign exchange risk in the Group's balance sheet
- To protect the Group's earnings from unexpected movements caused by market risks
- To develop retail products without creating unacceptably high structural risk for the Group
- To protect the Treasury investment portfolio from changes in interest rate and exchange rates or default risk.

40 Financial risk management (continued)

Off balance sheet items

Loan commitments

Contractual amounts to which the Group is committed for extension of credit to customers are summarised in the table below

Operating lease commitments

Minimum future lease payments under non-cancellable operating leases are summarised in the table below

Capital commitments

Capital commitments for the acquisition of buildings and equipment are summarised in the table below

2009	Within one year £m	In one to five years £m	Over five years £m	Total £m
Loan commitments	752 8	–	3,420 3	4,173 1
Operating lease commitments				
Land and buildings	0 4	1 1	3 8	5 3
Other operating leases	–	3 5	–	3 5
Capital commitments	7 4	0 2	–	7 6
	760 6	4 8	3,424 1	4,189 5

2008	Within one year £m	In one to five years £m	Over five years £m	Total £m
Loan commitments	516 1	3 0	3,746 1	4,265 2
Operating lease commitments				
Land and buildings	0 5	1 1	3 8	5 4
Other operating leases	–	4 6	–	4 6
Capital commitments	5 0	1 1	–	6 1
	521 6	9 8	3,749 9	4,281 3

Currency risk

Currency risk arises as a result of the Group having assets, liabilities and derivative items that are denominated in currencies other than sterling as a result of normal banking activities, including wholesale funding

In addition to raising funds through sterling money markets, capital markets and the domestic retail savings market, the Group raises Euro denominated retail funds through its branch in Ireland The Group's policy is to minimise exchange rate exposures by using cross currency swaps and forward foreign exchange contracts, or to match exposures with assets denominated in the same currency

At 31 December 2009, liabilities exceeded assets in US$, after taking into account foreign currency derivatives, by $249 0m, or £154 2m (2008 $76 5m/£52 8m) Liabilities exceeded assets denominated in € at the same date by €1,679 9m, or £1,492 7m (2008 €1 6m/£1 6m) after taking into account foreign currency derivatives The Group was sensitive to exchange rate gains and losses of £1 0m for each 1c movement in the £ US$ exchange rate at 31 December 2009 (2008 £0 4m), and of £12 0m for each 1c movement in the £ € exchange rate at the same date (2008 less than £0 1m)

The table below gives values of assets and liabilities at sterling carrying values denominated in different currencies at the balance sheet date

2009	US$ £m	€ £m	Other £m	Total £m
Assets				
Cash and balances with central banks	–	17 6	–	17 6
Loans and advances to banks	230 0	2,500 4	–	2,730 4
Investment securities and unsecured investment loans	156 1	1,443 7	–	1,599 8
Other assets	1 1	0 6	(0 1)	1 6
Total assets	387 2	3,962 3	(0 1)	4,349 4
Liabilities				
Deposits by banks	67 4	2,691 1	–	2,758 5
Customer accounts	5 9	916 4	–	922 3
Debt securities in issue	11,338 4	21,161 8	852 0	33,352 2
Other liabilities	(0 3)	161 0	1 5	162 2
Total liabilities	11,411 4	24,930 3	853 5	37,195 2
Notional values of derivatives affecting currency exposures	(11,178 4)	(19,475 3)	(851 5)	(31,505 2)
	233 0	5,455 0	2 0	5,690 0
Net position	154 2	(1,492 7)	(2 1)	(1,340 6)

40. Financial risk management (continued)

2008	US$ £m	€ £m	Other £m	Total £m
Assets				
Cash and balances with central banks	–	18 6	–	18 6
Loans and advances to banks	298 2	2,036 5	–	2,334 7
Loans and advances to customers	–	0 1	–	0 1
Investment securities and unsecured investment loans	271 4	1,725 7	–	1,997 1
Other assets	1 1	10 8	–	11 9
Total assets	570 7	3,791 7	–	4,362 4
Liabilities				
Deposits by banks	120 8	964 4	–	1,085 2
Customer accounts	10 0	973 4	–	983 4
Debt securities in issue	17,257 2	28,080 1	1,116 9	46,454 2
Other liabilities	23 0	238 6	1 7	263 3
Subordinated liabilities	574 6	–	–	574 6
Total liabilities	17,985 6	30,256 5	1,118 6	49,360 7
Notional values of derivatives affecting currency exposures	(17,362 1)	(26,463 2)	(1,115 5)	(44,940 8)
	623 5	3,793 3	3 1	4,419 9
Net position	(52 8)	(1 6)	(3 1)	(57 5)

Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value Assets are presented at bid prices, whereas offer prices are used for liabilities The accounting policy note sets out the key principles for estimating the fair values of financial instruments This note provides some additional information in respect of financial instruments carried at amortised cost Similar additional information in respect of instruments carried at fair value is included in the respective note for the instrument

	Carrying value		Fair value	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Financial assets				
Cash and balances with central banks	**7,510 4**	9,336 8	**7,510 4**	9,336 8
Loans and advances to banks	**3,702 4**	3,384 4	**3,702 4**	3,384 4
Loans and advances to customers	**64,268 2**	72,299 4	**64,572 2**	72,073 4
Investment securities held as loans and receivables	**2,561 0**	2,952 8	**2,307 1**	2,662 6
Unsecured investment loans	**358 3**	422 4	**358 3**	422 4
Financial liabilities				
Loans from HM Government	**14,315 5**	15,583 4	**14,315 5**	15,583 4
Deposits by banks	**6,022 3**	4,625 1	**6,019 6**	4,635 3
Customer accounts	**20,607 6**	20,722 7	**20,901 6**	20,990 2
Debt securities in issue	**41,973 7**	57,736 3	**37,405 1**	39,596 1
Subordinated liabilities	**935 0**	1,514 9	**616 7**	930 4
Tier one notes	**233 7**	251 8	**70 0**	115 0

Valuation methods for calculations of fair values in this table are set out below

Cash and balances with central banks
Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or reprice frequently

Loans and advances to banks
Fair value was estimated by using discounted cash flows applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is their carrying amount

Loans and advances to customers
The Group provides loans of varying rates and maturities to customers The fair value of loans with variable interest rates is considered to approximate to carrying value For loans with fixed interest rates, fair value was estimated by discounting cash flows using market rates or rates normally offered by the Group The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value

Investment securities held as loans and receivables
Fair values are based on quoted prices where available or by using discounted cash flows applying market rates

Unsecured investment loans
The carrying value of unsecured investment loans approximates the fair value due to the impairment of these assets to the value of the future expected cash flows

40. Financial risk management (continued)

Deposits by banks and customer accounts

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value The fair value of fixed interest deposits with less than six months to maturity is their carrying amount The fair value of all other deposit liabilities was estimated using discounted cash flows, applying either market rates or rates currently offered by the Group for deposits of similar remaining maturities

Debt securities in issue, subordinated liabilities and tier one notes

Fair values are based on quoted prices where available, or by using discounted cash flows, applying market rates

The table below summarises the fair value measurement basis used for assets and liabilities held on the balance sheet at fair value There are three levels to the hierarchy as follows

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

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

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

2009	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	-	3,459 7	4,014 1	7,473 8
Available for sale securities	-	168 5	-	168 5
Financial liabilities				
Derivative financial instruments	-	1,668 8	5 0	1,673 8

The movement in assets and liabilities measured using a valuation technique for which any significant input is not based on observable market data (Level 3) is as follows

2009	Financial assets Derivative financial instruments £m	Financial liabilities Derivative financial instruments £m	Total £m
At 1 January 2009	7,269 0	-	7,269 0
Total losses in the income statement	(3,218 2)	(41 7)	(3,259 9)
Transfers from assets to liabilities	(36 7)	36 7	-
At 31 December 2009	4,014 1	(5 0)	4,009 1

Total losses in the income statement of £3,259 9m are a result of fair value losses of £4,329 1m less settlement gains of £1,069 2m

iii) Liquidity risk

Liquidity risk represents the risk of being unable to pay liabilities as they fall due and arises from the mismatch in cash flows generated from current and expected assets, liabilities and derivatives Throughout 2009 the Group has continually improved the Liquidity Management Framework that was introduced on 30 April 2008 with the loan from HM Government The Liquidity Management Framework has been improved in line with the Financial Services Authority's regulations and guidelines that have been released on liquidity risk in 2009

Under the Framework, liquidity management had two key segments during 2009 as follows

- Back book liquidity Cash flows are generated from repayments and redemptions of retail customer loans and from maturities of Treasury investments These cash flows are used to repay wholesale funding maturities and after maintaining adequate liquidity to meet anticipated outflows are used to repay the Government loan
- Front book liquidity New lending to customers is required to be funded from new retail or new wholesale funding Liquidity levels are maintained to meet expected and unexpected levels of liquidity outflows with any permanent surplus liquidity used to repay the Government loan

The liquidity framework governance structure operates within the Board's delegated authorities and reports into Liquidity Management Group (LMG), Asset and Liability Committee (ALCO), Risk Committee, Executive Committee and Board Group Treasury and Finance monitor liquidity on a daily basis, using daily cash flow liquidity reports, together with daily movement reports, liquidity performance indicators, portfolio analyses and maturity profiles LMG reviews on a weekly basis proposed daily cash flows to ensure key liquidity performance indicators are met Any changes in legislation, regulation and other guidance which may affect the Group's liquidity position or any other matters relating to its obligations under the Government loan are reported directly to the Chief Financial Officer ALCO and Risk Committee receive monthly liquidity analysis and profiles and report directly to Executive Committee, which makes recommendations to the Board for its approval, and policies and strategies to ensure that capital and liquidity management are optimised to meet internal and external shareholder requirements

40. Financial risk management (continued)

The table below analyses the Group's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date Amounts shown in respect of loans and advances to customers include fair value adjustments of portfolio hedging

2009	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Assets						
Cash and balances with central banks	7,446 6	–	–	–	63 8	7,510 4
Derivative financial instruments	240 5	150 1	431 0	3,542 9	3,109 3	7,473 8
Loans and advances to banks	3,702 4	–	–	–	–	3,702 4
Loans and advances to customers	564 0	521 9	1,044 1	8,200 2	55,069 6	65,399 8
Investment securities and unsecured investment loans	126 2	83 6	90 9	724 8	2,062 3	3,087 8
Other assets	52 9	6 8	–	–	211 6	271 3
Total assets	12,132 6	762 4	1,566 0	12,467 9	60,516 6	87,445 5
Liabilities						
Loans from Government	14,315 5	–	–	–	–	14,315 5
Deposits by banks	5,800 1	88 9	–	133 3	–	6,022 3
Customer accounts	12,533 4	1,419 8	3,516 2	3,098 4	39 8	20,607 6
Derivative financial instruments	45 2	55 8	193 0	1,224 9	154 9	1,673 8
Debt securities in issue	53 9	246 7	964 1	5,650 4	35,058 6	41,973 7
Subordinated liabilities	–	–	–	–	935 0	935 0
Tier one notes	–	–	–	–	233 7	233 7
Other liabilities	342 6	83 5	94 5	93 3	14 9	628 8
Total liabilities	33,090 7	1,894 7	4,767 8	10,200 3	36,436 9	86,390 4
Net liquidity gap	(20,958 1)	(1,132 3)	(3,201 8)	2,267 6	24,079 7	1,055 1

2008	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Assets						
Cash and balances with central banks	9,285 4	–	–	–	51 4	9,336 8
Derivative financial instruments	1,045 8	990 8	534 0	5,024 9	5,718 9	13,314 4
Loans and advances to banks	3,384 4	–	–	–	–	3,384 4
Loans and advances to customers	672 3	626 1	1,268 1	9,327 0	62,107 8	74,001 3
Investment securities and unsecured investment loans	258 0	115 4	116 0	814 4	2,505 4	3,809 2
Other assets	132 9	22 7	10 9	0 8	332 6	499 9
Total assets	14,778 8	1,755 0	1,929 0	15,167 1	70,716 1	104,346 0
Liabilities						
Loans from Government	15,583 4	–	–	–	–	15,583 4
Deposits by banks	4,384 9	–	–	240 2	–	4,625 1
Customer accounts	15,762 4	1,044 8	2,574 7	1,340 8	–	20,722 7
Derivative financial instruments	29 6	60 8	195 0	1,704 1	231 3	2,220 8
Debt securities in issue	2,105 0	2,016 8	1,522 7	7,271 2	44,820 6	57,736 3
Subordinated liabilities	–	–	–	–	1,514 9	1,514 9
Tier one notes	–	–	–	–	251 8	251 8
Other liabilities	778 2	131 4	79 6	50 5	17 7	1,057 4
Total liabilities	38,643 5	3,253 8	4,372 0	10,606 8	46,836 3	103,712 4
Net liquidity gap	(23,864 7)	(1,498 8)	(2,443 0)	4,560 3	23,879 8	633 6

HM Treasury has confirmed that it is its intention to continue to fund the Company so as to maintain the Company as a going concern and enable the Company to meet its debts as and when they fall due for a period of not less than 18 months from 31 December 2009

40. Financial risk management (continued)

Non derivative cash flows

The table below analyses the Group's non derivative cash flows payable into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date The amounts disclosed are the contractual undiscounted cash flows These differ from balance sheet values due to the effects of discounting on certain balance sheet items and due to the inclusion of contractual future interest flows

2009	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Liabilities						
Loans from Government	14,325 7	-	-	-	-	14,325 7
Deposits by banks	5,802 2	89 5	1 0	138 3	-	6,031 0
Customer accounts	12,588 0	1,470 8	3,744 7	3,353 3	40 0	21,196 8
Debt securities in issue	1,850 9	1,257 2	3,815 7	25,320 1	16,196 1	48,440 0
Subordinated liabilities	487 2	1 2	15 2	375 7	178 6	1,057 9
Tier one notes	-	-	14 1	56 4	383 4	453 9
	35,054 0	2,818 7	7,590 7	29,243 8	16,798 1	91,505 3

2008	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Liabilities						
Loans from Government	15,826 5	-	-	-	-	15,826 5
Deposits by banks	4,389 9	3 8	2 9	276 3	-	4,672 9
Customer accounts	15,855 2	1,103 6	2,751 8	1,513 4	-	21,224 0
Debt securities in issue	6,098 3	4,300 9	4,033 3	29,493 4	27,382 1	71,308 0
Subordinated liabilities	186 2	15 9	30 0	815 2	782 2	1,829 5
Tier one notes	-	-	14 1	56 4	397 5	468 0
	42,356 1	5,424 2	6,832 1	32,154 7	28,561 8	115,328 9

Derivative cash flows

The following table analyses cash flows for the Group's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date The amounts disclosed are the contractual undiscounted cash flows Derivatives included within this analysis are single currency interest rate swaps

2009	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Derivatives in economic but not accounting hedges	(41 4)	(33 2)	(41 1)	(43 1)	1 2	(157 6)
Derivatives in accounting hedge relationships	(294 8)	(262 8)	(404 7)	(402 6)	(0 9)	(1,365 8)
	(336 2)	(296 0)	(445 8)	(445 7)	0 3	(1,523 4)

2008	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Derivatives in economic but not accounting hedges	(6 8)	(11 7)	(6 8)	(10 7)	(3 3)	(39 3)
Derivatives in accounting hedge relationships	(57 8)	(302 7)	(584 9)	(919 9)	(66 4)	(1,931 7)
	(64 6)	(314 4)	(591 7)	(930 6)	(69 7)	(1,971 0)

40. Financial risk management (continued)

The following table analyses cash flows for the Group's derivative financial liabilities that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date The amounts disclosed are the contractual undiscounted cash flows. Derivatives included within this analysis are cross currency interest rate swaps and forward currency contracts

2009	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Derivatives in economic but not accounting hedges						
Outflows	(104 7)	(43 8)	(77 4)	(499 3)	(115 7)	(840 9)
Inflows	93 7	39 3	70 1	459 3	114 3	776 7

2008	Within 3 months £m	After 3 months but within 6 months £m	After 6 months but within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
Derivatives in economic but not accounting hedges						
Outflows	(130 1)	(48 4)	(73 3)	(572 1)	(24 9)	(848 8)
Inflows	114 8	36 2	55 3	445 2	18 6	670 1

iv) Operational risk
The Group defines operational risk as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events including legal risks " This accords with the Basel Committee's definition of operational risk. In managing operational risk, the Group considers indirect financial costs and regulatory, reputational and customer impacts

The management of operational risk has been further strengthened during 2009 by

- Several new senior appointments
- The creation of a Financial Crime team within the Operational Risk function to provide a more integrated approach to fraud management, information security, anti money laundering and data protection
- An enhanced suite of Board approved operational risk policies
- Board approval of the Company's operational risk appetite
- The roll out of risk control self assessment
- The implementation of a new Product Approval Process
- Improved risk reporting to the Operational Risk and Compliance Committee and to the Risk Committee
- A full review of business continuity plans

During 2009 the Group calculated its capital requirement for operational risk using the Basel II Standardised Approach

v) Regulatory risk
Regulatory risk is the risk that because of a failure to comply with compliance standards and requirements, the Group suffers legal or regulatory sanctions, financial loss or a loss of reputation

To manage the risk, the Group has a dedicated Compliance function headed by an independent Compliance professional who reports to the Chief Risk Officer The new Risk Management Framework includes a Regulatory Risk Policy within which the Board has set a zero risk appetite (i e full compliance) in relation to regulatory risk, and standards that the business is expected to operate within The framework also includes the governance and policy controls to enable identification of key regulatory risks, and of prevailing and emerging regulatory risk developments, issues and trends. The impacts of these developments on the Group are then assessed by the business and Compliance function Where new procedures or changes in procedures are required to ensure full compliance with new developments is achieved, it is the role of the Compliance function to work with the Executive and assist line management to ensure that they are implemented fully

In addition to ensuring compliance with new developments, the framework requires ongoing review and challenge of the Group's compliance related processes and practices It also requires the monitoring of consistent application of policies, on a risk based approach The results of the reviews are reported to the Executive Committee, Risk Committee and Audit Committee on a regular basis

B) Capital Management
The Group manages its capital resources to meet the regulatory requirements established by its regulator, the FSA. Capital adequacy is monitored on an ongoing basis by the Group's executive management and Board, based on the regulations established by the FSA The required capital information is filed with the FSA on a quarterly basis

During 2009, the Group continued to adopt the Retail Internal Ratings Based (IRB) approach for residential and personal unsecured loans, the Foundation IRB approach for treasury portfolios and the Standardised approach for commercial loans and operational risk.

On 23 February 2009, the Company announced that it had concluded the strategic review of its business plan, in close consultation with the Government To facilitate anticipated new lending a legal and capital restructuring of the Company was undertaken on 1 January 2010, following receipt of EU State aid approval of the revised plan

Northern Rock's total available capital resources are shown in the table below The FSA's capital resources gearing rules require core tier 1 capital to account for at least 50% of total tier 1 capital and limit total tier 2 capital to 100% of tier 1 capital and lower tier 2 capital to 50% of tier 1 capital Certain elements of the total available capital resources shown above are therefore restricted for regulatory purposes Northern Rock was granted a waiver from the restriction that total tier 2 capital must not exceed total tier 1 capital during the period 31 July 2008 to 30 June 2009 and from 28 October 2009 until 31 December 2009

40. Financial risk management (continued)

As described further in note 44, Northern Rock was restructured into two separate companies with effect from 1 January 2010 The Company remains authorised and regulated by the FSA. However, it is now a regulated mortgage company rather than a bank and is therefore subject to significantly lower capital requirements than previously

Total capital resources of the Company are available without restriction in order to meet its regulatory capital requirement and are initially marginally higher than the total shown below

	2009 £m	2008 £m
Core Tier 1		
Ordinary share capital	**123 9**	123 9
Share premium on ordinary share capital	**6 8**	6 8
Capital redemption reserve	**7 3**	7 3
Retained earnings	**(454 6)**	(145 2)
Pension scheme	**(20 9)**	(9 9)
Total Core Tier 1 capital	**(337 5)**	(17 1)
Perpetual Non-Cumulative Preference Shares		
Preference share capital	**0.1**	0 1
Share premium on preference share capital	**396 4**	396 4
Tier one notes	**233 7**	251 8
Total Perpetual Non-Cumulative Preference Shares	**630 2**	648 3
Innovative Tier 1		
Reserve capital instruments	**299 3**	299 3
Total Innovative Tier 1 capital	**299 3**	299 3
Regulatory deductions from Tier 1	**(101 6)**	(146 4)
Tier 1 capital after deductions	**490 4**	784 1
Upper Tier 2		
Perpetual subordinated debt	**1,141 8**	1,310 9
Collectively assessed impairment allowance	**27.2**	2 6
Surplus provisions	**42 4**	-
Total Upper Tier 2 capital	**1,211 4**	1,313 5
Lower Tier 2		
Term subordinated debt	**935 0**	940 5
Total Tier 2 capital	**2,146 4**	2,254 0
Regulatory deductions from Tier 2	**(42 5)**	(76 3)
Tier 2 capital after deductions	**2,103 9**	2,177 7
Deductions from totals of Tier 1 and Tier 2		
Investments in subsidiary undertakings	**(5 1)**	(5 1)
Total available capital resources	**2,589 2**	2,956 7

C) Contingent Liabilities

The Financial Services Compensation Scheme

The Financial Services Compensation Scheme ("FSCS") is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it The FSCS has borrowed from HM Treasury to fund the compensation costs associated with institutions that failed in 2008 and will receive the receipts from asset sales, surplus cash flows and other recoveries from these institutions in the future

The FSCS meets its obligations by raising management expense levies These include amounts to cover the interest on its borrowings and compensation levies on the industry Each deposit-taking institution contributes in proportion to its share of total protected deposits

In 2009, the Group has accrued £16 4m in respect of its current obligation to meet management expense levies (2008 £16 8m)

If the FSCS does not receive sufficient funds from the failed institutions to repay HM Treasury in full, it will raise compensation levies At this time, it is not possible to estimate the amount or timing of any shortfall resulting from the cash flows received from the failed institutions and, accordingly, no provision for compensation levies, which could be significant, has been made in these financial statements

41. Collateral pledged and received

Northern Rock enters into securitisation transactions whereby portfolios of residential mortgage loans are sold or assigned to special purpose vehicles funded through the issue of mortgage backed securities Holders of these securities are only entitled to receive payments of interest and principal to the extent of the resources of the securitisation companies and have no other form of recourse At 31 December 2009, £27,254 4m of residential mortgage loans (2008 £32,325 0m) and £128 4m of cash (2008 £128 4m) were so assigned This is detailed further in note 19

Northern Rock also operates a covered bond programme, under which securities are issued to investors, secured on a ring-fenced pool of residential mortgage loans At 31 December 2009, £11,953 2m of residential mortgage loans (2008 £9,686 5m) had been pledged as security for covered bonds. This is detailed further in note 20

Cash collateral is given and received as part of normal derivative operations At 31 December 2009, £848 6m (2008 £642 1m) had been pledged and £5,564 9m (2008 £4,239 9m) had been received as cash collateral In addition the Group held securities collateral with a value of £394 3m (2008 £nil) In the absence of counterparty default, the Group has no right to sell or re-pledge these securities and therefore in accordance with the provisions of IAS 39 such securities are not recognised on the balance sheet

All collateral balances are the same in Group and Company with the exception of cash collateral received as part of derivative operations, which is £28 2m (2008 £460 9m) in the Company, and securities collateral, which is £nil (2008 £nil) in the Company

42. Related party transactions

A number of banking transactions are entered into with related parties as part of normal banking business These include loans and deposits The volumes of related party transactions, outstanding balances at the year end and related income and expense for the year are set out below

	Directors and key management personnel	
	2009	2008
	£m	£m
Loans		
Loans outstanding at 1 January	**2 2**	6 6
Movements due to changes in Directors and key management personnel	**0 7**	(4 5)
Net amounts (repaid)/advanced	**(1 2)**	0 1
Loans outstanding at 31 December	**1 7**	2 2
Interest income paid	**0 1**	0 1
Deposits		
Deposits outstanding at 1 January	**0 3**	2 7
Movements due to changes in Directors and key management personnel	**-**	(2 7)
Net amounts deposited	**0 2**	0 3
Deposits outstanding at 31 December	**0 5**	0 3
Interest income earned	**-**	-

	2009	2008
	£m	£m
Directors and key management personnel		
Salaries and other short term benefits	**4 2**	4 1
Post-employment benefits	**0 7**	0 2
Share-based payments	**-**	1 2
	4 9	5 5

As a consequence of the transfer of all shares in Northern Rock to the Treasury Solicitor on 22 February 2008, the Company regards the Government as a related party Details of loan facilities with the Government are set out in note 26 above Interest and guarantee fees payable on the loan, net of interest receivable on liquidity deposit accounts with the Bank of England, in 2009 were £385 9m (from 22 February 2008 to 31 December 2008 £990 0m) On 28 October 2009, the European Commission approved the Government's State aid package for Northern Rock. This resulted in the clawback of £472 4m of net interest income and guarantee fees previously payable to the Government, of which £200 0m related to 2008

In addition to these loans and guarantees the Group has transactions with numerous Government bodies on an arm's length basis in relation to the payment of corporation tax, value added tax and employment taxes and the payment of regulatory fees and levies Transactions with these entities are not disclosed owing to the volume of transactions conducted

The Company owns Northern Rock (Guernsey) Limited, which operates as a retail deposit taker The net funding repaid by the Company to Northern Rock (Guernsey) Limited during the year amounted to £142 0m (see note 27) (2008 £605 5m borrowed from Northern Rock (Guernsey) Limited)

During the year the Company repaid a net £4,707 3m to its securitisation SPEs (see note 19), being the net payment arising from securitisation transactions in the year (2008 £16,693 6m)

43 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition

	Group		Company	
	2009	2008	**2009**	2008
	£m	£m	**£m**	£m
Cash and balances with central banks	**7,446 6**	9,285 4	**7,446 6**	9,285 4
Loans and advances to banks	**3,702 4**	3,384 4	**3,552 6**	3,236 1
Investment securities and unsecured investment loans	**5 0**	140 6	**-**	140 6
	11,154 0	12,810 4	**10,999 2**	12,662 1

44. Events after the balance sheet date

On 1 January 2010 the following assets and liabilities were transferred to Northern Rock plc under the terms of The Northern Rock Transfer Order 2009, SI 2009/3226

	31 December 2009	Transfer	1 January 2010
	£m	£m	£m
Assets			
Cash and balances with central banks	7,510 4	(9 9)	7,500 5
Loans and advances to banks	3,702 4	(865 6)	2,836 8
Loans and advances to customers	64,268 2	(10,343 3)	53,924 9
Fair value adjustments of portfolio hedging	1,131 6	(160 3)	971 3
Investment securities and unsecured investment loans	3,087 8	(424 0)	2,663 8
Intangible assets	53 8	(23 1)	30 7
Property, plant and equipment	154 6	(32 7)	121 9
Other assets	28 9	(4 4)	24 5
Prepayments and accrued income	27 2	(13 7)	13 5
Total transferred assets		(11,877 0)	
Liabilities			
Deposits by banks	6,022 3	(235 3)	5,787 0
Customer accounts	20,607 6	(20,607 6)	-
Other liabilities	87 9	(19 2)	68 7
Accruals and deferred income	441 1	(188 4)	252 7
Other reserves	(512 1)	16 2	(495 9)
Retained earnings	(408 4)	(17 1)	(425 5)
Total transferred liabilities		(21,051 4)	
Balance owed to Northern Rock plc	-	9,174 4	9,174 4

There was no profit or loss associated with this transaction The balance owed to Northern Rock plc has been paid in full in cash This was funded by an increase in the loan to the Company from HM Treasury of £8,506m

The amounts transferred above represent the amounts transferred from the Group The difference between Group and Company amounts held for resale relates to Northern Rock (Guernsey) Limited

The transferred assets and liabilities above have been included on the balance sheet of Northern Rock (Asset Management) plc as 'held for resale' at 31 December 2009 in accordance with the requirements of IFRS 5

In addition to the transfer of the assets and liabilities set out above, all employees of Northern Rock (Asset Management) plc transferred to Northern Rock plc on 1 January 2010 The two companies entered into various agreements under which services are provided primarily by Northern Rock plc to Northern Rock (Asset Management) plc

As part of the transfer of assets and liabilities to Northern Rock plc, Northern Rock (Asset Management) plc has agreed to indemnify Northern Rock plc against potential claims arising from past business up to a maximum of £100m

45 Ultimate controlling party

As a result of The Northern Rock plc Transfer Order 2008, which transferred all shares in the Company to the Treasury Solicitor as nominee for HM Treasury on 22 February 2008, the Company considers Her Majesty's Government to be the ultimate controlling party from that date