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Annual Report and Accounts 2004

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MISSION STATEMENT

Northern Rock is a specialised lending and savings bank which aims to deliver superior value to customers and shareholders through excellent products, efficiency and growth.

COMPANY STRATEGY

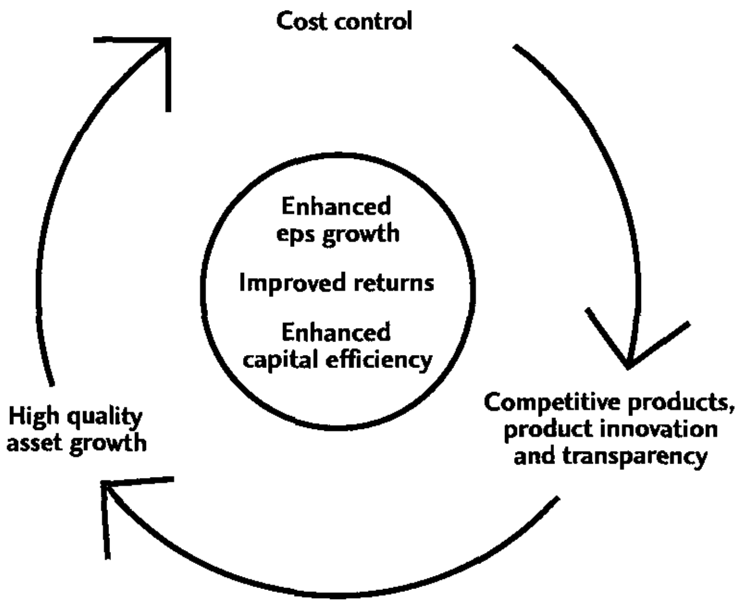
Northern Rock is a specialised lender providing funds for residential mortgages, secured commercial lending and personal finance. We obtain funds from both on-shore and off-shore personal savings, wholesale money markets and from the securitisation of mortgage assets.

The Northern Rock strategy encompasses efficiency, growth and value for both customers and shareholders.

Efficiency is paramount to the Northern Rock business strategy. Cost efficiency is enhanced by low cost, effective distribution and enables competitive pricing. Capital efficiency is achieved by optimising the use of debt and equity capital.

By growing lending and improving the mix of higher margin products, Northern Rock aims to grow earnings and improve returns to shareholders, at the same time as providing innovative and consumer friendly products to our customers.

THE VIRTUOUS CIRCLE



CHAIRMAN'S STATEMENT

Dr M W Ridley

I took on the chair of Northern Rock in April 2004 from Sir John Riddell, whose four years as Chairman saw not only significant growth in assets under management, but also a near doubling of the share price. That record speaks for itself, and I pay tribute to the skill and good humour with which he ran the Board of Northern Rock. He will be a hard act to follow.

Northern Rock once again hit its strategic targets in 2004 despite intense competition, expensive regulation and a sharply slowing market. We grew both assets and profits to record levels. We achieved this by sticking to the markets we know best, maintaining our position as the most cost-effective mortgage lender in the UK and continually adjusting our products to attract profitable business.

This performance has not come at the expense of service to customers, where Northern Rock remains committed to continually improving efficiency, transparency and fairness. Our customers benefit from our "Open Book" policy of making our new mortgage products available to existing borrowers as well as new customers.

Statutory mortgage regulation became effective on 31 October 2004. Extra regulation has plainly added to costs and erected barriers to entry. This may in the long run hamper competition, which has been the most powerful force in getting customers value for money in the mortgage market. None the less, we were compliant with the new regime from the first day.

Northern Rock is a global company in terms of where it raises funds, a national company in terms of where it lends and a regional company in terms of where it employs people: most of our employees are in the North-East of England. During 2004 we created over 1,000 new jobs based in the North-East. The latest stage of our Head Office expansion, which neared completion in 2004, will add capacity for a further 1,000 jobs. We also have plans to redevelop part of our Head Office accommodation to provide facilities for another 1,400 staff.

CHAIRMAN'S STATEMENT (continued)

ECONOMIC AND MARKET BACKGROUND

The British economy remains in reasonable shape in 2005. With the Bank of England Base Rate still low by historical standards, continued low unemployment, well controlled inflation and stable economic growth, the UK continues to offer an attractive environment for home ownership, especially given the limited supply of rented accommodation.

House price inflation has eased, and we expect it to be in line with earnings growth for the next few years. Barring surprises, we see little prospect of a crash, given that mortgages are still comparatively affordable and that credit quality remains good.

We fund our lending from retail deposits, wholesale funding, securitisation and covered bonds. All four funding arms are important to us, and give us access to large international markets where we work to ensure that the supply of affordable funding does not constrain the growth of profitable lending.

SOCIAL RESPONSIBILITY

Northern Rock's primary social responsibility is to prosper. By offering competitive rates to both savers and borrowers, we benefit them. In growing, we benefit our employees by providing new jobs and better working conditions. By meeting our targets, we benefit our shareholders and other key stakeholders.

Likewise, in order to do well it pays us to be a socially responsible business. By that I mean that Northern Rock will prosper if we recruit from all sections of the community, if we find flexible employment practices that suit those who want to work appropriate hours to balance life and work, if we provide good facilities for staff and if we minimise harmful impacts on the environment from our activities. There is, in other words, no conflict between creating shareholder value and being socially responsible. To ensure that we set the highest possible standards of personal and corporate ethics, provide good customer service and give employees a good working environment, we encourage assessments by Ethical Investments

Research Services, support the Work-Life Balance Initiative and maintain a high position in the Business in The Environment Index. But we do not mistake such commitments for action.

On top of the good we can do by doing well, we also remember those not benefiting directly from our prosperity. Northern Rock is consistently one of the top UK companies for corporate giving, because of its donation of 5% of pre-tax profits to The Northern Rock Foundation. In 2004 this amounted to £21.6m.
The Foundation supports local charities and community causes mainly in the North-East of England, a region that is comparatively under-served by charities. I am particularly pleased that our staff continue to take part in voluntary initiatives, fund-raising, mentoring and secondment programmes.

CORPORATE GOVERNANCE

This year has seen substantial changes to the Combined Code on Corporate Governance, with which the Board is obliged to comply or explain. We are in a position to comply with the code in full. The Board's procedures and practices ensure that it identifies and controls risks to the business in a transparent and accountable way. The results of our Board evaluation and appraisal process are summarised in the Corporate Governance statement.

I am pleased that since the year-end, we have strengthened the Board with four new appointments. Two senior executives, Keith Currie, our treasurer, and Andy Kuipers, our sales and marketing director, both joined the Board from 5 January 2005. Michael Queen, an executive director of 3i Group plc, joined the board as a Non-Executive Director on the same date. Furthermore, Rosemary Radcliffe, former complaints commissioner of the FSA and former chief economist of PricewaterhouseCoopers, will also join the Board as a Non-Executive Director, with effect from 1 March 2005.

DIVIDEND

Your board is recommending a final dividend of 18 pence per share making a total for the year 26.5 pence – an increase of 13.7 % on 2003.

CONCLUSION

In highly competitive markets we have once again risen to the challenge and hit strategic targets in 2004. Our business model remains robust: we keep costs low, invest in product and process innovation, give our customers transparency and so add low-risk assets to our balance sheet to provide attractive returns to our shareholders. We fund this growth through retail, wholesale and securitised channels.

We have always told shareholders that we can perform well in a weak housing market as well as a strong one. Our results differentiate us from our competitors and if, as expected, the housing market slows further in the coming year it will remain sufficiently large to enable us to achieve our targets without compromising on credit quality.

I am grateful to my Board colleagues, to management and all Northern Rock staff for their ingenuity, hard work and success in 2004.

CHIEF EXECUTIVE'S REPORT

Adam J Applegarth

In 2004 Northern Rock delivered excellent results including:

- RECORD PRE TAX PROFITS OF £431.2 MILLION - A LIKE-FOR-LIKE INCREASE OF 13.0%
- ASSETS UNDER MANAGEMENT OF £64.9 BILLION - AN INCREASE OF 24.9%
- RECORD NET LENDING OF £12.9 BILLION - AN INCREASE OF 51.9% AND A MARKET SHARE OF 11.2%
- RATIO OF COSTS TO ASSETS UNDER MANAGEMENT IMPROVED TO 0.38% (2003 UNDERLYING - 0.41%)
- RETURN ON EQUITY OF 21.3%
- TOTAL DIVIDEND PER SHARE 26.5P - AN INCREASE OF 13.7%
- THE NORTHERN ROCK FOUNDATION - SUPPORTING CHARITABLE CAUSES - TO RECEIVE £21.6 MILLION

2004 has been a very challenging year and so I am delighted to announce results that show record growth, record profits and further improvement in earnings per share.

High quality asset growth and cost efficiency form the essence of our strategy. Through a combination of being a small stock player, having a unit cost advantage and retaining customers, whilst attracting new borrowers and savers, we are able to grow our assets under management strongly, leveraging our equity capital to enhance shareholder returns. Cost efficiency is key to our strategy, as this allows profitable growth of the business and the manufacture of competitive products for our customers.

Our core products of mortgages, savings and personal loans all performed well in 2004. They were complemented by general insurance and protection products offered in conjunction with our partners, providing our customers with both choice and peace of mind.

During 2004 we invested significantly in our infrastructure, both in terms of technology and commencement of the latest phase of planned building expansion at our Head Office site. The demands of regulation show no signs of abating and our cost base also absorbed an extra £3.6 million from increased regulatory requirements. However, growth in operating expenses was well contained.

We continue to pursue a multi-channel distribution strategy and have opened several specialist mortgage branches in key areas around the country. These additions further strengthen our franchise and provide a logical extension to complement our existing network. In addition to this important investment, we continue to invest in other channels, encouraging e-business links with both mortgage intermediaries and direct customers.

LENDING

During 2004 we once again delivered record levels of low risk lending. Gross lending was £23,342 million, an increase of 34.8% over the previous year, with net lending of £12,932 million, an increase of 51.9%. We achieved gross residential lending of £20,051 million, an increase of 31.8% over 2003 and net residential lending of £11,383 million, an increase of 44.8%, which represented 11.2% of the UK market.

Our mix of new residential lending during the first half of 2004 reflected the shift in customer preferences towards discounted products. In the second half, as interest rates moved closer to their cyclical peak and the price of fixed rate products reduced, short term fixed rate lending was more prevalent. Our lifestyle range of products, including our credit bundling product, "together", residential Buy to Let and Lifetime Home Equity Release Mortgages (HERM), which allow older borrowers to withdraw equity from their home to aid retirement income, continued to be popular. We remain at the forefront of providing a competitive choice of products for homeowners and homebuyers, whether they are new or existing customers.

With the Bank Base Rate remaining low by historical standards, continued low unemployment, inflation well controlled and stable UK economic growth rates, fundamentals will remain supportive to home ownership. The remortgage market, which accounted for around 40% of UK gross lending in 2004, will also remain strong, particularly as interest rates appear close to their cyclical peak and the incidence of overhanging redemption charges has diminished.

Due to our relative size and focus on the retention of existing customers our net lending figures are higher than our natural share of the market. Our competitive pricing and transparent approach,

CHIEF EXECUTIVE'S REPORT (continued)

combined with our Mortgage Review Service support our retention performance and limit the impact of redemptions from our portfolios. Consequently our net lending is very strong with volume growth of gross lending being leveraged further by low redemptions.

As borrowers seek to refinance to obtain better deals, Northern Rock, with its unit cost advantage and transparent policy, remains well placed to deliver its growth objectives. As a result Northern Rock should not be considered as a proxy for either the housing market or the industry's net lending figures. We are a major player in the wider mortgage market, which importantly includes remortgaging and remains a key part of our growth plans.

We have grown our commercial lending and personal unsecured lending portfolios steadily, maintaining our emphasis on quality. We maintain an appropriate balance in these books relative to our overall assets under management.

FUNDING

Funding remained strong during 2004. All three traditional funding arms – retail funding, wholesale funding and securitisation – continued to perform well. We added a fourth stream by completing an inaugural covered bond issue in April 2004. Our funding platform is flexible, diverse and robust.

Our retail funding franchise remains an important part of our funding strategy. Retail funding inflows were restrained during the first half of the year following successful non-retail activities.

During the second half, however, we funded strongly attracting over £1 billion of new funds, representing our strongest ever half-year performance. The overall increase in retail balances during 2004 was £896 million resulting in total retail balances under management of £17.2 billion at the year-end.

We have a broad distribution platform of branch, postal, telephone and on-line accounts, as well as off-shore and Ireland operations, which we will continue to develop. In particular we have seen strong inflows in our Silver Savings account, for over 50's, which attracted balances of over £1.25 billion, following its launch in September 2004. We also funded strongly in fixed rate bonds where contractual guarantees provided customers with added confidence.

Our Treasury operation continues to raise wholesale funds, manage interest rate and currency risks, and manage a portfolio of investments primarily for liquidity purposes. It is not a separate profit centre and does not operate trading portfolios. We have continued to develop our non-retail funding in international markets with further funding diversification in Continental Europe, North America and Asia. By diversifying our funding geographically and by mixing the term of funding appropriately over short, medium and long term horizons we are able to underpin our growth aspirations, whilst reducing the risk to our platform. During the year net new wholesale funding totalled £2.77 billion, increasing balances to £19.7 billion.

Our residential securitisation programme is firmly established as a reliable source of funding, a reflection of the high credit quality of Northern Rock's loan book and the huge investor appetite for this type of financial instrument. During 2004, we issued £11.1 billion of securitised notes. Assets under management subject to securitisation now amount to £22.3 billion, representing 40% of our lending portfolios. Securitisation, with increasing diversification, will continue to play an important role in funding our future growth plans as well as contributing to capital efficiency.

Already in 2005 we have raised a further US$1.75 billion under our US Medium Term Note programme and £4.5 billion from our fourteenth residential securitisation transaction further strengthening the split between short term and medium term funding.

CREDIT QUALITY

The credit quality of our assets remains very strong. We do not attract volume growth at the expense of quality. The credit quality of our lending is excellent and continues to be tightly monitored and controlled. We operate rigorous underwriting processes that include credit checking and affordability tests. Our monthly behavioural scoring system confirmed during 2004 that there were no early warning signs of significant credit deterioration. Even though mortgage balances have grown significantly, we have not increased our appetite for risk.

The arrears performance of our residential lending book improved further during 2004 with only 0.37% of accounts three months or more in arrears compared with 0.45% the year before. Once again, despite significant growth in mortgages under management we have been able to reduce the percentage of loans in arrears. Overall our residential arrears remain below half the industry average.

Commercial loan arrears and standalone personal unsecured loan arrears are also significantly better than industry average, reflecting our policy of attracting high quality lending. Our provisioning policies remain prudent and we have no loan exposure outside the UK, nor exposure to unsecured commercial lending or leasing.

OUTLOOK

Our strategy of combining competitive products, effective distribution and efficient customer service, driven off a low unit cost base works well. We will continue to develop our business so that it is highly focussed, resilient and scalable to meet our growth aspirations. By continuing to deliver our strategic targets and maintaining our responsible approach to lending we will continue to enhance value for our customers and our shareholders in the future.

We expect the housing market to slow but activity will be underpinned by relatively low interest rates, continuing low levels of unemployment and a restricted supply of new housing stock. The attractive pricing for new customers and the further erosion of overhanging redemption charges should ensure that levels of remortgaging will more than offset the level of slowdown in the housing market. Our small market share allows us significant room for growth regardless of overall market performance. This should enable us to achieve our strategic growth range of 20% +/– 5% in high quality, low risk, assets under management.

We are relatively small, have a unit cost advantage, retain existing customers well and are increasingly good at attracting new loans. Our broad funding platform, efficient distribution network and continued investment in buildings, systems and people will enable us to originate and service increased volumes of profitable business. We are therefore well placed to continue to deliver strong growth in high quality, low risk assets. Our strategic targets remain unchanged for 2005 and beyond, reflecting our confidence in our business model to deliver and maintain shareholder value.

THE BOARD

During 2004, the number of meetings attended by each Director was as follows:

	Board	Audit	Nominations	Remuneration	Chairman's	Risk
Number of meetings held in 2004	**11**	**6**	**3**	**2**	**1**	**4**
Non – Executive Directors						
Dr M W Ridley, BA, D.Phil Chairman - (appointed Chairman 27 April 2004)	**11**	**3**	**3**		**1**	**1**
Sir George Russell, CBE, D.Eng., BA – Senior Independent Director	**7**	**4**		**2**		**2**
Sir Derek Wanless, MA, FCIB, MIS	**10**	**5**	**3**	**1**		**4**
N Pease, BA	**10**	**5**		**2**		**4**
Sir Ian Gibson, CBE	**10**	**5**	**3**	**2**		**4**
N A H Fenwick, MA	**10**	**6**		**1**		**3**
Sir John Riddell, Bt., CVO, MA, CA - (Retired 27 April 2004)	**4**		**1**			
Sir David Chapman, Bt., DL, B.Comm - (Retired 27 April 2004)	**3**	**1**				
Executive Directors						
A J Applegarth, BA	**11**				**1**	**4**
D F Baker, BSc, FCIB	**11**				**1**	**4**
R F Bennett, FCA, ACMA, IPFA	**11**				**1**	**4**

EXECUTIVE DIRECTORS

R F Bennett
Group Finance Director

K M Currie
Treasury Director
(appointed 5 January 2005)

C Taylor
Company Secretary

A M Kuipers
Sales & Marketing Director
(appointed 5 January 2005)

A J Applegarth
Chief Executive

D F Baker
Chief Operating Officer

THE BOARD

Dr M W Ridley, BA, D.Phil

Matt Ridley (aged 47), was appointed Chairman of the Company on 27 April 2004. He was appointed as a Non-Executive Director of Northern Rock plc in November 1996 having previously joined the Board of Northern Rock Building Society on 1 June 1994.
Dr Ridley is an author and businessman who also holds other Non-Executive Directorships which include Northern Investors Company PLC, Northern 2 VCT plc and P A Holdings Limited. He is Chairman of both the Nominations and Chairman's Committees.

A J Applegarth, BA

Adam Applegarth (aged 42) has worked for Northern Rock for 21 years. He became an Executive Director of Northern Rock Building Society in January 1996, was appointed as an Executive Director of Northern Rock plc in October 1996 and subsequently became the Company's Chief Executive in March 2001. Mr Applegarth is a governor of the Royal Grammar School, Newcastle upon Tyne. Mr Applegarth is a Member of both the Chairman's and Risk Committees.

D F Baker, BSc, FCIB

David Baker (aged 51) was appointed as the Company's Chief Operating Officer in January 2001. He became an Executive Director of Northern Rock Building Society in January 1996 and was appointed as an Executive Director of Northern Rock plc in October 1996. He is a Fellow of the Chartered Institute of Bankers. In his present role he is responsible for the direction and management of the Company's operations and in particular, Retail Savings, Credit, Customer Services, Personnel, Premises and Legal and Compliance. Mr Baker is Chairman of The Newcastle Employment Bond Limited and a Trustee of the University of Newcastle upon Tyne Development Trust. Mr Baker is a Member of both the Chairman's and Risk Committees.

R F Bennett, FCA, ACMA, IPFA

The Group Finance Director, Bob Bennett (aged 57), is a Chartered Accountant. He became an Executive Director of Northern Rock Building Society in November 1993 and was appointed as an Executive Director of Northern Rock plc in November 1996. In his present role, he is responsible for Finance, Treasury, Securitisation, Internal Audit, Risk Management and Institutional Relations. Mr Bennett is also a Trustee of the Northern Rock Pension Scheme and a Non-Executive Director of Greggs plc. Mr Bennett is a Member of both the Chairman's and Risk Committees.

K M Currie

Keith Currie, (aged 48) was appointed to the Board as an Executive Director in January 2005. Mr Currie is responsible for the management of the Company's Group Treasury function including liquidity, wholesale funding, derivative portfolios and the management of the Company's securitisation funding and covered bond programmes. Mr Currie is a Member of the Chairman's Committee.

N A H Fenwick, MA

Adam Fenwick (aged 44), was appointed to the Board as a Non-Executive Director in November 2003. He is an Executive Director of Fenwick Limited and a Non-Executive Director of John Swire and Sons Limited. He is also a Trustee of Newcastle Theatre Royal Trust Limited. Mr Fenwick is a Member of both the Audit and Remuneration Committees.

Sir Ian Gibson, CBE

Sir Ian Gibson (aged 58), was appointed to the Board as a Non-Executive Director in September 2002. He is Chairman of BPB plc and a Non-Executive Director of GKN plc and Chelys Limited. He was also a member of the Court of the Bank of England from 1999 to 2004. Sir Ian is a Member of the Audit, Nominations, Risk, and Remuneration Committees.

A M Kuipers

Andy Kuipers (aged 47), was appointed to the Board as an Executive Director in January 2005. He is responsible for the co-ordination and direction of the Group's sales, marketing, products and new mortgage loans processing activities. Mr Kuipers is a Member of the Chairman's Committee.

N Pease, BA

Nichola Pease (aged 43), is Chief Executive of J O Hambro Capital Management Limited and a Non-Executive Director of Grainger Trust PLC. She was appointed as a Non-Executive Director of Northern Rock plc in February 1999. Ms Pease is Chairman of the Remuneration Committee and is a Member of the Audit Committee.

M J Queen, BA, FCA

Michael Queen (aged 43) is the Finance Director of 3i Group PLC. He was appointed to the Board as a Non-Executive Director in January 2005. Mr Queen is a Member of both the Audit and Remuneration Committees.

Sir George Russell, CBE, D.Eng., BA

The Senior Independent Director, Sir George Russell (aged 69), was appointed a Non-Executive Director of Northern Rock plc in November 1996 having previously joined the Board of Northern Rock Building Society as a Non-Executive Director in 1985. He is also Deputy Chairman of ITV plc. Sir George is a Member of both the Remuneration and Risk Committees.

Sir Derek Wanless, MA, FCIB, MIS

Sir Derek Wanless (aged 57), joined the Board as a Non-Executive Director in March 2000. He was previously Group Chief Executive of National Westminster Bank plc from 1992-1999. He is also a Non-Executive Director of Northumbrian Water Group plc. Sir Derek is Vice Chairman of the Statistics Commission and a Trustee of the National Endowment for Science, Technology and the Arts. Sir Derek is Chairman of both the Audit and Risk Committees and a Member of the Nominations and Remuneration Committees.

Note: On 27 April 2004 Sir John Riddell and Sir David Chapman retired from the Board of Directors.

CORPORATE GOVERNANCE

Northern Rock plc (the Company) regards adherence to the principles of good corporate governance to be of the utmost importance. The Board is accountable to the Company's shareholders for corporate governance, and the following describes how the Company applies the principles and provisions contained in the Combined Code of Corporate Governance published in July 2003 (the Combined Code). The Listing Rules of the United Kingdom Listing Authority require listed companies to disclose how they comply with the Combined Code and, where they do not do so, to provide a clear explanation of why they do not comply. For the period 1 January 2004 to 31 December 2004, the Company complied with all aspects of the Combined Code.

THE BOARD OF DIRECTORS

The Board of Directors meets regularly throughout the year, retains full and effective control over the Company and its subsidiaries (the Group), is collectively responsible for the success of the Group and determines its strategy and policies whilst monitoring performance. The Board met eleven times during 2004 and, after the retirement of Sir John Riddell and Sir David Chapman on 27 April 2004, comprised the Chairman, the Senior Independent Director, four other Non-Executive Directors, the Chief Executive and two other Executive Directors.

The Board has a formal written schedule of matters reserved for its review and approval and has adopted a detailed procedures manual which covers the responsibilities and procedures of the Board, its Committees and its officers. This includes setting policies for Balance Sheet structural risk management, the raising of Non Retail Funds, Liquidity and Credit Risk, the setting of capital expenditure budgets, the declaration of dividends and the approval of the Annual Report and Accounts.

Authority for the execution of approved policies has been delegated by the Board to the Company's Executive Committee and the Chief Executive. The Executive Committee comprises the Chief Executive, the other Executive Directors and the Company Secretary.

Within the parameters set out in the Committee's terms of reference, the Executive Committee has responsibility for facilitating the Company's effective operation to ensure that it meets its objectives through the implementation of the Strategic and Operational Plans. The Committee also monitors developments in the Company's core markets, and examines, appraises and reviews defence initiatives, potential acquisitions and corporate finance initiatives. It also establishes processes to control, appraise and review the implementation of any new procedures that are agreed upon.

The Management Board Asset and Liability Committee is responsible for overseeing the management and review of the Company's balance sheet risk profile and processes together with the Company's balance sheet, profit and loss and liquidity profiles. In addition, the Committee has authority to authorise use by the Company of structured financial products and private equity investments in accordance with the polices and procedures set down in the Corporate Finance and Structured Financial Policy statement approved by the Board.

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 clearly set out in the Chairman's letter of appointment and the Chief Executive's job description.

APPOINTMENTS TO THE BOARD

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 by shareholders at the first opportunity after their appointment. The Directors to retire by rotation will be those in office longest since their previous re-election. Non-Executive Directors are appointed for a specified term subject to re-election.

The Company's policy is that Non-Executive Directors will stand down from office at the conclusion of the next Annual General Meeting following their seventieth birthday.

DIRECTORS

More than half of the Board comprises Non-Executive Directors all of whom have experience in a wide range of commercial and banking activities. The Board considers all of the Non-Executive Directors to be independent for the purposes of the definition in the Combined Code. This requires the Board to determine whether each Director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the Director's judgement.

Sir George Russell, who was appointed Senior Independent Director of the Company on 27 April 2004, was first elected to the Board as a Non-Executive Director in September 1997 immediately prior to demutualisation, having served as a Director of Northern Rock Building Society between 1985 and 1997. The Board has no hesitation in confirming Sir George's independence for Combined Code purposes, and is satisfied that his period of service as a Director of Northern Rock Building Society should not be aggregated with his period of service as a Director of the Company in view of the different legal structure and business objectives of the two entities. The Board is also satisfied that Sir George's deferred membership of a Northern Rock Building Society pension scheme does not affect his independence. Sir George ceased to accrue pension benefits after 30 June 1997 and will become eligible to receive a pension on 25 October 2005 or on his earlier retirement from the Company. In accordance with the Company's policy Sir George Russell will retire from office at the conclusion of the 2006 AGM.

As a highly experienced company director, Sir George's sound judgement and challenging approach ensure that he makes a significant contribution to the work of the Board and its Committees. He and the other Non-Executive Directors also provide close scrutiny of the performance of management and the reporting of its performance.

It is the Company's policy that every Director should receive appropriate training on the first occasion that he or she is appointed to the Board, and subsequently as necessary. A detailed induction process exists for new Directors and, to ensure that Directors are able to discharge their responsibilities effectively, this is supported by an ongoing training programme. As part of the annual appraisal process, Directors are asked to identify areas where additional training is required.

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 arranges additional, specific training or 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. Additionally, the Company Secretary provides regular reports to the Board to ensure that it remains up to date on the latest regulatory, legal and governance developments relevant to the Company and its officers. Where necessary, the Directors are able to take independent professional advice at the Company's expense.

CHAIRMAN'S APPOINTMENT

As announced on 17 July 2003 Dr M W Ridley succeeded Sir John Riddell as Chairman of the Company on 27 April 2004. The selection process to identify Sir John's successor commenced in 2002 and was conducted by the Nominations Committee in accordance with governance standards and best practice in force prior to the publication of the revised Combined Code.

The Nominations Committee concluded that Dr Ridley was the best person for appointment as Chairman because of his exceptional leadership skills and business acumen. Additionally, the Committee concluded that Dr Ridley satisfied the important requirements of demonstrating experience of the way in which the Company operated and an understanding of how it developed so that he was best equipped to lead its continued evolution.

Dr Ridley was first elected to the Board in September 1997. In the opinion of the Board, Dr Ridley was independent (for the purposes of the revised Combined Code) on his appointment as Chairman. Dr Ridley's letter of appointment sets out his role and responsibilities and the time commitment expected of him. A copy of his letter of appointment will be available for inspection at the Annual General Meeting.

BOARD APPRAISAL

The Combined Code requires that Non-Executive Directors, the Board and its Committees should be subject to annual appraisal. Where a Non-Executive Director is proposed for re-election beyond six years, the proposal should be subject to a particularly rigorous review, and should take into account the need for progressive refreshing of the Board.

All Executive Directors, Non-Executive Directors and the Chairman were subject to an appraisal during the financial year under review to ensure that their contribution continued to be of the highest standard. The Chief Executive and all of the Non-Executive Directors were appraised by the Chairman whilst the appraisal of the Group Finance Director and Chief Operating Officer was completed by the Chief Executive. The Senior Independent Director conducted the appraisal of the Chairman, after meeting with the Non-Executive Directors in absence of the Chairman and having also canvassed the opinions of the Executive Directors.

For the year under review, the conclusion of the appraisal exercise was that each Non-Executive Director, Executive Director and the Chairman demonstrated a continued commitment and effective contribution to their position. The terms of appointment of each Non-Executive Director have been renewed for a further year with effect from 1 January 2005, subject to re-election where appropriate at the Annual General Meeting to be held in April 2005.

As part of the appraisal exercise, each individual also completed an evaluation of the Board and its Committees to enable the Secretary to report to the Board on how effective each was in discharging its responsibilities. The appraisal exercise was completed by the Board considering and debating the Secretary's report and reviewing the respective strengths and weaknesses of the Board, its members and its Committees. The Secretary reported to the Board that the evaluation of the Board and its Committees showed that they were discharging their responsibilities effectively and confirmed the process also provided useful feedback that would be used to improve current practice and procedures.

BOARD COMMITTEES

In accordance with the Combined Code and the best principles of corporate governance, the Board has established a number of Committees to assist it in the way that it deals with matters that are reserved for its consideration. The Chairman and membership of each Committee are set out on page 17.

Each Committee has detailed terms of reference clearly setting out its remit and authority. In accordance with the Combined Code, the terms of reference of the Audit, Nominations, Remuneration and Risk Committees are available on the Company's website and on request in writing from the Company Secretary.

In addition to the meetings of the Board and the Committees which took place throughout the year, the Chairman also held meetings with Non-Executive Directors in absence of the Executive Directors and Sir George Russell met with the Non-Executive Directors in absence of the Chairman and the Executives.

The following paragraphs set out details of the Committees and the particular work that they undertake.

AUDIT COMMITTEE

The Audit Committee comprises five independent Non-Executive Directors and met six times during 2004. It considers and, where appropriate, advises the Board on all matters relating to regulatory, prudential and accounting requirements that may affect the Group. It also reports to the Board on both financial and non-financial controls. 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. In February 2004 the Audit Committee reviewed the effectiveness of the external auditors and made a recommendation that they be re-appointed for a further 12 months. The Board accepted this recommendation and an appropriate resolution was passed at the 2004 Annual General Meeting.

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 may attend all meetings and have direct access to the Audit Committee and its Chairman at all times. The Chief Internal Auditor provides further assurance that the significant risks identified by the business are properly managed. The Chief Internal Auditor has direct access to the Audit Committee and its Chairman. The Executive Directors are not members of the Audit Committee but attend meetings by invitation of the Audit Committee, as necessary, to facilitate its business.

The Audit Committee reviews the internal control system on behalf of the Board and is also responsible for reviewing the effectiveness of the Internal Audit function. At each meeting the Committee receives reports of reviews conducted throughout the Company by the Internal Audit and (periodically) Compliance functions.

The Combined Code requires the Board to be satisfied that at least one member of the Audit Committee has recent and relevant financial experience. The Board is satisfied in this regard and, in addition, in the opinion of the Board the qualifications of each of the Audit Committee members gives the Audit Committee the breadth of financial experience to discharge its responsibilities.

CHAIRMAN'S COMMITTEE

The principal function of the Chairman's Committee is to review the Company's strategy and to consider any major operational issues or proposals for significant new initiatives that may arise. The Committee only meets as a formal Committee in exceptional circumstances and its activities are reported to the Board. The Committee is made up of the Chairman, the Executive Directors and the Company Secretary.

NOMINATIONS COMMITTEE

The Nominations Committee is made up of the Chairman and two independent Non-Executive Directors. The Committee met three times during 2004. It 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 to understand the activities of Northern Rock and its subsidiary undertakings.

During 2004, the Nominations Committee assessed the size of the Board, the attributes of the Board members, the continued growth of the Company and its strategic aims. The Committee concluded that, whilst the Company placed an appropriate level of demand on its Directors, the performance of the Board and its Committees would be enhanced by the appointment of two further Non-Executive Directors and two further Executive Directors.

Spencer Stuart Recruitment Limited was retained by the Company to assist in the identification and recruitment of Non-Executive Directors who would add value to the Board and its Committees. An extensive search by Spencer Stuart Recruitment Limited led to Mr Queen and Miss Radcliffe being considered and recommended to the Board by the Nominations Committee. The Committee also recommended Mr Kuipers and Mr Currie as appropriate candidates for the position of Executive Director.

The Company announced on 5 January 2005 that with immediate effect Mr Queen would be joining the Board as a Non-Executive Director and that Mr Kuipers and Mr Currie would be joining the Board as Executive Directors. Brief biographies of the new appointees are detailed at page 12 of the Annual Report. Mr Queen will augment the Board's financial expertise and has joined the Board's Audit and Remuneration Committees, whilst the promotions of Mr Kuipers and Mr Currie reflect the importance of the Marketing and Treasury functions to the Company's strategy. In addition to these appointments the Company also announced on 5 January 2005 that Miss Radcliffe would join the Board as a Non-Executive Director with effect from 1 March 2005. As a former Independent Complaints Commissioner for the Financial Services Authority, Miss Radcliffe will increase the Board's regulatory expertise and will join the Board's Remuneration and Risk Committees.

The Company believes that the appointment of all four individuals is in the best interests of its shareholders. It should be noted that Spencer Stuart Recruitment Limited has no other connection with the Company.

REMUNERATION COMMITTEE

The Remuneration Committee comprises six independent Non-Executive Directors and met twice in 2004. It 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 takes 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 in the Articles of Association. The Remuneration Committee also determines the level of remuneration for the Company's Management Board Directors (comprising management at the level immediately below the Board).

In accordance with the requirements of the Directors' Remuneration Report Regulations 2002 further information may be found in the Company's Directors' Remuneration Report.

CORPORATE GOVERNANCE (continued)

RISK COMMITTEE

The Risk Committee comprises three independent Non-Executive Directors plus Mr Applegarth, Mr Baker and Mr Bennett. The Risk Committee met four times during 2004. The main role of the Risk Committee is to review, on behalf of the Board, the key risks inherent in the business, the system of control necessary to manage such risks, and to present their findings to the Board.

This responsibility requires the Risk Committee to keep under review the effectiveness of the Group's system of internal controls, which includes 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 Group. The Risk Committee fulfils this remit by reinforcing management's control consciousness and making appropriate recommendations to the Board on all significant matters relating to the Group's risk strategy and policies.

Other responsibilities of the Risk Committee include keeping under review the effectiveness of the Group's risk management infrastructure. This involves an assessment of risk management procedures (for the identification, measurement and control of key risk exposures) in accordance with changes in the operating environment. It is also primarily responsible for considering the major findings of any of the Financial Services Authority or internal/external audit's risk management review and management's response.

To assist the Board in discharging its responsibilities for the setting of Risk policy, the Risk Committee periodically reviews the Group's credit risk, interest rate risk, liquidity risk and operational risk exposures in relation to the Board's risk appetite and the Group's capital adequacy. The Risk Committee also ensures that the public disclosure of information regarding the Group's risk management policies and key risk exposures is in accordance with the statutory requirements and financial reporting standards.

INTERNAL CONTROL

The Board of Directors is responsible for the Group's system of internal control and for annually reviewing its effectiveness. The system of internal control is designed to manage risk rather than eliminate it and in this regard, the Board considers that Northern Rock is a well-controlled, risk-averse business that continues to adopt a prudent stance in the management of risk. The Board has reviewed the effectiveness of the system of internal control and is satisfied that there is a sound system of internal control that safeguards shareholders' investments and the Company's assets.

In accordance with the guidance set out in the Turnbull Guidance on Internal Control, the Company has an ongoing process for identifying, evaluating and managing the significant risks faced by it. This process was in place for the period 1 January 2004 to 31 December 2004 and remained in place on the date that the 2004 Annual Report and Accounts was approved by the Board. As part of the Company's continuing evaluation of Internal Control, the Board has reviewed and (where necessary) updated the process for identifying and evaluating significant risks affecting the business and the policies and procedures by which these risks are managed.

The Company is committed to developing and maintaining a control-conscious culture in all areas. This is achieved through a well-defined organisational structure with clear reporting lines and a commitment to recruiting and training staff governed by appropriate codes of conduct. In addition, the Group maintains procedure manuals that detail the procedures to control physical and logical access, segregation of duties and credit, expenditure and other authorisation limits. There are well-established budgetary and strategic planning cycles, and the Board reviews the results monthly against budgets, forecasts and prior year actual results, together with other key business measures.

The Chief Executive reports to the Board on behalf of the Executive Committee on significant changes in the business and the external environment which affect significant risks. The Board also receives monthly financial information, which includes key performance and risk indicators. Where areas for improvement in the system are identified, the Board considers the recommendations made by the Executive Committee, the Risk Committee and the Audit Committee.

A detailed description of the Group's approach to financial risk management and the related use of derivatives is set out in note 37 to the accounts. Material risk exposures are subject to Board policy statements that set out the exposure limits of the risks and the hedges and control techniques to be utilised. In addition, regular reporting of all risk exposures is monitored throughout the Company by the Operational Risk Committee whose membership is drawn from each of the Company's departments within which operational risk may arise.

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.

COMMUNICATIONS

A Summary Financial Statement is issued to all shareholders and a copy of the Annual Report and Accounts and The Northern Rock Foundation's report is available by written request to the Company Secretary or from the Northern Rock website: www.northernrock.co.uk. The Company communicates regularly with its shareholders who are given the opportunity to raise matters for discussion at the Annual General Meeting. The Company also deals with a number of written enquiries from shareholders throughout the year.

The Company regards communication with institutional shareholders as important. To ensure that concerns of major shareholders are addressed, the Company has incorporated a number of initiatives into its procedures during 2004. In October 2004 the Company held a governance day, to which the Company's major institutional investors were invited. The day was hosted by the Chairman and attended by the Chief Executive and the

CORPORATE GOVERNANCE (continued)

Senior Independent Director. In addition, all of the other Non-Executive Directors were offered the opportunity to attend the presentation. The Company was pleased with the attendance of a number of its investors and found that the day provided an excellent opportunity to engage with shareholders on the Company's governance arrangements.

In addition to the governance day, the Company Secretary reports to the Board on feedback received from shareholders. Additionally, the Chief Executive and Group Finance Director have extensive ongoing contact with shareholders and feedback arising from this is also reported to the Board. Coupled with presentations from analysts and brokers throughout the year, these arrangements ensure that all Directors, both Executive and Non-Executive, remain up to date on the views of major shareholders.

As Senior Independent Director, Sir George Russell is available to shareholders if they have concerns which contact through the normal channels of Chairman, Chief Executive or Group Finance Director has failed to resolve or for which such contact is inappropriate.

To ensure that opportunities are offered to major shareholders to meet with members of the Board, a number of more informal lunches are also held throughout the year where investor feedback on strategy and governance is encouraged.

GOING CONCERN

The Directors are satisfied 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 Companies Act 1985 requires the Directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and Group as at the end of the year and of the profit or loss of the Group for the year.

The Directors consider that in preparing the financial statements on pages 46 to 77 appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used and that applicable accounting standards have been followed.

The Directors are responsible for ensuring that the Company and Group keeps accounting records that disclose with reasonable accuracy at any time the Company and Group's financial position and that enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps to prevent and detect fraud and other irregularities.

COMMITTEES

Membership of the Board's Committees is set out below.

AUDIT COMMITTEE

+ Sir Derek Wanless (Chairman) (appointed Chairman 27 April 2004)

+ N A H Fenwick

+ Sir Ian Gibson

+ N Pease

+ M J Queen (appointed 5 January 2005)

+ Dr M W Ridley (resigned from Committee 27 April 2004)

+ Sir George Russell (resigned from Committee 31 December 2004)

+ Sir David Chapman, Bt. (retired 27 April 2004)

CHAIRMAN'S COMMITTEE

+ Dr M W Ridley (appointed Chairman 27 April 2004)

* A J Applegarth

* D F Baker

* R F Bennett

* A M Kuipers (appointed 5 January 2005)

* K M Currie (appointed 5 January 2005)

• C Taylor

+ Sir John Riddell, Bt. (retired 27 April 2004)

NOMINATIONS COMMITTEE

+ Dr M W Ridley (appointed Chairman 27 April 2004)

+ Sir Ian Gibson

+ Sir Derek Wanless

+ Sir John Riddell, Bt. (retired 27 April 2004)

REMUNERATION COMMITTEE

+ N Pease (Chairman) (appointed Chairman 27 April 2004)

+ Sir George Russell (retired as Chairman of the Committee on 27 April 2004)

+ N A H Fenwick

+ Sir Ian Gibson

+ M J Queen (appointed 5 January 2005)

+ Sir Derek Wanless

+ Dr M W Ridley (resigned from Committee on 27 April 2004)

+ Sir David Chapman, Bt. (retired 27 April 2004)

RISK COMMITTEE

+ Sir Derek Wanless (Chairman) (appointed Chairman 27 April 2004)

+ Sir Ian Gibson

+ Sir George Russell

+ N A H Fenwick (resigned from Committee on 31 December 2004)

+ N Pease (resigned from Committee on 31 December 2004)

* A J Applegarth

* D F Baker

* R F Bennett

+ Dr M W Ridley (resigned from Committee on 27 April 2004)

+ Sir David Chapman, Bt. (retired 27 April 2004)

+ Non-Executive Director

* Executive Director

• Executive

DIRECTORS' REMUNERATION REPORT

SUMMARY

The Directors' Remuneration Report is presented to shareholders by the Board and contains the following information:

- A description of the role of the Remuneration Committee;
- A summary of the Group's Remuneration Policy including a statement of the Company's policy on Directors' remuneration;
- Graphs illustrating the performance of the Company relative to the FTSE 100 Index and the FTSE 350 Index for the last five years;
- Details of the terms of the service contracts and the remuneration of each Director for the preceding financial year;
- Details of the share options and awards under long-term incentive schemes held by the Directors; and
- Details of each Director's interest in Ordinary Shares in the Company.

This Report complies with the Directors' Remuneration Report Regulations 2002 ("the Regulations"). This Report also sets out how the principles of the Combined Code relating to Executive Director remuneration are applied by the Group.

A resolution will be put to Shareholders at the Annual General Meeting on 26 April 2005 inviting them to consider and approve this Report.

THE REMUNERATION COMMITTEE

The Remuneration Committee consists entirely of independent Non-Executive Directors and comprises Ms N Pease (appointed Chairman on 27 April 2004), Sir George Russell, Mr N A H Fenwick, Sir Ian Gibson, Mr M J Queen (appointed 5 January 2005) and Sir Derek Wanless. Dr M W Ridley resigned from, and Sir David Chapman retired from, the Committee on 27 April 2004. Where appropriate, the Chairman and Chief Executive attend meetings of the Remuneration Committee by invitation of the Committee, save that they are absent when their own remuneration is under consideration. The Remuneration Committee operates within agreed terms of reference and has responsibility for making recommendations to the Board on the Group's general policy relating to executive remuneration. It also determines, on behalf of the Board, specific remuneration packages for the Chairman, the Executive Directors and the Management Board Directors, being the level of management immediately below the Board.

The Remuneration Committee meets regularly and takes advice from both inside and outside the Group 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 provided advice or services that materially assisted the Remuneration Committee in its consideration of Directors' remuneration matters during the year:

- The Committee consulted the Chief Executive on matters relating to the remuneration of the other Executive Directors who report to him. The Chairman was also consulted in relation to the remuneration of all Executive Directors;
- Internal support was provided to the Remuneration Committee by the Company Secretary;
- Watson Wyatt LLP advised the Remuneration Committee on a range of issues including the benchmarking of Executive Directors' salaries and the Chairman's fee. In addition to providing this advice to the Remuneration Committee, Watson Wyatt LLP are consulting actuaries to the Company and advised on various pension issues;
- Inbucon Administration Ltd were responsible for preparing Total Shareholder Return calculations for the purposes of the Company's Long Term Incentive Plan and this Remuneration Report. Inbucon Administration Ltd did not provide other advice or services to the Company; and
- Freshfields Bruckhaus Deringer advised the Company on various share plan matters and compliance with the Directors' Remuneration Report Regulations. They are the Company's main legal advisor.

COMPLIANCE

The Group has complied with the Combined Code's provisions relating to Directors' remuneration throughout the year.

REMUNERATION POLICY FOR EXECUTIVE DIRECTORS

The Remuneration Committee believes that the continuing improvement in performance of Northern Rock depends on individual contributions made by the Executive Directors. For this reason, the remuneration policy is designed to provide competitive packages to motivate, reward and retain Executive Directors of high quality and to align their interests with those of shareholders.

The Board has adopted, on the recommendation of the Remuneration Committee, a remuneration policy with the objectives set out below. It is intended that this policy should continue to apply for 2005 and subsequent years:

(i) the remuneration packages for Executive Directors are designed to be competitive in terms of market practice;

(ii) performance-related remuneration should seek to align the interests of Executive Directors with those of the shareholders through the imposition of stretching corporate performance targets and the satisfaction of most short and longer term incentives in the form of shares; and

(iii) *to motivate for future achievement, a* significant proportion of remuneration should be based on operational and financial performance both in the short and long term together with the individual contribution made by the Executive Directors.

The Remuneration Committee regularly reviews all aspects of remuneration to ensure these remain appropriate. This report sets out the Company's policy on Executive Directors' remuneration for 2005 and, so far as practicable, for subsequent years. The inclusion in the report of remuneration policy in respect of years after 2005 is required by the Regulations. The Remuneration Committee is able to state its remuneration policy for 2005 with reasonable certainty, and this policy will continue in subsequent years unless changed by the Remuneration Committee. The Remuneration Committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Company's business environment and in remuneration practice. Any changes in policy for years after 2005 will be described in future Directors' Remuneration Reports; such reports will continue to be subject to shareholder approval. All statements in this report in relation to remuneration policy for years after 2005 should be read in light of this paragraph.

ELEMENTS OF REMUNERATION

Remuneration comprises: basic salary, annual bonus, pension benefits and benefits in kind. In addition, Executive Directors and senior executives participate in certain share based incentive schemes, comprising the bonus matching plan, deferred share scheme and long term incentive plan. These share-based incentive schemes, and the annual bonus, are performance-related, and the Remuneration Committee regards them as a key element in the Executive Directors' remuneration package.

As a result of changes to the performance-related elements of remuneration in recent years (including, from 2005, the proposed imposition of a corporate performance condition on awards vesting under the bonus matching plan and deferred share scheme, and the increase in annual bonus potential as described below), the performance-related element of total potential remuneration has materially increased in recent years.

BASIC SALARY

The Committee's objective is that Executive Directors' basic salaries should be paid at an appropriate level to take account of both personal performance and of salaries within a comparator group of financial institutions. The Committee considers that exceptional performance, whether corporate or individual, should be rewarded through bonus and incentive schemes rather than basic salary.

Salaries are reviewed annually for each Executive Director, and revised salaries took effect from 1 January 2005 as follows:

A J Applegarth
£625,000 (2004 - £565,000)

D F Baker
£390,000 (2004 - £375,000)

R F Bennett
£390,000 (2004 - £375,000)

Mr A M Kuipers and Mr K M Currie were appointed to the Board on 5 January 2005, and their initial salaries were £270,000 each.

The revised salaries of the Executive Directors have been benchmarked against salaries paid for similar positions in banks in the FTSE 100 Index and for companies in positions 51 – 75 in the FTSE 100 Index.

During 2004 the Company's 13 Management Board Directors were paid salaries ranging from £90,000 to £215,000.

SHORT TERM BONUS SCHEME

Northern Rock operates a short term cash bonus scheme under which payments are made on an annual basis at the discretion of the Remuneration Committee. All of the Executive Directors and certain senior executives participate in this scheme.

This cash bonus scheme relates to year-on-year increases in the Group's pre-tax profit on ordinary activities, with increases in pre-tax profits generating a bonus payment equal to a percentage of salary. Only where there is an increase in adjusted like-for-like pre-tax profits will Executive Directors be eligible for a short term bonus. Every 1% increase in pre-tax profits generates a bonus payment equal to 5% of salary with a maximum of 75% of salary by way of bonus for 15% increase in profits (with a sliding scale between these points). Payment of one-third of the bonus will be subject to the Remuneration Committee's view of the participant's personal performance, and the remaining two-thirds relates to the performance of the business. The bonus payable is reduced by the value of shares appropriated under the all-employee Inland Revenue Approved Share Incentive Plan for the year, to the extent needed to ensure that the relevant bonus cap is not exceeded.

On this basis, the bonus earned in respect of 2004 was 65.15% of salary.

For 2005 the Remuneration Committee will continue to operate the cash bonus scheme on the basis described above however, following a careful review of bonus arrangements (and consideration of a review by Watson Wyatt LLP of comparator companies), whilst every 1% increase in pre-tax profits will continue to generate a bonus equal to 5% of salary, the bonus cap has been increased to 100% of salary for a 20% increase in profits.

BONUS MATCHING PLAN

Participants are also encouraged to identify with the interests of shareholders by investing some of their own funds in Northern Rock. Executive Directors (and other senior executives invited by the Remuneration Committee to participate) are entitled to elect for all or part of the after tax amount of their annual cash bonus to be used to acquire shares which will be held for a period of three years; alternatively they may elect to deposit their own shares with an aggregate value not exceeding the cash amount of the after tax bonus. The shares acquired or deposited will be eligible for additional "matched" shares at the end of the three-year period, provided the participant has remained an employee of the Group. The plan is designed to achieve one-for-one matching on an after tax basis. As the participant's shares are invested in the plan on an after-tax basis, but the matched shares only attract income tax and national insurance contributions if and when they are released from the plan, the number of matched shares is increased (by reference to tax rates at the time the matching shares are initially awarded) to reflect the fact that they will attract income tax and national insurance contributions if and when they are released. Entitlement to the matched shares will normally be lost if the participant leaves employment except in certain "good leaver" circumstances. For awards made in 2005 and in future years, the release of matched share awards will be dependent on the Group achieving average real EPS growth of 3% per annum over the three financial years pending their release. The imposition of this target is subject to shareholder approval at the Annual General Meeting on 26 April 2005.

For 2004 and previous years, the release of matched share awards was not dependent on satisfaction of a further performance condition because the value of matched share awards was derived from the annual bonus criteria and was therefore dependent on corporate performance.

The bonus matching plan was operated in respect of 2004, resulting in the share awards described on page 26. The Remuneration Committee will continue to operate it in respect of 2005 and future years.

The beneficial ownership of the matched shares transfers to the participant on the grant of an award. The matched shares will be forfeited if the participant ceases to be entitled to them except in certain "good leaver" circumstances. The participant will be entitled to any dividends paid on his matched shares during the restricted period.

DEFERRED SHARE SCHEME

Under a separate element of the short term bonus scheme, the Remuneration Committee may grant to Executive Directors and other executives who receive a cash bonus under that scheme an award of shares with a pre-tax value equal to the pre-tax value of his cash bonus. A participant who is granted an award must normally continue to hold these shares and remain an employee of the Group for a period of three years from the date of the award in order to retain the full number of shares so granted to him, although shares will be released earlier in certain "good leaver" circumstances. For awards made in 2005 and in future years, the release of any deferred share awards will be dependent on the Company achieving average real EPS growth of 3% per annum over the three financial years that the shares are held. The imposition of this target is subject to shareholder approval at the Annual General Meeting on 26 April 2005.

For 2004 and previous years, the release of deferred share awards was not dependent on satisfaction of a further performance condition because the value of deferred share awards was derived from annual bonus criteria and was therefore dependent on corporate performance.

This deferred share scheme was operated in respect of 2004 resulting in the share awards described on page 27. The Remuneration Committee will continue to operate the deferred share scheme in respect of 2005 and future years.

LONG TERM INCENTIVE PLAN

All Executive Directors and certain senior executives participate in a long term incentive plan ("LTIP"), which was approved by shareholders in 1998. Awards have been made in 1998 and each subsequent year thereafter. The plan involves the grant of share awards, which can only be released if demanding performance targets are achieved and if the participant remains in employment, except in certain "good leaver" circumstances. The number of shares comprised in an award is calculated by reference to a percentage of salary, with the maximum award of shares being 100% of salary.

Performance is measured over a three year period on the basis of total shareholder return ("TSR"), comparing the Company's performance to that of the companies in an appropriate index at the date of an award. The Remuneration Committee has decided that, for awards in 2005 and future years, the FTSE 100 Index will be used. For previous awards, the FTSE 350 Index was used because at the time the LTIP was approved in 1998, the Company's market capitalisation placed it around the mid-point of the constituents of that index. The Company joined the FTSE 100 Index in September 2001. The extent to which an award is realisable depends on the Company's ranking in this comparison. Awards are released on a sliding scale between median and top quartile performance with 25 per cent of an award being released for median performance and 100 per cent of the award being released for a ranking within the top quartile. If the Group's performance is below the median, none of the shares in an award will vest. There is no re-testing of targets.

There is also an earnings per share threshold, which requires that the Group's earnings per share growth over the three year period must exceed the growth in the UK Retail Prices Index by an average of at least 3% per annum. This performance condition is designed to ensure that the vesting level of LTIP awards is dependent on satisfactory year-on-year financial performance as well as above-median TSR ranking.

The LTIP was operated in 2004, resulting in the share awards set out in the table on page 28. The Remuneration Committee will continue to operate it for Executive Directors in 2005 and future years. A separate share scheme, in substantially the same terms as the LTIP, has been adopted by the Remuneration Committee and is extended to 33 executives. This is also now subject to the FTSE 100 performance target. Executive Directors are not eligible to participate in this scheme, and awards under it will be satisfied with existing shares only.

ALL-EMPLOYEE SHARE SCHEMES

Executive Directors are eligible to participate in the Company's all-employee share schemes on the same terms as other employees. These schemes comprise:

(i) the Sharesave Scheme, a savings-related share option scheme available to all employees. This scheme operates within specific tax legislation (including a requirement to finance exercise of the option using the proceeds of a monthly savings contract), and exercise of the option is not subject to satisfaction of a performance target;

(ii) the Employee Share Option Scheme, an Inland Revenue approved share option scheme under which options have been granted to substantially all employees. Under this scheme the aggregate exercise value of unexercised options may not exceed £30,000. Options under this scheme may not be exercised unless real earnings per share of the Company has grown by more than 2% over the life of the option. This performance condition is designed to ensure that the exercisability of options is dependent on satisfactory year-on-year financial performance on a sustained basis; and

(iii) the Share Incentive Plan ("SIP"), under which the maximum value of free shares awarded to employees cannot exceed £3,000. The value of share awards under this scheme is dependent on the Group's profits. The SIP operates within specific tax legislation. Any payment made under the SIP together with any amount payable under the short term cash bonus scheme may not exceed the overall bonus cap from time to time.

The Remuneration Committee is satisfied that these schemes constitute a well considered overall plan for Executive Directors' and senior executives' long-term remuneration. These schemes are kept under regular review, to take account of changing circumstances. Bonus and share incentive scheme payments are not taken into account for pension purposes. It should be noted that the Executive Directors elected not to participate in the last two grants made under the Employee Share Option Scheme, namely those made in 2002 and 2005.

PENSION BENEFITS

The following section describes the pension arrangements currently in force for the Executive Directors. These arrangements will be affected by changes to the tax treatment of the current UK pension regime contained in the Finance Act 2004. The Remuneration Committee is currently reviewing appropriate actions to take in response to these changes and will report on the outcome next year.

It is the intention of the Committee that changes in pensions legislation expected to commence in 2006 will not increase the Directors' actuarial pension cost.

Each of the Executive Directors currently participates in the Northern Rock Pension Scheme, a contributory pension scheme which provides a pension of up to two-thirds of pensionable salary on retirement, dependent upon service. On death in service the scheme also provides for a dependent's pension and a lump sum of four times basic salary. This pension and life assurance is provided from the scheme (to the extent permitted by legislation) and otherwise from separate arrangements.

The normal retirement age under the pension scheme is 60 which enables members to achieve the maximum pension of 2/3rds of their salary at normal retirement age after 40 years service.

For death before retirement whilst in service, a capital sum equal to four times the annual rate of basic earnings, excluding Director's fees, is payable, plus a return of member's contributions. In addition, a pension of 50% of the member's prospective pension at the age of 60, based on pensionable earnings at death, is payable to a surviving spouse providing the couple were married before retirement. On death before retirement after leaving the scheme, a benefit of 50% of the member's deferred pension, re-valued to the date of death, is payable to a surviving spouse. For death in retirement, a spouse's pension of 50% of the member's pre-commutation pension is payable. In certain circumstances a children's allowance is payable, usually up to the age of 18 (or up to the age of 21 if they are in full-time education).

Subject to the Trustees' approval, early retirement may be granted from the age of 50, or at any age due to ill-health. The pension is calculated at the date of retirement based on accrued pensionable service and final pensionable earnings at that date. The pension will then be actuarially reduced to take account of early payment by an amount of 0.25% for each complete month before normal retirement date. The Company and the Trustees have agreed that if Mr A J Applegarth or Mr D F Baker (having attained age 55) retire with the consent of the Company they will receive immediate payment of their accrued pension without the application of an actuarial reduction. If Mr Applegarth or Mr Baker elect to retire after attaining the age of 55 without the consent of the Company they will receive an immediate pension being the accrued deferred pension reduced by 3% for each year or proportionate part thereof by which retirement precedes age 60.

Post retirement increases to pensions arising from membership of the defined benefit scheme are guaranteed each year at the rate of 3% per annum compound, subject to any guaranteed minimum pension. Pension benefits accrued after 5 April 1997 are guaranteed to increase in line with inflation, to a maximum of 5% per annum.

In addition to the normal scheme increases, and subject to the defined benefit scheme fund having adequate resources, the Trustees may award further discretionary increases each April.

Members of the scheme have the option to pay additional voluntary contributions to secure additional benefits within regulatory limits, to which the Company does not contribute.

The Company also operates an unapproved unfunded arrangement for Mr Bennett (which is provided for in the Company's accounts and maintains pension entitlement from previous employment) to provide additional benefits to the main scheme. The unfunded arrangement is designed to ensure that the individual (or his spouse) will receive the level of pension benefit in respect of his eligible earnings in excess of the pensions "earnings cap", currently £102,000 (2003/04 - £99,000) per annum, which are not pensioned by the Northern Rock Pension Scheme. Mr Bennett contributes 5% of his basic salary including those earnings in excess of the earnings cap. Mr Bennett's pension will accrue at the rate of 1/36th of pensionable earnings for each year (and pro rata for each part year) of pensionable service from 1 November 1993 (date joined pension scheme). In addition, all pension calculations shall include pensionable service brought forward from previous employers of 19 years 5 months at a rate of accrual of 1/60th per annum and 5 years 1 month at a rate of accrual of 1/36th per annum.

The total of the pension provided for Mr Bennett at normal retirement date or at any age after his 55th birthday, where the retirement is by mutual consent or at the Company's request, shall be the maximum of two thirds of his uncapped final pensionable earnings. If retirement occurs prior to age 60 without the consent of the Company, he may elect to receive an immediate pension being the accrued deferred pension with a maximum of two thirds of his uncapped final pensionable earnings reduced by 3% for each year (and proportionate for each part thereof) by which retirement precedes age 60. The aggregate of pension increases to be provided whether in deferment or in payment shall be the greater of 5% per annum or RPI, subject to any guaranteed minimum pension and the increases as granted by the Trustees of the scheme inclusive of any discretionary increases.

Should Mr Bennett die in service or in receipt of benefits under the Company's Permanent Health Insurance Scheme prior to age 60, a lump sum shall be paid of four times his earnings at death plus a return of his contributions. In addition, if he leaves a surviving spouse she shall receive a pension of four ninths of his uncapped final pensionable earnings. Any child or children under the age of 25 receiving full-time education would receive an allowance of one half of the entitlement of the surviving spouse. Should Mr Bennett die whilst in receipt of a pension prior to age 60, a lump sum of four times his earnings at retirement shall be payable. On death in receipt of a pension, any surviving spouse would receive a pension of two thirds of the pension Mr Bennett would have been receiving at death, ignoring any pension commuted for a tax free cash sum.

Any income tax or other related tax due on the Company's contribution to the unfunded arrangement which, under an uncapped arrangement, would not have been paid by Mr Bennett, will be borne by the Company up to two thirds of the contribution amount. In addition, any income tax or related tax due on the cash sum commutation will be borne by the Company up to two thirds of the commutation amount.

BENEFITS IN KIND

Each Executive Director is provided with company car and medical insurance benefits. The Executive Directors had as employees of Northern Rock Building Society (or in the case of Mr K M Currie and Mr A M Kuipers as employees of the Company prior to their appointment as Directors), entitlement to participate in a concessionary mortgage scheme at the discretion of the Board. No further new loans may be made under the scheme following conversion to plc status, but existing loans are not affected.

POLICY ON EXECUTIVE DIRECTORS' SERVICE CONTRACTS

It is the policy of the Company that Executive Directors' service contracts can be terminated by 12 months' notice given to an Executive Director at any time. Each Executive Director can terminate his employment by giving 6 months' notice. All of the Executive Directors' contracts may be terminated immediately by Northern Rock either with (for Mr D F Baker and Mr R F Bennett) the payment of liquidated damages equal to 12 months' salary and the value of annual bonus and benefits or (for Mr A J Applegarth, Mr A M Kuipers and Mr K M Currie) a payment in lieu of notice equal to such amount. Mr Applegarth, Mr Baker and Mr Bennett would, in the event of a change of control of Northern Rock, be entitled to terminate employment and receive a liquidated damages payment calculated on the same basis. The terms of reference of the Remuneration Committee make it clear that the Remuneration Committee seeks, in appropriate circumstances to mitigate the amount of termination payments made to Executive Directors.

POLICY ON EXTERNAL NON-EXECUTIVE DIRECTORSHIPS HELD BY EXECUTIVE DIRECTORS

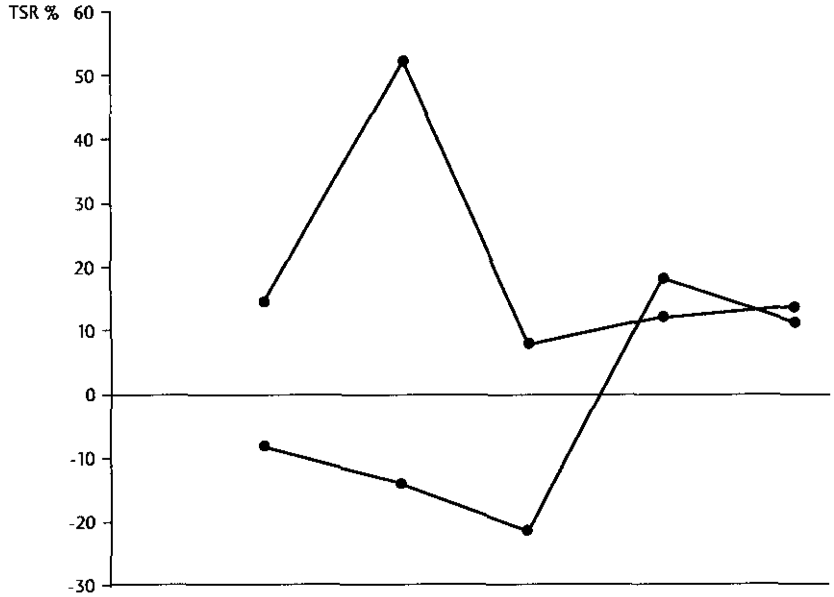
Executive Directors are permitted to hold one external non-executive directorship unrelated to the Company's business, provided that the time commitment is not material. Executive Directors are permitted to retain any fees arising from such a non-executive directorship. On this basis, Mr R F Bennett is a Non-Executive Director of Greggs plc, and Mr Bennett was entitled to fees of £28,000 from that company in respect of 2004.

DIRECTORS' REMUNERATION REPORT (continued)

PERFORMANCE GRAPHS

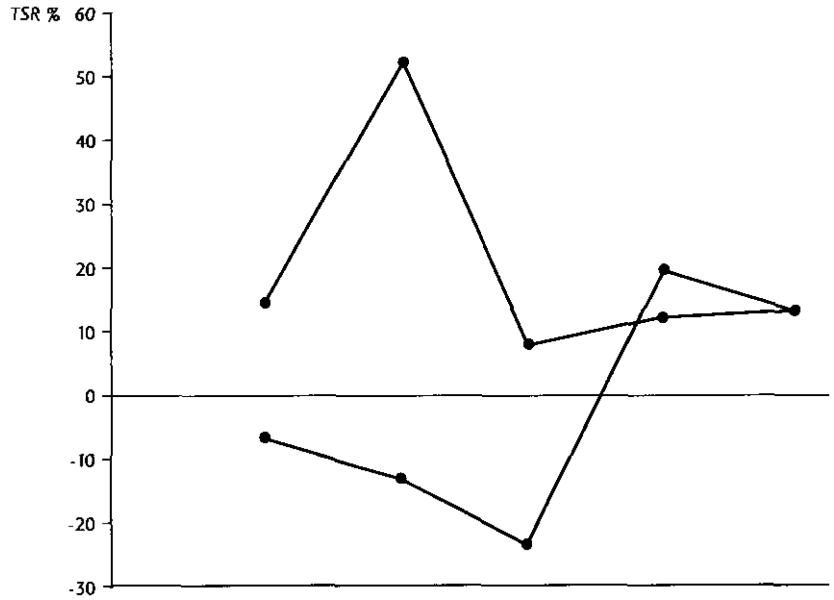
The performance graphs set out below illustrate the Group's Total Shareholder Return ("TSR") performance over the preceding five years, 2000 to 2004, compared with that of the FTSE 100 Index of which Northern Rock has been a constituent since September 2001, and that of the FTSE 350 Index of which Northern Rock was a constituent prior to September 2001. The FTSE 350 Index has been included because members of this index comprise the comparator group for long term incentive plan purposes for 2004 and prior. The performance graphs have been prepared in accordance with the Regulations.

FTSE 100



	2000 (%)	2001 (%)	2002 (%)	2003 (%)	2004(%)
Northern Rock	+14	+51	+8	+12	+13
FTSE 100	-8	-14	-22	+18	+11

FTSE 350



	2000 (%)	2001 (%)	2002 (%)	2003 (%)	2004(%)
Northern Rock	+14	+51	+8	+12	+13
FTSE 350	-6	-13	-23	+20	+13

SERVICE CONTRACTS

Mr A J Applegarth is employed under a service contract with the Company dated 1 March 2001. Mr Applegarth's current annual salary is £625,000, and he is entitled under the contract to participation in the Company's bonus scheme, a company car (or allowance in lieu), membership of the Company's pension scheme, life assurance cover equal to four times salary, permanent health insurance, private medical insurance cover and the continuation of a mortgage at a concessionary rate (which was granted before the Company's conversion to plc status). Mr Applegarth's contract is for an indefinite term ending automatically on his retirement date (age 60), but may be terminated by 12 months notice given by the Company and 6 months notice given by Mr Applegarth. The Company may at its discretion elect to terminate the contract by making a payment in lieu of notice equal to:

(i) 100 per cent of basic annual salary;

(ii) the amount of annual bonus paid in respect of the preceding financial year; and

(iii) the annual cost to the Company of providing pension and all other benefits to which Mr Applegarth is entitled under his contract.

In addition, Mr Applegarth may elect to terminate the contract on one month's notice given within six months following a change of control of the Company. In these circumstances, Mr Applegarth would become entitled to a lump sum payment equal to the aggregate of:

(i) 100 per cent of basic annual salary;

(ii) the amount of annual bonus paid in respect of the preceding financial year; and

(iii) the annual cost to the Company of providing pension and all other benefits specified in his service contract.

Mr R F Bennett is employed under a service contract with the Company dated 26 August 1997, which was amended by a

supplemental agreement dated 12 March 1998. Mr Bennett's current annual salary is £390,000. He is entitled to the same benefits as those specified above in relation to Mr Applegarth, save that Mr Bennett is entitled to special pension arrangements which are described on page 22.
Mr Bennett's contract is for an indefinite term ending automatically on his retirement date (age 60), but may be terminated by 12 months' notice given by the Company and 6 months' notice given by Mr Bennett. The Company may at its discretion elect to terminate the contract early by making a payment of liquidated damages calculated in the manner set out above in relation to Mr Applegarth's post-change of control liquidated damages entitlement.

In the event of a change of control of the Company, Mr Bennett may elect to terminate the contract and receive a lump sum payment calculated in the manner set out above in relation to Mr Applegarth.

Mr D F Baker is employed under a service contract with the Company dated 26 August 1997, which was amended by supplemental agreements dated 12 March 1998 and 1 July 1999. Mr Baker's current annual salary is £390,000. He is entitled to the same benefits as those specified above in relation to Mr Applegarth (save that Mr Baker has repaid the mortgage awarded to him before the Company's conversion to plc status, and is not entitled to a further mortgage on concessionary terms).
Mr Baker's contract is for an indefinite term ending automatically on his retirement date (age 60), but may be terminated by 12 months' notice given by the Company and 6 months' notice given by Mr Baker. The Company may elect to terminate the contract by making a payment of liquidated damages calculated in the manner set out above in relation to Mr Bennett. In the event of a change of control of the Company, Mr Baker may elect to terminate the contract and receive a lump sum payment calculated in the manner set out above in relation to Mr Applegarth.

Mr K M Currie and Mr A M Kuipers are each employed under service contracts with the Company, dated 5 January 2005. Their current annual salaries are £270,000, and they are entitled under the terms of their contracts to participate in the Company's bonus scheme, to receive a company car and expenses (or a monthly car allowance), membership of the Company's pension scheme, life assurance cover equal to four times basic salary and the continuation of a concessionary mortgage (which was granted to them before they became directors of the Company). Their contracts are for an indefinite term ending automatically on their retirement (age 60). The contracts may however be terminated by 12 months' notice given by the Company and six months' notice given by the Directors.

The Company may at its discretion elect to terminate Mr Currie's and Mr Kuipers' contracts by making a payment in lieu of notice equal to:

(i) 100 per cent of basic salary;

(ii) the amount of annual bonus paid in respect of the preceding financial year; and

(iii) the annual cost to the Company of providing pension and all other benefits to which they are entitled under their contracts.

The payment in lieu of notice payments may be made in phased instalments at the Company's discretion.

REMUNERATION OF THE CHAIRMAN AND NON-EXECUTIVE DIRECTORS

The remuneration of the Chairman is determined by the Remuneration Committee and that of the other Non-Executive Directors is determined by the Board as a whole, on the basis of external independent advice.

The Chairman's annual fee is £150,000. The Senior Independent Non-Executive Director's annual fee is £49,500. Non-Executive Directors receive an annual fee of £28,500. The fee payable for membership of each of the Audit, Nomination, Risk and Remuneration Committees is £2,500 or, where a Non-Executive Director is chairman of a Board Committee, the additional annual fee payable to them is £12,500.

Subject to shareholder approval at the Annual General Meeting of an increase in the aggregate cap on fees payable to Non-Executive Directors, with effect from 26 April 2005:

(a) the Chairman's annual fee will be increased to £250,000;

(b) the Senior Independent Non-Executive Director's annual fee will be increased to £55,000;

(c) the Non-Executive Directors' annual fee will be increased to £40,000;

(d) the annual fee payable for membership of each of the Audit, Nomination, Risk and Remuneration Committees will be increased to £3,500; and

(e) where a Non-Executive Director is chairman of a Board Committee, the additional annual fee payable will be increased to £13,000.

These proposed revised fees for the Chairman and Non-Executive Directors were determined after consideration of a report by Watson Wyatt LLP on the fees paid for similar roles at banks in the FTSE 100 Index, and for Companies positioned 51-75 in the FTSE 100 Index.

The Chairman and Non-Executive Directors serve the Company under letters of appointment, which are terminable by the Company at any time without liability for compensation; they do not have service contracts. The Chairman and Non-Executive Directors are entitled to fees from the Group and it is the Group's policy that they do not participate in bonus, incentive or pension schemes. However, Sir George Russell, who also served on the Board of Northern Rock Building Society, (see page 25) is a deferred member of a non-contributory pension scheme established by Northern Rock Building Society under which pension entitlement accrued for each complete year of qualifying service subject to a maximum of 60% of qualifying fees. This scheme ceased to accrue benefits after 30 June 1997.

DIRECTORS' REMUNERATION REPORT (continued)

INFORMATION SUBJECT TO AUDIT

The information set out below in the remainder of the Directors' Remuneration Report has been subject to audit as required by Part 3 of Schedule 7A of the Companies Act 1985.

DIRECTORS' INDIVIDUAL REMUNERATION

Details of Directors' individual remuneration is set out below:

Non-Executive Directors	**2004**	2003
	£000	£000
Dr M W Ridley (Chairman)	**127**	77
N A H Fenwick	**36**	5
Sir Ian Gibson	**38**	36
N Pease	**43**	36
Sir George Russell*	**53**	46
Sir Derek Wanless	**51**	36
Sir John Riddell, Bt.(retired 27 April 2004)	**50**	150
Sir David Chapman, Bt. (retired 27 April 2004)	**12**	36
	410	422

*Sir George Russell is a deferred member of the Northern Rock Building Society non-contributory pension scheme, which ceased to accrue benefits after 30 June 1997. This deferred pension commences on retirement as a Non-Executive Director or 25 October 2005, whichever is earlier and for 2004 was valued at £11,470 (2003 £10,771). In line with the scheme rules this will increase to £12,229 per annum in October 2005.

Executive Directors	**Chief Executive**	**Chief Operating Officer**	**Group Finance Director**	
	A J Applegarth	**D F Baker**	**R F Bennett**	**Total**
	£000	**£000**	**£000**	**£000**
2004				
Salaries and fees	**565**	**375**	**375**	**1,315**
Bonus	**368**	**244**	**244**	**856**
Total remuneration	**933**	**619**	**619**	**2,171**
Non cash benefits	**13**	**11**	**18**	**42**
Total emoluments	**946**	**630**	**637**	**2,213**
2003				
Salaries and fees	525	350	350	1,225
Bonus	394	263	263	920
Total remuneration	919	613	613	2,145
Non cash benefits	13	10	17	40
Total emoluments	932	623	630	2,185

There were no payments by the Company during the financial year for compensation for loss of office or payments in connection with the termination of qualifying services.

There were no amounts paid to the Executive Directors in respect of their qualifying services by way of expenses allowance that was chargeable to UK income tax.

The nature of the non-cash benefits is set out on page 22.

BONUS MATCHING PLAN

Details of the Ordinary Shares over which the Directors have conditional rights under the bonus matching plan by year of grant are as follows:

Rights under bonus matching plan

	Date granted	Rights held under plan at 31 Dec 03	Rights granted during 2004	Market price of each share on date of grant £	Rights released during 2004	Rights held under plan at 31 Dec 04	Date of end of qualifying period
A J Applegarth	Feb 01	18,663	-	4.65	(18,663)	-	-
	Jan 02	23,723	-	6.66	-	23,723	Jan 05
	Jan 03	52,253	-	6.10	-	52,253	Jan 06
	Jan 04	-	53,208	7.40	-	53,208	Jan 07
D F Baker	Feb 01	19,658	-	4.65	(19,658)	-	-
	Jan 02	21,621	-	6.66	-	21,621	Jan 05
	Jan 03	38,728	-	6.10	-	38,728	Jan 06
	Jan 04	-	35,472	7.40	-	35,472	Jan 07
R F Bennett	Feb 01	22,273	-	4.65	(22,273)	-	-
	Jan 02	21,621	-	6.66	-	21,621	Jan 05
	Jan 03	38,728	-	6.10	-	38,728	Jan 06
	Jan 04	-	35,472	7.40	-	35,472	Jan 07
L P Finn (former Director)	Feb 01	35,433	-	4.65	(35,433)	-	-

The value of these awards is being charged to the profit and loss account over the three year period to which they relate. In 2004 £718,646 was charged to the profit and loss account (2003 £561,246).

Further awards were granted on 28 January 2005 at £7.73 per share as follows:

A J Applegarth	47,618
D F Baker	31,605
R F Bennett	31,605
K M Currie (appointed 5 January 2005)	18,120
A M Kuipers (appointed 5 January 2005)	18,120

Rights vested under bonus matching plan during 2004

	Number of ordinary shares	Date on which rights awarded	Market price of each share at award date £	Vesting date	Market price of each share at vesting date £
A J Applegarth	18,663	Feb 01	4.65	Feb 04	7.40
D F Baker	19,658	Feb 01	4.65	Feb 04	7.40
R F Bennett	22,273	Feb 01	4.65	Feb 04	7.40
L P Finn (former Director)	35,433	Feb 01	4.65	Feb 04	7.40

Rights were released in January 2005 at £7.73 per share as follows:

A J Applegarth	23,723
D F Baker	21,621
R F Bennett	21,621
K M Currie (appointed 5 January 2005)	9,383
A M Kuipers (appointed 5 January 2005)	9,383

There were no variations made in the terms and conditions of the Scheme interests during 2004.

The value of the bonus matching award is derived from the annual bonus criteria (relating to the year on year increases in the Group's pre-tax profits on like-for-like ordinary activities) and is therefore dependent on corporate performance. The release of bonus matching share awards at the end of the three year restricted period is not dependent on satisfaction of a further performance condition. For awards in 2005 and subsequent years, subject to shareholder approval at the 2005 AGM, the value of any bonus matching share awards will be dependent on the Group achieving real EPS growth of 3% per annum over the three years prior to their release.

DIRECTORS' REMUNERATION REPORT (continued)

DEFERRED SHARE SCHEME

Details of the Ordinary Shares over which the Directors have conditional rights under the deferred share scheme by year of grant are as follows:

	Date of grant	Rights held under the plan at 31 Dec 03	Rights granted during 2004	Market price of each share on date of grant £	Rights released during 2004	Rights held under the plan at 31 Dec 04	Date of end of qualifying period
A J Applegarth	Feb 01	19,658	-	4.65	(19,658)	-	-
	Jan 02	27,778	-	6.66	-	27,778	Jan 05
	Jan 03	52,254	-	6.10	-	52,254	Jan 06
	Jan 04	-	53,208	7.40	-	53,208	Jan 07
D F Baker	Feb 01	19,658	-	4.65	(19,658)	-	-
	Jan 02	21,622	-	6.66	-	21,622	Jan 05
	Jan 03	38,730	-	6.10	-	38,730	Jan 06
	Jan 04	-	35,472	7.40	-	35,472	Jan 07
R F Bennett	Feb 01	22,273	-	4.65	(22,273)	-	-
	Jan 02	21,622	-	6.66	-	21,622	Jan 05
	Jan 03	38,730	-	6.10	-	38,730	Jan 06
	Jan 04	-	35,472	7.40	-	35,472	Jan 07

The value of these awards is being charged to the profit and loss account over the three year period to which they relate. In 2004 £727,662 was charged to the profit and loss account (2003 £571,805).

Further awards were granted on 28 January 2005 at £7.73 per share as follows:

A J Applegarth	47,618
D F Baker	31,605
R F Bennett	31,605
K M Currie (appointed 5 January 2005)	18,120
A M Kuipers (appointed 5 January 2005)	18,120

Rights vested under deferred share scheme during 2004

	Number of ordinary shares	Date on which rights awarded	Market price of each share at award date £	Vesting date	Market price of each share at vesting date £
A J Applegarth	19,658	Feb 01	4.65	Feb 04	7.40
D F Baker	19,658	Feb 01	4.65	Feb 04	7.40
R F Bennett	22,273	Feb 01	4.65	Feb 04	7.40

There were no variations in the terms and conditions of the scheme interests during 2004.

Rights were released in January 2005 at £7.73 per share as follows:

A J Applegarth	27,778
D F Baker	21,622
R F Bennett	21,622
K M Currie (appointed 5 January 2005)	9,384
A M Kuipers (appointed 5 January 2005)	9,384

The value of any deferred share award is derived from annual bonus criteria (relating to year on year increases in the Group's pre-tax profits on like-for-like ordinary activities) and is therefore dependent on corporate performance. The release of deferred share awards at the end of the three year restricted period is not dependent on satisfaction of a further performance condition. For awards in 2005 and subsequent years, subject to shareholder approval at the 2005 AGM, the value of any deferred share awards will be dependent on the Group achieving average real EPS growth of 3% per annum over the three years prior to their release.

DIRECTORS' REMUNERATION REPORT (continued)

LONG TERM INCENTIVE PLAN

Details of the Ordinary Shares over which the Directors have conditional rights under the long term incentive plan by year of grant are as follows:

Rights under long term incentive plan

	Date granted	**Rights held under plan at 31 Dec 03**	**Rights granted during 2004**	**Market price of each share on date of grant £**	**Rights released during 2004**	**Rights held under plan at 31 Dec 04**	**Date of end of performance period**
A J Applegarth	Feb 01	44,516	-	4.65	(44,516)	-	-
	Jan 02	63,814	-	6.66	-	63,814	Jan 05
	Jan 03	86,066	-	6.10	-	86,066	Jan 06
	Jan 04	-	76,351	7.40	-	76,351	Jan 07
D F Baker	Feb 01	44,516	-	4.65	(44,516)	-	-
	Jan 02	47,297	-	6.66	-	47,297	Jan 05
	Jan 03	57,377	-	6.10	-	57,377	Jan 06
	Jan 04	-	50,676	7.40	-	50,676	Jan 07
R F Bennett	Feb 01	50,436	-	4.65	(50,436)	-	-
	Jan 02	47,297	-	6.66	-	47,297	Jan 05
	Jan 03	57,377	-	6.10	-	57,377	Jan 06
	Jan 04	-	50,676	7.40	-	50,676	Jan 07
L P Finn (former Director)	Feb 01	26,746	-	4.65	(26,746)	-	-

Rights vested during 2004

	Number of ordinary shares	*Date on which rights awarded*	*Market price of each share at award date £*	*Vesting date*	*Market price of each share at vesting date £*
A J Applegarth	44,516	Feb 01	4.65	Feb 04	7.40
D F Baker	44,516	Feb 01	4.65	Feb 04	7.40
R F Bennett	50,436	Feb 01	4.65	Feb 04	7.40
L P Finn (former Director)	26,746	Feb 01	4.65	Feb 04	7.40

The value of conditional awards is charged to the profit and loss account over the three year performance period to which they relate after taking account of the probability of performance criteria being met. In 2004 £879,251 was charged to the profit and loss account (2003 £874,716).

The gross awards granted in 2002 shown above, matured in January 2005 and led to the release at £7.73 per share of 72.7% of shares originally awarded. Subject to the performance criteria being met, other awards may be exercised during the three month period commencing on the third anniversary of the award dates. The awards will lapse if they are not exercised during these times.

Further awards were granted on 28 January 2005 at £7.73 per share as follows:

A J Applegarth	80,854
D F Baker	50,453
R F Bennett	50,453
K M Currie (appointed 5 January 2005)	34,929
A M Kuipers (appointed 5 January 2005)	34,929

There were no variations made in the terms and conditions of the plan interests during 2004. The number of shares comprised in an award is calculated by reference to a percentage of salary, up to a maximum of 100% of salary. Shares may only be released if demanding performance targets are achieved and if the participant remains in employment, except in certain "good leaver" circumstances. In relation to awards granted in 2004 and previous years, performance is measured over a three year period on the basis of Total Shareholder Return, comparing the Company's performance to that of the other companies in the FTSE 350 Index at the date of the award. For awards in 2005 and subsequent years, the Company's Total Shareholder Return will be compared to that of other companies in the FTSE 100 Index at the date of the award. See page 20 for further details.

DIRECTORS' REMUNERATION REPORT (continued)

PENSIONS

Set out below are details of the pension benefits to which each of the Executive Directors is entitled.

	Age at 31 Dec 04	Years & months of service at 31 Dec 04	Accrued pension entitlement at 31 Dec 04 (Per Annum) £	Accrued pensiom entitlement at 31 Dec 03 (Per Annum) £	Additional pension entitlement earned in year £	Additional pension entitlement earned in year (in excess of inflation) £
A J Applegarth	42	21 years 2 months	199,319	176,458	22,861	17,920
D F Baker	*51*	*27 years 7 months*	*195,833*	*176,458*	*19,375*	*14,434*
R F Bennett	57	11 years 2 months	250,000	233,333	16,667	10,133

	Transfer value of accrued pension entitlement at 31 Dec 04 £	Transfer value of accrued pension entitlement at 31 Dec 03 £	Increase in transfer value less Directors' contributions £	Transfer value of increase in accrued pension entitlement in excess of inflation (less Directors' contributions) £
A J Applegarth	1,471,285	1,216,374	226,661	103,438
D F Baker	*2,368,096*	*1,979,205*	*370,141*	*155,450*
R F Bennett	4,415,009	3,789,807	606,452	160,582

The accrued pension entitlement is the amount that the Director would receive if he retired at the end of the year. The increase in the accrued pension entitlement is the difference between the accrued pension entitlement at the year end and that at the previous year end. The Listing Rules also require this to be disclosed excluding inflation.

All transfer values have been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11. The transfer values of the accrued pension entitlement represent the value of assets that the pension scheme would need to transfer to another pension provider on transferring the scheme's liability in respect of the Directors' pension benefits. They do not represent the sums payable to individual Directors and, therefore, cannot be added meaningfully to annual remuneration.

The increase in the transfer value less Directors' contributions is the increase in the transfer value of the accrued pension entitlement during the year after deducting the Director's personal contributions to the scheme.

The transfer value of the increase in accrued pension entitlement, required by the Listing Rules, discloses the current value of the increase in accrued pension entitlement (excluding inflation) that the Director has earned in the period, whereas the change in his transfer value, required by the Companies Act, discloses the absolute increase or decrease in transfer values and thus includes the change in value of the accrued pension entitlement that results from market volatility affecting the transfer value over the year, as well as the value of the additional accrued pension entitlement earned in the year.

Including Mr R F Bennett's unfunded arrangement he has an estimated accrued annual pension entitlement at 31 December 2004 of £250,000. This is based on his total pensionable service of 11 years 2 months and his pensionable service of 19 years 5 months at the rate of accrual of 1/60th per annum and 5 years 1 month at the rate of accrual of 1/36th and his pensionable earnings above the earnings cap. The contributions cost during the year in respect of this unfunded arrangement amounted to £84,862 for the Company and £13,688 for Mr Bennett.

DIRECTORS' REMUNERATION REPORT (continued)

DIRECTORS' INTERESTS IN SHARES

The following Directors held a beneficial interest in the Company's Ordinary Shares:

				Contingent interests		
	At 22 Feb 05	At 31 Dec 04 (or date of appointment)	At 31 Dec 03	At 22 Feb 05	At 31 Dec 04 (or date of appointment)	At 31 Dec 03
Non-Executive Directors						
Dr M W Ridley	26,200	26,200	26,200	-	-	-
N A H Fenwick	1,500	1,500	-	-	-	-
Sir Ian Gibson	5,000	5,000	2,000	-	-	-
N Pease	8,350	8,350	8,350	-	-	-
Sir George Russell	36,755	36,755	36,755	-	-	-
Sir Derek Wanless	20,500	20,500	20,500	-	-	-
Sir John Riddell, Bt. (retired 27 April 2004)			10,000			-
Sir David Chapman, Bt. (retired 27 April 2004)			5,620			-
M J Queen (appointed 5 January 2005)	-	-		-	-	
Executive Directors						
A J Applegarth	93,177	79,668	58,941	549,430	488,655	388,725
D F Baker	64,819	59,657	52,458	370,118	346,995	309,207
R F Bennett	64,813	59,652	63,380	370,118	346,955	320,357
K M Currie (appointed 5 January 2005)	38,852	32,889		217,811	187,031	
A M Kuipers (appointed 5 January 2005)	37,641	31,678		217,811	187,031	

Contingent interests represent Ordinary Shares over which the Directors have conditional rights under the bonus matching plan, the deferred share scheme and the long term incentive plan which is subject to stringent performance criteria being met as described above. Contingent interests on 22 February 2005 includes awards made since 31 December 2004 under the bonus matching plan, the deferred share scheme and the long term incentive plan for periods commencing on or after 1 January 2004.

DIRECTORS' REMUNERATION REPORT (continued)

DIRECTORS' SHARE OPTIONS

Movements in options to subscribe for Ordinary Shares in the Company in which the Directors have an interest during the period 1 January 2004 to 31 December 2004 are as follows:

	Option type	At 31 Dec 03	Exercised in 2004	Exercise price £	At 31 Dec 04 (or date of appointment)	Date from which first exercisable	Expiry date
A J Applegarth	Sharesave 2	7,848	-	2.15	7,848	1 May 05	1 Nov 05
	Share Option Scheme	4,854	(4,854)	6.18	-	-	-
D F Baker	Sharesave 2	7,848	-	2.15	7,848	1 May 05	1 Nov 05
	Share Option Scheme	4,854	(4,854)	6.18	-	-	-
R F Bennett	Sharesave 3	1,580	-	5.98	1,580	1 May 06	1 Nov 06
K M Currie	Sharesave 2			2.15	7,848	1 May 05	1 Nov 05
(appointed 5 January 2005)	Share Option Scheme			6.18	4,854	1 Jun 01	1 Jun 08
A M Kuipers (appointed 5 January 2005)	Sharesave 2			2.15	8,546	1 May 07	1 Nov 07

For each unexercised option at the end of the year, the market price of each share at 31 December 2004 was £7.815, the highest market price during the year was £7.94 (20 December 2004) and the lowest market price during the year was £6.865 (11 August 2004).

On 30 January 2004 A J Applegarth and D F Baker each exercised and sold 4,854 Share Option Scheme shares at a price of £7.40.

The specific individual interests of Executive Directors are shown in the tables above. In addition the Directors are deemed to have an interest in shares held by Trusts for various executive and other employee share schemes at 31 December 2004 as follows:

(i) Northern Rock Employee Trust holds 5,779,139 shares (31 December 2003 – 6,433,225 shares);

(ii) Northern Rock Qualifying Employee Share Ownership Trust holds 2,054,261 shares (31 December 2003 – 2,056,063 shares); and

(iii) Northern Rock Trustees Limited holds 511,241 shares (31 December 2003 – 749,729 shares).

No Executive Director option terms were varied during 2004 and no price was paid for any of the options in the table, other than the all employee Sharesave Scheme, where each Director paid £250 per month.

Options listed in the table above are Inland Revenue approved schemes. The Employee Share Option Scheme was subject to an EPS target which was met in 2004. Options under the Sharesave Scheme do not have any performance conditions.

Nichola Pease
Chairman, Remuneration Committee
22 February 2005

COMMUNITY AND ENVIRONMENTAL REPORT

REPORTING

The Company's website contains detailed information on corporate, social and environmental activities and is our main reporting medium. Updated quarterly, the website contains reports from current and previous years. A hard copy summary of significant events and achievements during 2004 has been produced and is available on request from the Company Secretary. Northern Rock's approach to managing Corporate Social Responsibility (CSR) issues and some notable aspects of 2004 performance are outlined here.

MANAGEMENT OF CSR

The Chief Operating Officer provides Board level representation and leadership of CSR.

Development and implementation of our CSR Policy is now carried out by six working groups made up of senior staff from across the Company. A launch event was held on formation of the groups, led by the Chief Operating Officer, setting out the corporate approach and aims for CSR.

A CSR Department co-ordinates and monitors operational activities and reporting on CSR.

ENGAGEMENT

We continued our engagement with stakeholders and research organisations although this is an area where we need to be selective to ensure effective use of resources.

Contractor evaluation systems were developed further to ensure that our working partners operate to acceptable standards.

GOVERNANCE AND ACCOUNTABILITY

Northern Rock's approach to compliance with the Combined Code was delivered in a presentation to shareholders by the Chairman which was broadcast on our website.

CSR risks were reviewed as part of the formal corporate risk management process and are included in our operational risk monitoring and reporting systems.

BUSINESS ETHICS AND HUMAN RIGHTS

Our Code of Conduct was reviewed and the revised version published on the Company's website.

Existing training on awareness and prevention of money laundering was supplemented by refresher training for senior management.

The Company reviewed its obligations under public interest disclosure, strengthening the policy to protect staff in the event of 'whistle blowing'.

WORKPLACE

We continued to demonstrate pro-active and sustained commitment to equality in employment, working with various organisations to provide opportunities for individuals from diverse groups and ensure our workforce is representative of the community. Specific initiatives included increasing the numbers of disabled staff, assisting the long-term unemployed to find work, support for refugee programmes, ensuring best practice in diversity and racial equality and support for the Age Positive Campaign.

Worklife Balance activities were geared towards improved flexibility and the move away from core hours. Lifestyle working extends to all graded staff, including managers.

Training and education remain key features of staff development and in 2004 we carried out the largest training exercise we have ever undertaken, delivering a Customer Service training programme to all staff, led by the Chief Executive and Chief Operating Officer.

We supported the Government sponsored National Learning Day by holding our own Learning Week, with activities available to all staff. Personal development was further encouraged through wider availability of e-learning materials.

In Health and Safety, we implemented a new management system, focusing on key risk areas. Progress was tested by participation in the Corporate Health and Safety Performance Index (CHASPI) pilot exercise, where we recorded sector-leading results.

MARKETPLACE

Affordability of loans for customers is a key aspect of responsible lending. Enhanced procedures for the certification of affordability were introduced and are followed by our sales force and intermediaries.

A programme of work continued to ensure that we comply with all relevant aspects of the Disability Discrimination Act.

Surveys of customers who transferred to Northern Rock on our acquisition of Legal & General Bank in 2002, continued in 2004, with positive results recorded.

More detailed information on our Marketplace activities is set out in the Operating and Financial Review.

COMMUNITY

The annual donation of 5% of pre-tax profits to The Northern Rock Foundation is the biggest single contribution we make to the communities in which we operate. In 2004, this amounted to £21.6 million.

Northern Rock staff contribute to many charitable causes and community activities, notably the corporate charity which is chosen by staff on an annual basis. In 2004, the Children's Wish Foundation was selected and staff raised over £100,000, matched by The Northern Rock Foundation.

ENVIRONMENT

Positive recognition for our well-developed environmental management systems included retention of our Premier League status in the Business in The Environment Index.

Our largest sites operated on renewable energy until contracts ended in October. When renewing our energy contracts, we were unable to obtain renewable energy but secured energy exempt from climate change levy for the whole portfolio.

A review of secure paper recycling methods yielded significant cost savings whilst maintaining data protection compliance.

A transport survey of all staff working at our Gosforth Head Office showed that use of alternative forms of transport had increased in recent years, whilst driver-only car journeys had reduced. Further development and promotion of travel plans for Head Office were carried out using feedback from the survey.

THE NORTHERN ROCK FOUNDATION

Since 1997 Northern Rock plc has donated nearly £120 million to The Northern Rock Foundation, which was established following Northern Rock Building Society's conversion to a public limited company. The Company covenants 5% of its pre-tax profit each year to the Foundation. By percentage of profits Northern Rock is the UK's 3rd biggest corporate donor (as reported in 'The Giving List', the Guardian, November 2004).

The Foundation is an independent grant-making trust supporting charitable causes in Cumbria, Northumberland, Tyne and Wear, Durham and the Tees Valley. Its primary aim is to help improve the conditions of those disadvantaged in society. 2004 was the Foundation's seventh year of operation. During the year its Trustees awarded 329 grants worth £17.3 million and invested a further £8.2 million in two special initiatives: tackling domestic violence and reducing re-offending. Since 1997 the Foundation has awarded grants worth more than £92.6 million.

In 2004 the Foundation's Trustees continued the grant programmes introduced in the previous year, and maintained their policy of funding activities exclusively in the North East and Cumbria. The majority of the Foundation's grants targeted social and economic disadvantage. The Prevention, Regeneration and Basics programmes dealt with a broad range of issues, including prejudice and discrimination, the decline of decent community facilities, youth disaffection, tackling economic inactivity, development of social enterprises, mental ill-health and welfare advice.

During the year the Foundation maintained its role as a major funder of cultural activity in the region. Through its Aspiration and Capital programmes it made grants worth £4.8 million for high profile arts, heritage, environment and sport organisations. The Foundation also became a key partner in the Culture 10 initiative, a ten-year programme of high profile cultural activity focused on Newcastle Gateshead, but including other parts of the North East. The Foundation has committed £2 million from its existing Aspiration programme to projects brought forward under the Culture 10 banner up to 2006.

In 2004 the Foundation made its third Writer's Award, one of the largest literary prizes in the UK, which it runs in partnership with New Writing North. The 2004 winner was Newcastle-based poet Tony Harrison. Tony said:

"The Northern Rock Foundation Writer's Award could not have come at a better time in my career. I need to look back on my poetic ventures, make sense of them as a whole and move forward... and to experiment without external demands. The award makes all this finally possible and I am extremely grateful to The Northern Rock Foundation."

The Foundation continued to play a key role in regional and national developments in the grant-making world. It was a founder member of a campaign to raise awareness of, and seek solutions to the problems arising from the decline and disappearance of a number of national funding streams that have supported social and economic regeneration in the region. Under its loan scheme, introduced in 2003, the Foundation invested £968,000 in organisations to provide working capital, and to purchase assets. The Foundation also played a lead role in the consortium running the Government's £125 million Futurebuilders fund, designed to strengthen the capacity of voluntary organisations to deliver public services. The Foundation's Director is Vice-Chair of the Futurebuilders' Board, a Trustee sits on its investment committee and a member of staff is seconded to manage its investment team.

The Foundation also runs a scheme to match every pound donated to charities by Northern Rock employees. Some of the money comes from the Give as You Earn (GAYE) scheme through which employees donate a regular monthly sum from their salary, also attracting a small government subsidy. But by far the majority of the donations come from the fundraising efforts of staff members. In 2004 the seven-year total raised by staff when matched by the Foundation reached £2 million. The total raised and matched in 2004 was £264,000.

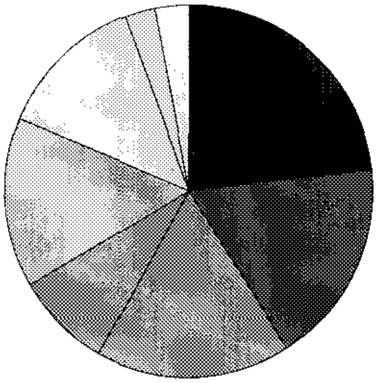
The Trustees expect to maintain the current grant programmes in 2005, although particular priorities within them may change.

More information about the Foundation is available from:

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

Telephone: 0191 284 8412, Fax: 0191 284 8413
e-mail: generaloffice@nr-foundation.org.uk
Web: www.nr-foundation.org.uk

Grant programmes 2004 approved amounts:



Awards £	Programme
4,014,000	Prevention
3,084,000	Regeneration
2,960,000	Basics
1,461,000	Better Sector
2,558,000	Aspiration
2,249,000	Cultural Capital
458,000	Exploration
520,000	Exceptional
£17,304,000	
8,173,000	Special Initiatives
968,000	Loans
385,000	Other
£26,830,000	**Total Investment**

OPERATING AND FINANCIAL REVIEW

OVERVIEW

Profit before tax for the year increased by 11.5% to £431.2 million and profit after tax increased by 11.6% to £306.2 million. The 2003 results have been restated to reflect a change in accounting policy following the adoption of UITF 38 – Accounting for ESOP Trusts, resulting in an increase in staff costs and a decrease in profit of £0.2 million. On a like-for-like basis (excluding from the 2003 restated results, the £5.6 million non-recurring costs associated with the closure of certain branches, the £7.3 million surplus on the disposal of the credit card portfolio together with a £3.6 million contribution prior to its sale, and the effect on the covenant to The Northern Rock Foundation), both profit before tax and profit after tax increased by 13.0%. Return on equity in 2004 was 21.3% compared with a restated 21.9% in 2003. Reported earnings per share grew to 74.1p in 2004 (2003 - restated 66.6p), an increase of 11.3%.

		2003		
	2004	**Reported (Restated)**	**Adjustments**	**Like-for-Like (Restated)**
	£m	**£m**	**£m**	**£m**
Total income	730.9	659.7	(10.9)	648.8
Administrative expenses				
Operating	(203.5)	(178.0)	-	(178.0)
Non-recurring	-	(5.6)	5.6	-
Covenant to The Northern Rock Foundation	(21.6)	(19.3)	0.3	(19.0)
Total administrative expenses	(225.1)	(202.9)	5.9	(197.0)
Depreciation of tangible fixed assets	(19.0)	(16.5)	-	(16.5)
Amortisation of goodwill	(3.6)	(3.6)	-	(3.6)
Operating expenses	(247.7)	(223.0)	5.9	(217.1)
Provisions for bad and doubtful debts	(56.5)	(48.7)	-	(48.7)
Provisions against fixed asset investments	4.5	(1.4)	-	(1.4)
Profit on ordinary activities before tax	431.2	386.6	(5.0)	381.6
Tax on profit on ordinary activities	(125.0)	(112.2)	1.5	(110.7)
Profit on ordinary activities after tax	306.2	274.4	(3.5)	270.9
Dividends	(110.0)	(96.3)	-	(96.3)
Profit retained for the period	196.2	178.1	(3.5)	174.6

Assets under management, including loans and advances subject to securitisation, at 31 December 2004 amounted to £64.9 billion, an increase of 24.9% (2003 – restated £51.9 billion). Net assets, including the securitised bonds (shown as a deduction from assets) grew by 15.3% to £42.8 billion (2003 - restated £37.1 billion).

TOTAL INCOME

	2004	**2003**
	£m	**£m**
Net interest income	466.9	450.7
Other income	264.0	201.7
Total underlying income	730.9	652.4
Surplus on sale of credit card portfolio	-	7.3
Total income	730.9	659.7
Total income : mean total assets (underlying)	1.83%	1.87%
Total income : mean total assets	1.83%	1.89%
Total income : mean assets under management (underlying)	1.25%	1.39%
Total income : mean assets under management	1.25%	1.41%

OPERATING AND FINANCIAL REVIEW (continued)

Total reported income in 2004 amounted to £730.9 million (2003 - £659.7 million), an increase of 10.8%. Underlying total income amounted to £730.9 million an increase of 12.0%. On the same basis, total income as a proportion of mean total assets at 1.83% shows only a slight reduction from 1.87% for 2003. The ratio of underlying total income to mean total assets under management at 1.25% remained unchanged compared with the first half of 2004, having eased from an underlying 1.39% in 2003.

INTEREST SPREAD AND MARGINS

	2004	**2003**
	£m	**£m**
Interest receivable	2,989.4	2,153.8
Interest payable	(2,522.5)	(1,703.1)
	466.9	450.7
Average balances		
Interest bearing assets	57,071.3	46,435.1
Interest bearing liabilities	55,957.2	45,570.6
Interest margin	0.82%	0.97%
Interest spread	0.73%	0.90%

Interest receivable and payable represent amounts reported in the Profit and Loss account, adjusted to transfer securitisation interest payable to interest payable, and include income from equity shares and other variable yield securities in interest receivable. Interest bearing assets and liabilities have been adjusted for securitised assets and non-recourse finance and interest bearing assets include equity shares and other variable yield securities.

Interest margin has been calculated by reference to average interest earning assets. Interest spread represents the difference between interest receivable as a % of average interest earning assets and interest payable as a % of average interest bearing liabilities. Average balances have been calculated on a monthly basis.

In 2004 interest margin and spread were 0.82% and 0.73% respectively compared with 0.85% and 0.77% in the first half of the year (2003 full year - 0.97% and 0.90%). During the second half of 2004 spreads on lending were stable compared with the first half, consistent with the mix of lending volumes. Throughout 2004, liability spreads were, however, adversely affected by money market rates anticipating increases in bank base rate, resulting in a net increase in our cost of funding. The differential in rates is expected to return to more normal levels in 2005 as evidenced by the reduction in money market rates towards the end of 2004.

OPERATING EXPENSES

(excluding the covenant to The Northern Rock Foundation and amortisation of goodwill)

	2004	**2003**
		(Restated)
	£m	**£m**
Staff costs	119.3	101.0
Other expenses	84.2	77.0
Depreciation	19.0	16.5
Total underlying expenses	222.5	194.5
Non-recurring costs	-	5.6
Total operating expenses	222.5	200.1

Non-recurring costs in 2003 represent costs incurred in relation to the closure of certain branches.

Total operating expenses amounted to £222.5 million representing an increase of 14.4% over 2003 underlying operating expenses of £194.5 million (excluding one off costs of £5.6 million relating to the closure of certain branches). The increase of 14.4% compares with an increase in assets under management of 24.9% and total income of 12.0% on an underlying basis, resulting in a cost to assets under management ratio of 0.38% (2003 underlying - 0.41%) and cost to income ratio of 30.4% (2003 underlying - 29.8%).

OPERATING AND FINANCIAL REVIEW (continued)

Included in 2004 operating expenses are £3.6 million incremental costs in relation to increased regulatory requirements. Excluding these additional costs, the cost to assets under management ratio would have been 0.37% and the cost to income ratio 29.9%.

The full impact of additional regulatory costs, which will affect all UK banks, will amount to around £10.0 million for Northern Rock in 2005. Our competitive advantage of cost efficiency remains in place as do our targets of improving our cost ratios by growing costs at less than the rate of growth of income and between one half and two thirds the growth in assets under management.

SOCIAL RESPONSIBILITY - THE NORTHERN ROCK FOUNDATION

Northern Rock donates 5% of pre-tax profit to The Northern Rock Foundation under a deed of covenant. Such donations are used to support community and charitable causes mainly in the North East of England and Cumbria. In addition, a £0.5 million donation is to be made by the Foundation to support the Asian tsunami aid relief. The donation from 2004 profits amounts to £21.6 million (2003 - £19.3 million), resulting in almost £120 million having been distributed since its inception in 1997 as an integral part of Northern Rock's conversion to a plc.

PROVISIONS FOR BAD AND DOUBTFUL DEBTS

The arrears position of our residential mortgage book has further improved despite the growth in mortgages under management. At 31 December 2004 there were 2,135 (2003 - 2,414) accounts three months or more in arrears representing only 0.37% (2003 - 0.45%) of all mortgage accounts, less than half the UK average at 31 December 2004 of 0.80%. The "together" secured advances default performance has also remained consistent, with three months plus arrears at 0.77% at 31 December 2004 (2003 - 0.77%). At 31 December 2004 181 properties, representing only 0.03% of all accounts were in possession compared with 179 (0.03%) at the end of 2003.

Standalone personal unsecured loan arrears are also significantly better than industry average, reflecting our policy of attracting high quality lending via our risk reward pricing. At 31 December 2004 only 1.04% of our standalone personal unsecured loans were three months or more in arrears (2003 - 0.98%) compared with an historic industry average of around 3%. Unsecured loans within the "together" brand continued to perform in line with the "together" secured advances and better than traditional personal unsecured loans with only 0.78% three months or more in arrears (2003 - 0.80%).

Our commercial loan portfolio also continued to perform well with only 0.31% of our commercial loans three months or more in arrears (2003 - 0.53%).

The charge for provisions for bad and doubtful debts amounted to £56.5 million for the year (2003 - £48.7 million) representing 0.18% of mean advances to customers (2003 - 0.19%). The combination of high quality lending, low interest rates, low arrears and strong house price inflation have continued to contain the levels of specific provisions required for residential mortgages. Provisions for the other secured lending portfolio have been maintained consistent with performance and expected economic conditions for this sector.

The growth in provision balances against our personal credit portfolios reflects growth in balances, the maturing nature of the portfolios and our continued prudent provisioning policy. As a result, general provisions are 47% (2003 - 51%) of total provision balances for these portfolios with total provision cover of 1.68% (2003 - 1.70%). Total provisions against our personal credit portfolios are considered appropriate given the quality and performance of our loans.

TAXATION

The tax charge for the year as a percentage of profit before tax was 29.0% (2003 - 29.0%). We anticipate, with a corporation tax rate of 30%, that the ongoing effective tax rate will be 29.0% to 30.0% in the medium term.

	%
Standard corporation tax rate for 2003	30.00
Effect of net non-taxable items	(0.33)
Adjustment to prior year tax provisions	(0.67)
Effective tax rate	29.00

LENDING

During 2004 Northern Rock has again achieved record levels of total lending. Total gross lending was £23,342 million, an increase of 34.8% (2003 - £17,315 million), with total net lending of £12,932 million, an increase of 51.9% (2003 - £8,514 million). Prospects for 2005 are good, with an opening pipeline of £5.1 billion, an increase of 31.8% (2004 opening - £3.9 billion). The opening residential lending pipeline at £4.7 billion represents an increase of 36.6% (2004 opening - £3.4 billion).

OPERATING AND FINANCIAL REVIEW (continued)

The UK residential lending market was particularly buoyant during the first half of 2004 with levels of both gross and net lending exceeding the equivalent period in 2003. Since then both gross and net lending and net awards have slowed, following the effect of 5 one quarter per cent increases in bank base rate since November 2003. By the end of 2004 annual house price inflation was at similar levels to that seen in 2003 although the second half of the year showed limited growth, providing clear evidence that house price inflation is slowing. With the level of housing transactions at the lower end of long term trends and house price inflation likely to be over for the time being, new residential lending is likely to show some contraction in 2005. Gross lending will, however, be supported by sustained levels of remortgage activity as customers seek to refinance to obtain better deals and to protect their personal budgets. Economic conditions remain supportive to the market with low inflation, low unemployment, low interest rates and consequently good affordability.

Against this background we achieved gross residential lending of £20,051 million (2003 - £15,212 million) and net residential lending of £11,383 million (2003 - £7,861 million), representing increases of 31.8% and 44.8% respectively. Our share of gross residential lending for the year was 6.8% and our market share of net residential lending was 11.2%. This compares with 5.8% and 8.2% respectively for the first half of 2004. Our share of redemptions was only 4.5%, again significantly lower than our closing share of mortgage stock of 5.5%. This was due to our pro-active customer retention process and our fair and transparent policy of allowing existing customers, subject to contractual terms, to transfer their loan to any product available to new borrowers.

The low risk profile of our new lending has continued despite strong growth in volumes. The proportion of lending to first time buyers reduced to 21% (2003 - 23%) with 79% of new customers having a proven payment track record. The average Loan to Value ratio ("LTV") of new lending in 2004 remained similar to 2003 at around 75% and new lending below 90% LTV was 75% (2003 - 71%) of completions. The average indexed LTV of our mortgage book is now 53% (2003 - 55%) providing strong cover in the event of default. We have minimal exposure to large loans with only around 3.5% of new loans over £500,000 and we maintained an excellent geographic spread of lending.

We offer customers a wide range of innovative and attractive products including lifestyle products and traditional price-led products. Our lifestyle products comprise our "together" family of products, Lifetime Home Equity Release Mortgages ("HERM") and residential Buy to Let mortgages. The "together" products combine a secured and unsecured loan at one interest rate and one monthly payment. Gross lending of "together" products amounted to £4.5 billion of which £3.8 billion were advances secured on residential property representing 20.7% of new residential lending, excluding further advances. Outstanding balances of "together" mortgages remained around one fifth of our mortgage portfolio throughout 2004.

Our HERM range is aimed at homeowners aged over 60 who wish to utilise equity in their homes to enhance their lifestyle. Such lending accounted for 1.8% of gross new residential lending (2003 - 3.4%), with outstanding HERM balances representing 3.1% (2003 - 3.0%) of our year end mortgage balances.

Residential Buy to Let lending is focussed on lending to private investors secured on good quality residential properties with low LTVs. Such lending accounted for 4.0% (2003 - 2.4%) of our year end mortgage portfolio and for 6.4% (2003 - 1.7%) of gross new residential lending. This type of lending is likely to remain a niche part of our overall portfolio of lending and will be supported by demand following changes in pension legislation allowing rental properties to be included within investors' pension plans.

In total, our lifestyle products, which are margin enhancing, represented 28.9% (2003 - 30.1%) of our gross new residential lending and 25.3% (2003 - 25.4%) of year end mortgage balances.

Of our traditional price-led mortgage products, fixed-rate mortgages remained the most popular with 46.4% (2003 - 45.5%) of total new lending accounted for by short term fixed products up to two years, and 7.5% (2003 - 10.1%) by longer term fixes normally up to a maximum of seven years. This demand reflected customers' preferences to obtain certainty of monthly repayments during a period of rising interest rates.

Our personal unsecured credit portfolios comprise the unsecured element of "together" lending and standalone unsecured loans not linked to a residential mortgage. During 2004 gross unsecured lending amounted to £2,792 million (2003 - £1,694 million) with net lending of £1,367 million (2003 - £569 million). Gross standalone unsecured lending amounted to £2,068 million (2003 - £1,130 million) with net lending of £1,104 million (2003 - £417 million). The increase in standalone unsecured lending over 2003 reflects the deliberate containment of such lending in the first half of 2003 with a return to the market in the second half of that year. At 31 December 2004 our unsecured lending balances were £4,669 million (2003 - £3,293 million) of which 40.3% (2003 - 48.7%) represented "together" unsecured advances.

We have continued to grow our commercial lending portfolio gradually, maintaining our emphasis on quality rather than volume of lending. Gross lending in the year amounted to £499 million (2003 - £409 million) with net lending of £182 million (2003 - £84 million).

The composition of our lending portfolios has continued to be low risk. At the year end 88.7% of our loans under management were residential (2003 - 89.1%), 2.9% commercial secured loans (2003 - 3.3%) and only 8.4% (2003 - 7.6%) within our personal unsecured portfolios. This mix is not expected to significantly change going forward.

OPERATING AND FINANCIAL REVIEW (continued)

RETAIL FUNDING

Total retail deposit balances for the year increased by £896 million to £17,239 million (2003 - £16,343 million), an increase of 5.5%. This increase comprised a net inflow of retail funds for the year of £489 million plus interest credited of £407 million. In the second half of the year we achieved a net inflow of over £1.0 billion of retail funds, following a net outflow of £163 million in the first half, representing our best ever half year performance and clearly demonstrating the strength and diversity of our retail franchise.

The funding during the year was largely into our Silver Savings account launched in September 2004 for the over 50s which had attracted balances of over £1,250 million by the year end. Fixed rate bonds also remained popular. Balances in our Ireland based operation rose by 18.3% to £628 million, with £1,871 million (2003 - £1,875 million) in our Guernsey based off-shore vehicle.

NON-RETAIL FUNDING

Total net non-retail funding for the year amounted to £2,770 million with balances at 31 December 2004 amounting to £19,746 million (2003 - £16,976 million). Our non-retail funding provides a balanced mixture of short and medium term funding with increasing diversification of our global investor base.

During 2004 we raised £3.4 billion medium term, wholesale funds from a variety of sources located globally, with specific emphasis on the US and Europe. A major feature was the increased utilisation of our US Medium Term Note programme from which we raised US$3.7 billion in both senior and subordinated form. Already in 2005 we have raised a further US$1.75 billion under this programme and in the remainder of the year plan to raise further non-retail funds, including possible issuances in Asia.

With regards to short term funding, key developments include the establishment of a €2.0 billion French Certificate of Deposit programme which provides access to domestic French investors. This programme had outstanding balances of €1.1 billion at the year end. Further diversification will be achieved in the current year with the intended establishment of a Canadian Commercial Paper programme.

SECURITISATION

Funding through securitisation has remained an integral part of Northern Rock's funding strategy. During 2004 three issues were completed raising £11.1 billion. Diversification of our investor base continued with over 70% of the securitised bonds in 2004 being issued in US dollars or euros. The characteristics of the mortgages securitised, in terms of product type, LTV and geographic distribution remain similar to those of our on-balance sheet mortgages, ensuring that we are maintaining the quality of our balance sheet.

At 31 December 2004 assets under management subject to securitisation amounted to £22.3 billion (2003 - £15.7 billion), representing 40% (2003 - 36%) of our total lending portfolios.

In 2005 we have already raised a very well received £4.5 billion securitisation of residential mortgages. Our programmes will continue to be developed with further issues during 2005.

COVERED BOND

In the first half of 2004 we raised €2.0 billion from an inaugural covered bond issue from a newly established €10 billion programme. The covered bond is secured by a pool of ring-fenced residential mortgages which remain on-balance sheet as Northern Rock retains substantially all the risks and rewards associated with the loans.

DIVIDENDS

The interim dividend paid in October 2004 was 8.5p per share. The proposed final dividend of 18.0p per share is payable on 27 May 2005 to shareholders on the register on 29 April 2005. This results in a total dividend payable for the year of 26.5p per share (2003 - 23.3p), an increase of 13.7%.

CAPITAL

At 31 December 2004 total capital amounted to £3,239 million resulting in a total capital ratio of 14.0%, comfortably above regulatory and internal requirements. Tier 1 capital was £2,015 million and the Tier 1 ratio 8.7%. The comparable ratios at 31 December 2003 were 14.3% and 9.0% respectively.

In the first half of 2004 we raised $700 million (£396 million equivalent) of Upper Tier 2 capital via our US Medium Term Note programme delivering an excellent diversification of capital from the US domestic market.

During 2004 we continued to embed our Basel II credit risk systems within our normal operational activities and remain on target to adopt the Retail Internal Ratings Based approach currently anticipated to commence on 1 January 2007. Significant investment is also being made in our Operational Risk management systems and in line with the FSA's expectations for the sector we intend to initially adopt the *Standardised Approach to Operational Risk. We will closely examine the consultation paper from the FSA, issued at the end of January* 2005, with a view to seeking approval for our proposed approaches as early as possible.

Our low risk balance sheet means that we expect to achieve significant reductions to the levels of our total regulatory risk weighted assets for credit exposures compared to current levels. This should result in future capital efficiencies subject to consultation with the FSA and credit rating agencies.

OPERATING AND FINANCIAL REVIEW (continued)

The table below analyses Northern Rock's capital resources at 31 December 2004 and 2003:

	2004	2003 (Restated)
	£m	£m
Tier 1		
Share capital	123.9	123.9
Share premium account	6.8	6.8
Capital redemption reserve	7.3	7.3
Profit and loss account	1,403.9	1,201.9
Reserve capital instruments	300.0	266.3
Tier one notes	200.0	200.0
Goodwill	(27.1)	(30.7)
Total Tier 1 capital	2,014.8	1,775.5
Upper Tier 2		
Perpetual subordinated debt	746.4	350.3
Reserve capital instruments	-	33.7
General provisions	83.1	75.4
Total Upper Tier 2 capital	829.5	459.4
Lower Tier 2 capital		
Term subordinated debt	769.3	769.2
Total Tier 2 capital	1,598.8	1,228.6
Deductions	(374.7)	(190.5)
Total capital	3,238.9	2,813.6
Risk weighted assets	23,099.2	19,690.5
Tier 1 ratio (%)	8.7%	9.0%
Total capital (%)	14.0%	14.3%

POTENTIAL IMPACT OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Northern Rock, along with all European Union listed companies will be required to prepare its financial statements under International Financial Reporting Standards ("IFRS") (sometimes referred to as International Accounting Standards) from 1 January 2005. In certain areas these standards represent a significant change from UK GAAP. A number of uncertainties currently exist concerning the adoption of the new standards and their impact on Northern Rock. In particular, the approach of the Financial Services Authority towards IFRS was outlined in Consultation Paper 04/17. The discussion period for this Consultation Paper ended on 31 January 2005. In addition, the tax treatment of certain aspects of IFRS has not yet been fully determined by the Inland Revenue and the effect of these uncertainties is under review. The combination may affect both the tax charge and our accounting and regulatory equity ratios.

IFRS includes a number of areas, principally financial instruments, where fair values are required to a far greater extent than under UK GAAP. This will create greater volatility in reported results and have an associated impact on other financial measures. However, the change to IFRS does not alter the cash flows of the business, but spreads the profitability throughout the life of the loan. The change to IFRS will not change the way Northern Rock does business.

OPERATING AND FINANCIAL REVIEW (continued)

The key changes and their anticipated effect on Northern Rock are set out below.

Issue	Effect on financial statements
Hedge accounting Northern Rock manages the financial risks arising from its business using a number of derivatives instruments such as interest rate swaps, interest rate options, forward rate agreements, interest rate and bond futures, currency swaps and forward exchange contracts. IAS 39 requires derivatives to be recognised at fair value, with changes in valuation impacting the profit and loss account, potentially resulting in significant earnings volatility. Hedge accounting permissibility is much more restricted under IAS 39 than at present under UK GAAP. Northern Rock has reviewed its underlying processes to ensure it maximises the natural offsets between assets and liabilities and designs compliant hedging strategies wherever possible for the remainder. However, the overriding objective continues to be to provide an economic hedge for the market risks arising from its underlying business.	To the extent that hedge effectiveness is not achieved for derivatives, the movements in fair value of the derivatives would impact on the profit and loss account increasing volatility in earnings.
Effective interest rate IAS 39 requires the inclusion of all origination fees, including prepayment penalties in the calculation of the effective interest rate. Only direct costs of origination may be included within the calculation of effective interest rate.	Income earned and introducer fees paid will be spread throughout the life of the loan, reducing the amount of income earned in early years and increasing the amount of income earned in later years.
Provisions IAS 39 will remove the split between specific and general provisions, and, in common with current UK GAAP, will only allow impairment allowances to be established where the loss has already been incurred based on whether objective evidence exists that the asset or group of assets is impaired. The impairment allowance must be calculated using the present value of future cash flows, using the financial asset's original effective interest rate.	Slight increase in volatility as provisions reflect the economic climate at the reporting date.
Pensions IAS 19 is broadly consistent with the existing UK standard on pensions, (FRS 17), with the fund valuation depending on market conditions at the year end. However, actuarial gains and losses may be recognised in full as they arise outside the profit and loss account in a statement of recognised income and expense.	As with FRS 17 the pension charge is likely to be higher than the present SSAP 24 charge. The equity impact will depend on market conditions.
Taxation IAS 12 (Income Taxes) is conceptually different to the previous accounting standard (FRS 19), however, little difference is expected in practice between the two standards.	The Group's effective tax rate is not expected to be materially different although there may be greater volatility in the current charge. It is expected that this would be broadly offset by compensating movements in deferred tax.

Issue	Effect on financial statements
Classification of debt versus equity Under IAS 32 certain financial instruments which are currently classified as debt instruments may be classified as equity instruments.	The coupon payable on such instruments would be classified as an equity distribution. This would increase profit before tax, but become a distribution of profit to investors.
Employee share schemes *IFRS 2 requires that for all equity settled transactions with employees the fair value of* the employee services should be measured by reference to the fair value of the instrument at the date of grant. This charge is spread over the vesting period. The standard applies to all share schemes and has no exemption for SAYE schemes.	*The impact on Northern Rock will result in a* small increase in employee costs.
Securitised assets A significant source of funding to Northern Rock is through the securitisation of residential and commercial mortgage assets. The structure of these funding vehicles results in the disclosure of these mortgage assets, and the related funding, through linked presentation in accordance with FRS 5. Under IFRS no such presentation exists, so all assets and liabilities will remain within their normal line items.	Both mortgage assets and liabilities will remain within their original line items. All profit and loss items will also remain within their usual captions.

OUTLOOK

The home moving market is expected to continue to remain at similar levels to 2004, at the lower end of longer term trends, for at least the next two years. Many first time buyers will continue to be excluded from the market as a result of higher house prices, the competition with Buy to Let investors for traditional first time buyer properties, especially in urban areas, and higher levels of indebtedness linked to the funding of higher education. In conjunction with subdued levels of house moving transactions we expect to see muted house price inflation with some price falls in areas that have seen excessive growth. We expect, however, given low unemployment, low interest rates and good affordability, house prices to be growing in line with average earnings by the end of 2005.

The UK's gross residential mortgage market, supported by remortgage activity, is anticipated to be £265 billion to £270 billion in 2005 and 2006 compared with over £290 billion in 2004. Such levels of gross lending remain conducive to Northern Rock achieving its lending targets for 2005.

A slower housing market, reduced inflationary pressures and a dampening in retail sales mean that the prospects for rising interest rates are significantly lower than in mid 2004, as a consequence the difference between LIBOR and Bank Base Rate is expected to return to more normal levels in 2005. Unemployment, the key driver of credit loss on home loans, looks set to remain benign giving a stable outlook for future provisioning levels.

These conditions, together with our continued focus on customer service, cost and capital efficiency and the strength of our opening pipeline enable us to view 2005 with confidence. We reaffirm our strategic targets of assets under management growth of 20% + / – 5%, profit growth of 15% + / – 5% and return on equity of 19% to 22%.

Our growth will continue to be supported by our four funding arms; retail, non-retail, securitisation and covered bonds. We intend to develop further each franchise in terms of flexibility and diversification to enhance our overall funding platform and investor base.

We remain confident of the continued success of the Northern Rock business model.

DIRECTORS' REPORT AND ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2004

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2004

The Directors are pleased to present their report and the audited financial statements for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The principal purpose of the Group is the provision of housing finance, savings and a range of related personal financial and banking services.

REVIEW OF BUSINESS AND FUTURE DEVELOPMENTS

A review of the business and future developments is given in the Chairman's Statement, the Chief Executive's Report and the Operating and Financial Review.

DIVIDENDS

An interim dividend of 8.5p per share (2003 - 7.5p per share) was paid on 29 October 2004. The Directors propose a final dividend of 18.0p per share (2003 - 15.8p per share) to be paid on 27 May 2005 to shareholders on the register at the close of business on 29 April 2005.

TANGIBLE FIXED ASSETS

Land and buildings, which are included in the balance sheet at cost less accumulated depreciation, amounted to £87 million at 31 December 2004. In the Directors' opinion, based on valuations carried out by the Group's qualified Chartered Surveyors, the total market value of these assets was not significantly different.

Details of changes to tangible fixed assets are provided in note 21 to the accounts.

POST BALANCE SHEET EVENTS

The Directors are of the opinion that there have been no significant events which have occurred since 1 January 2005 to the date of this report that are likely to have a material effect on the Group's financial position as disclosed in the accounts.

DIRECTORS

The current composition of the Board of Directors together with brief biographical details of each Director is shown on page 12. With the exception of the Directors noted below, all Directors have served on the Board throughout the year ended 31 December 2004.

On 27 April 2004 Sir John Riddell, Bt., and Sir David Chapman, Bt. retired from the Board. On 5 January 2005, Mr K M Currie, Mr A M Kuipers and Mr M J Queen were appointed to the Board. On 1 March 2005 Miss R Radcliffe will join the Board.

Mr K M Currie, Mr A M Kuipers, Mr M J Queen and Miss R A Radcliffe, having been appointed since the last Annual General Meeting, retire at the Annual General Meeting and offer themselves for re-election. Mr D F Baker, Mr R F Bennett and Dr M W Ridley retire by rotation at the Annual General Meeting and, being eligible, offer themselves for re-election. There are no service contracts in respect of the other Non-Executive Directors seeking re-election.

The interests of Directors in the shares of the Company at 31 December 2004 and 22 February 2005 are set out on page 30.

SHARES

The authorised and issued share capital of the Company are set out in note 32 to the accounts.

At the Annual General Meeting on 27 April 2004, a resolution was passed giving the Company the authority to make market purchases of Ordinary Shares up to a maximum of 10% of the issued share capital. A further resolution was passed providing for the Company to enter into a contingent share purchase contract with The Northern Rock Foundation to repurchase Foundation Shares in the same proportion and at the same price as the Ordinary Shares repurchased. These authorities expire at the Annual General Meeting in 2005 when a resolution will be proposed for their renewal.

SUBSTANTIAL SHAREHOLDINGS

At 22 February 2005, the following notifiable interest in the Company's Ordinary Shares had been reported to the Company:

Fidelity International Limited	4.95%
Legal & General Investment Management Limited	3.88%
Lloyds TSB Group plc	3.54%
Morgan Stanley Securities Ltd	4.09%

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 suppliers within an agreed payment period.

The average creditor payment period at 31 December 2004 was 21 days (2003 24 days).

EMPLOYEES

Northern Rock's desire to involve employees as financial stakeholders in the Company continued in 2004. Under the All Employee Share Ownership Plan, shares with a market value at the date of award of £1.8 million were given to employees during the year. In February 2005 a further grant of options under the Employee Share Option Scheme was made. A total of 4,477,000 options were granted at an exercise price of £7.73 per share.

Employee communications are vital to the success of the Company, and good staff relations are a key part of managerial responsibility at all levels. Employee consultation takes place with the national committee of UNIFI. The Company also issues a bi-monthly staff magazine and weekly news bulletins.

The Company is committed to equal employment opportunities for everyone, and treats applicants for work solely on their ability to do the job. In line with this policy, the Company will, wherever possible, retain employees who become disabled, either in the same job or, with the aid of retraining and provision for special needs, in a suitable alternative position.

CHARITABLE CONTRIBUTIONS

The Company is committed to a total contribution to The Northern Rock Foundation under a deed of covenant of £21.6 million based on its profits in 2004. Of this amount, it has already made a contribution of £10.0 million in October 2004 with a further contribution of £11.6 million to be paid in May 2005.

AUDITORS

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution to re-appoint them will be proposed at the Annual General Meeting.

By order of the Board

C Taylor, Company Secretary

22 February 2005

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF NORTHERN ROCK PLC

We have audited the financial statements, which comprise the consolidated profit and loss account, the consolidated balance sheet, the company balance sheet, the consolidated cash flow statement, the statement of total recognised gains and losses and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' Remuneration Report ("the auditable part").

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the financial statements and the auditable part of the Directors' Remuneration Report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, 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.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the Directors' Remuneration Report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Chairman's Statement, the Chief Executive's Report, the Corporate Governance statement, the Community and Environmental Report, the Northern Rock Foundation report, the unaudited part of the Directors' Remuneration Report, the Operating and Financial Review and the Directors' Report.

We review whether the Corporate Governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its risk and control procedures.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the auditable part of the Directors' Remuneration Report. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the auditable part of the Directors' Remuneration Report are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

OPINION

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 2004 and of the profit and cash flows of the Group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the Directors' Remuneration Report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

Chartered Accountants and

Registered Auditors

Newcastle upon Tyne

22 February 2005

PRICEWATERHOUSECOOPERS

CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2004

	Note	2004	2003
			(as restated)
		£m	£m
Interest receivable			
– interest receivable and similar income arising from debt securities		**205.7**	159.1
– other interest receivable and similar income	3	**1,760.3**	1,279.9
– securitisation interest receivable	16	**998.5**	696.0
– securitisation interest payable	16	**(953.9)**	(538.3)
		2,010.6	1,596.7
Interest payable	4	**(1,568.6)**	(1,164.8)
Income from equity shares and other variable yield securities		**24.9**	18.8
Net interest income		**466.9**	450.7
Fees and commissions receivable		**292.6**	216.9
Fees and commissions payable		**(60.1)**	(43.1)
Other operating income		**31.5**	27.9
Surplus on sale of credit card portfolio	5	**-**	7.3
Total other income		**264.0**	209.0
Total income		**730.9**	659.7
Administrative expenses			
– operating expenses		**(203.5)**	(178.0)
– non-recurring		-	(5.6)
– covenant to The Northern Rock Foundation		**(21.6)**	(19.3)
Total administrative expenses	6	**(225.1)**	(202.9)
Depreciation and amortisation			
– *tangible fixed assets*		**(19.0)**	(16.5)
– goodwill	20	**(3.6)**	(3.6)
Operating expenses		**(247.7)**	(223.0)
Provisions for bad and doubtful debts	9	**(56.5)**	(48.7)
Provisions against fixed asset investments	17,18	**4.5**	(1.4)
Profit on ordinary activities before tax		**431.2**	386.6
Tax on profit on ordinary activities	10	**(125.0)**	(112.2)
Profit on ordinary activities after tax		**306.2**	274.4
Dividends	12	**(110.0)**	(96.3)
Profit retained for the financial year	33	**196.2**	178.1

Earnings per Ordinary Share	13	**74.1p**	66.6p
Fully diluted earnings per Ordinary Share	13	**73.5p**	66.0p

All results arise from continuing operations.

The notes on pages 50 to 77 form an integral part of these accounts.

CONSOLIDATED BALANCE SHEET

At 31 December 2004

	Note	2004	2003
			(as restated)
		£m	£m
Assets			
Cash and balances at central banks		**10.2**	11.6
Loans and advances to banks	14	**3,305.4**	3,450.2
Loans and advances to customers not subject to securitisation	15	**32,869.3**	27,355.8
Loans and advances to customers subject to securitisation	16	**22,339.2**	15,678.7
Less: *non-recourse finance*	16	**(22,103.7)**	(14,832.4)
		33,104.8	28,202.1
Debt securities	17	**4,742.2**	4,185.5
Equity shares and other variable yield securities	18	**575.6**	410.8
Intangible fixed assets	20	**27.1**	30.7
Tangible fixed assets	21	**208.2**	179.1
Other assets	22	**69.6**	76.6
Prepayments and accrued income	23	**746.9**	564.8
Total assets		**42,790.0**	37,111.4
Liabilities			
Deposits by banks	24	**1,201.6**	1,461.5
Customer accounts	25	**20,342.0**	18,797.3
Debt securities in issue	26	**16,781.6**	13,060.1
Other liabilities	27	**335.6**	338.8
Accruals and deferred income	28	**539.8**	475.3
Provisions for liabilities and charges	22	**31.8**	19.0
Subordinated liabilities	29	**1,515.7**	1,119.5
Reserve capital instruments	30	**300.0**	300.0
Tier one notes	31	**200.0**	200.0
Total subordinated liabilities		**2,015.7**	1,619.5
Shareholders' funds			
Called up share capital	32	**123.9**	123.9
Share premium account	33	**6.8**	6.8
Capital redemption reserve	33	**7.3**	7.3
Profit and loss account	33	**1,403.9**	1,201.9
Shareholders' funds - equity	35	**1,541.9**	1,339.9
Total liabilities		**42,790.0**	37,111.4
Memorandum items			
Commitments	36 (v)	**1,488.5**	1,018.5

The notes on pages 50 to 77 form an integral part of these accounts.

Approved by the Board on 22 February 2005 and signed on its behalf by:

Dr M W Ridley	*Chairman*	
A J Applegarth	Chief Executive	
R F Bennett	Group Finance Director	

COMPANY BALANCE SHEET
At 31 December 2004

	Note	2004	2003
			(as restated)
		£m	£m
Assets			
Cash and balances at central banks		**10.2**	11.6
Loans and advances to banks	14	**3,222.4**	3,337.8
Loans and advances to customers not subject to securitisation	15	**32,900.9**	27,392.6
Loans and advances to customers subject to securitisation	16	**22,339.2**	15,678.7
Less: non-recourse finance	16	**(22,228.7)**	(14,983.3)
		33,011.4	28,088.0
Debt securities	17	**4,578.6**	4,032.3
Equity shares and other variable yield securities	18	**458.1**	319.9
Shares in group undertakings	19	**120.5**	212.9
Tangible fixed assets	21	**182.3**	156.5
Other assets	22	**86.3**	85.3
Prepayments and accrued income	23	**839.5**	698.1
Total assets		***42,509.3***	*36,942.4*
Liabilities			
Deposits by banks	24	**3,067.6**	3,337.6
Customer accounts	25	**18,472.9**	17,016.4
Debt securities in issue	26	**16,781.6**	13,060.1
Other liabilities	27	**234.0**	210.5
Accruals and deferred income	28	**544.9**	464.2
Subordinated liabilities	29	**1,515.7**	1,119.5
Reserve capital instruments	30	**300.0**	300.0
Tier one notes	31	**200.0**	200.0
Total subordinated liabilities		**2,015.7**	1,619.5
Shareholders' funds			
Called up share capital	32	**123.9**	123.9
Share premium account	33	**6.8**	6.8
Capital redemption reserve	33	**7.3**	7.3
Profit and loss account	33	***1,254.6***	*1,096.1*
Shareholders' funds - equity	35	**1,392.6**	1,234.1
Total liabilities		**42,509.3**	36,942.4
Memorandum items			
Commitments	36 (v)	**1,504.0**	1,034.0

The notes on pages *50* to *77* form an integral part of these accounts.

Approved by the Board on 22 February 2005 and signed on its behalf by:

Dr M W Ridley	Chairman
A J Applegarth	Chief Executive
R F Bennett	Group Finance Director

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2004

	Note	2004	2003
		£m	£m
Net cash inflow from operating activities	41	**33.2**	845.8
Returns on investments and servicing of finance	42	**(111.0)**	(86.9)
Taxation		**(106.0)**	(96.0)
Capital expenditure and financial investment	42	**(817.5)**	(419.5)
Acquisitions and disposals		**-**	217.0
Equity dividends paid		**(100.6)**	(87.6)
Net cash (outflow)/inflow before financing		**(1,101.9)**	372.8
Financing	42	**396.1**	-
(Decrease)/increase in cash	43	**(705.8)**	372.8

The notes on pages 50 to 77 form an integral part of these accounts.

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31 December 2004

	2004	2003
		(as restated)
	£m	£m
Profit retained	**196.2**	178.1
Total recognised gains and losses for the period	**196.2**	178.1
Prior year adjustment – UITF 38 (note 2)	**0.3**	
Total gains and losses recognised since the last annual accounts	**196.5**	

1. Principal accounting policies

Accounting convention
The accounts have been prepared under the historical cost convention and in accordance with the special provisions of Part VII of the Companies Act 1985 relating to banking companies and banking groups, applicable UK accounting standards and the Statements of Recommended Practice issued by the British Bankers' Association.

Accounting policies are unchanged from 2003, except that the Group has implemented the requirements of UITF 38 "Accounting for ESOP trusts". The impacts of this change are detailed in note 2 to the accounts.

Basis of consolidation
The consolidated accounts include the results of the Company and its subsidiary undertakings all of which have accounting periods ending 31 December. Unless otherwise stated, the acquisition method of accounting has been adopted.

Taxation
Corporation tax is charged in the accounts based on the profit for the year as adjusted for taxation purposes.

Deferred tax
Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Deferred tax is provided on a non-discounted basis.

Tangible fixed assets and depreciation
Depreciation is provided in order to write down fixed assets, which are included at cost, to their estimated residual value over their anticipated useful lives as follows:

Freehold land and buildings	100 years
Long leasehold land and buildings	Over the period of the lease up to 100 years
Short leasehold land and buildings	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

Where the cost of freehold land can be identified separately from buildings on acquisition, the land value is not depreciated. Provision is made for diminution in value of any fixed asset where an impairment is identified. Annual impairment reviews are carried out for fixed assets with an expected remaining life over 50 years. The resulting net book value is then written off over its remaining anticipated useful life.

Assets in the course of construction are not depreciated until they have been completed and transferred to the appropriate category of tangible fixed assets. The costs of financing assets in the course of construction are not included in the costs of the assets.

Goodwill
Goodwill arises on the acquisition of subsidiary and associated undertakings. It represents the excess of cost over fair value of the Group's share of net assets acquired. It is capitalised as an intangible fixed asset and is amortised through the profit and loss account on a straight line basis over its expected useful economic life. The expected useful economic life is determined at the time of acquisition by considering the nature of the business acquired and the period of time over which the value of the business is expected to exceed the value of its net assets. This period is ten years for recent acquisitions.

Goodwill is subject to impairment reviews in accordance with FRS 11 "Impairment of fixed assets and goodwill". The carrying value is written down by the amount of any impairment, and the loss is recognised in the profit and loss account in the period in which this occurs.

Leased assets
Rentals payable under operating leases are charged to administrative expenses as incurred over the lease term.

Securities
Debt securities and equity shares ("securities") are held with the intention of use on a continuing basis and are stated at cost, adjusted to exclude accrued interest at the date of purchase, less provision for any permanent diminution in value. A similar adjustment for accrued interest is made on realisation. Where the adjusted purchase price differs from the nominal value, the premium or discount is amortised or released on an effective yield basis over the period to maturity.

Securities sold subject to repurchase agreements are retained on the balance sheet where the Group retains the risks and rewards of ownership. Funds received under such agreements are included within deposits by banks or customer accounts. Securities purchased under a commitment to resell are treated as collateralised lending transactions where the Group does not acquire the risks and rewards of ownership, and the purchase price is included within either loans and advances to banks or loans and advances to customers. The difference between sale and repurchase prices for such transactions is reflected in the profit and loss account over the lives of the transactions, within interest receivable or interest payable as appropriate.

Pension costs
Northern Rock operates a Defined Benefit Scheme and a Defined Contribution Scheme. Contributions to the Northern Rock Defined Benefit Pension Scheme are charged to the profit and loss account with the objective of spreading the cost over the employees' working lives within the Scheme. Costs are based upon actuarial advice following the most recent valuation of the Scheme. The costs of the Defined Contribution Scheme are charged to the profit and loss account for the period in which they are incurred. The disclosure requirements of FRS17 "Retirement Benefits" are being adopted under transitional arrangements.

Further information on pension arrangements is set out in note 7 to the accounts.

Provisions for bad and doubtful debts
Provisions against loans and advances are based upon assessments of the losses that are anticipated on outstanding balances at the year-end. The amount charged to the profit and loss account comprises amounts written off during the year plus the net change in the amounts provided. Bad debts are written off in part or in whole when a loss has been confirmed. The loss provisioning methodology is as follows:

Advances secured on owner-occupied residential property

Specific provision
Where the collection of interest and/or principal on an individual loan is in doubt a specific provision is recorded. Specific provisions are calculated using a model which is used to evaluate losses based on historical default experience and other appropriate risk factors related to the delinquent loan portfolio at a given point in time. All loans which are three or more payments overdue are evaluated using the model to identify the need for a specific provision. Loans six or more payments overdue and properties in possession are evaluated on an individual basis to measure potential loss. Various factors are considered in this evaluation including, but not limited to, collateral valuations, expected recoveries from mortgage indemnity guarantees and estimated recovery costs.

1. **Principal accounting policies** (continued)

Provisions for bad and doubtful debts (continued)

General provision

A general provision is maintained to cover inherent losses in the loan portfolio related to loans that have not yet been specifically identified as impaired. A statistically based model is used to calculate the appropriate general provision for each completion year. The model considers appropriate risk factors specific to the loan portfolio and historical default experience. Other factors, including economic conditions, are also considered by management in determining the appropriate level of reserves required at a given point in time.

Interest in respect of all loans is credited to the profit and loss account as it becomes receivable. Once a property is taken into possession interest charges are suspended. If a property is sold at sufficient value, interest previously suspended is added back to the loan and released to the profit and loss account.

Other secured advances

Specific provision is made as appropriate in respect of loans and advances that are identified as impaired at the balance sheet date, based on payment history, loan balance and net realisable value. Interest is suspended on loans identified as impaired if its recovery is deemed unlikely. General provisions are recorded to cover losses inherent in the portfolio which have not yet been specifically identified.

Unsecured lending

Specific provision is made against all loans where three or more payments are overdue. In calculating the required provision an appropriate factor is applied based on the number of overdue payments, which is subject to periodic review to ensure its continuing applicability based on current experience, to reflect the probability that not all such loans will result in eventual losses. General provisions are recorded to cover losses inherent in the portfolio which have not yet been specifically identified.

Repairs and renewals

Repairs, renewals and refurbishments of a non-capital nature are charged to administrative expenses in the year in which the expenditure is incurred.

Deferred income

The Company has entered into insurance arrangements with Northern Rock Mortgage Indemnity Company Limited, a wholly owned subsidiary, to cover a proportion of future losses on certain residential secured loans with high loan to value ratios. In the Group accounts, income from risk charges paid by customers in relation to such loans is deferred and is included in the balance sheet under the heading "accruals and deferred income". The deferred income is released to the profit and loss account on a level yield basis over the life of the loan.

Derivatives

Derivatives comprise, mainly, currency and interest rate swaps, forward rate agreements, foreign exchange forwards and financial futures and options. All transactions are undertaken for hedging purposes.

Transactions are initially recorded at cost and are accounted for on an accruals basis in accordance with the item or items being hedged. Consequently, profits and losses on the hedges are recognised on a similar accounting basis as the profits or losses on the underlying item or items being hedged. They are therefore recognised in the financial statements as adjustments to the profit or loss of the item or items being hedged. To the extent necessary to achieve a consistent timing of income recognition on the item or items being hedged, deferred gains or losses are included in the balance sheet under the headings "accruals and deferred income" and "prepayments and accrued income". Profits and losses on early termination of contracts that modify the characteristics of designated items are deferred and amortised over the remaining lives of the hedged items. Income and expenses on hedges are recognised as adjustments to interest receivable and interest payable.

When a derivative no longer represents a hedge, because either the underlying asset, liability or position has been extinguished or derecognised, it is restated to market value. Any profit or loss is accounted for in interest income or expense. It is then either redesignated as a hedge of a different asset, liability or position, is disposed of, or the position is otherwise closed, and accounted for accordingly. Where a derivative is no longer a hedge because it ceases to be effective, it is restated to market value and any profit or loss arising is deferred and amortised into interest income or expense over the remaining life of the item previously being hedged.

Foreign currency transactions

Interest income and expense denominated in foreign currency is translated into sterling at the rate of exchange current on the date of the receipt or payment, unless it is hedged, in which case it is translated at the underlying rate of exchange inherent in the associated hedge contract. Assets and liabilities denominated in foreign currency that are hedged by means of matching foreign currency contracts are included in the balance sheet at the exchange rate inherent in those contracts.

Other assets and liabilities denominated in foreign currency are included at the rate of exchange current at the balance sheet date.

Exchange differences arising on currency conversion are dealt with in the profit and loss account.

Mortgage incentives

Incentive costs of discounts, fixed rate and other similar mortgage products are expensed in equal annual amounts over the effective incentive clawback period for early redemption of these products. Early repayment charges, designed to recover incentive costs, are normally charged to customers on prepayment of loans within contractually agreed periods of time, ie the clawback period. Other forms of incentives, such as valuation fees which are not directly linked to the interest rate on the mortgage, are expensed through the profit and loss account as they are incurred.

All incentives which are not subject to incentive clawback periods and any excess cost of an incentive over and above the cost recoverable by the clawback are written off as incurred. The costs of mortgage incentives are charged against interest receivable.

Securitisation

Securitisation transactions are reported in accordance with FRS 5 "Reporting the Substance of Transactions". Where assets are sold under securitisation, if there is no significant change to the Group's rights and benefits to those assets and its exposure is limited to a fixed monetary ceiling, linked presentation is used. Under linked presentation, only the net amount of the Group's interests in the assets is consolidated, and the related gross amounts are shown on the face of the balance sheet. The interest attributable to the Northern Rock Group is included in the profit and loss account under the heading "interest receivable". The other income and expenses are included within "other operating income". Where the conditions for linked presentation are not met, the transactions are accounted for by separate presentation of the gross assets and the related funding, and all profit and loss transactions are included within the appropriate captions in the profit and loss account. The special purpose vehicles used for these transactions are accounted for as quasi subsidiaries (see note 16).

Revenue recognition

Interest income is recognised in the profit and loss account on an accruals basis, except for income on loans taken into possession which is taken to income when it is received.

Fees receivable from customers to reimburse the Group for costs incurred are taken to the profit and loss account when due. Fees and commissions receivable relating to ongoing services are taken to income when the related service is performed, and fees in lieu of interest are taken to income on a level yield basis over the life of the loan.

2. Prior year adjustment

The Group has implemented the requirements of Urgent Issues Task Force ("UITF") Abstract 38 – "Accounting for ESOP Trusts" with effect from 1 January 2004. As a result, holdings of Ordinary Shares in Northern Rock plc owned by the Group's employee share ownership trusts are now shown as a deduction from shareholders' funds. Previously they were shown as part of other assets in the balance sheet. Purchases and sales of Northern Rock plc Ordinary Shares are now accounted for as movements in shareholders' funds and no gains and losses are reflected in the profit and loss account. UITF Abstract 38 also amends UITF Abstract 17 – "Employee Share Schemes" to reflect the consequences for the profit and loss account of the changes in the presentation of an entity's own shares held by an ESOP trust. The charge to the profit and loss account in respect of shares and share options granted to employees that are expected to be met from shares held by employee share trusts is now based on the difference between the value on the date of grant and the exercise price. Previously, where shares were purchased to meet these obligations, the charge was based on the carrying value of the shares.

The effect of this change in accounting policy, which has been accounted for as a prior year adjustment, is to increase staff costs and decrease profit for the year ended 31 December 2004 by £0.1m (year to 31 December 2003 – £0.2m). The effect on other assets, other liabilities, staff costs and shareholders' funds at the balance sheet dates is as follows:

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Reduction in shareholders' funds – beginning of year (note 33)	**(48.0)**	(44.5)	**(47.3)**	(44.0)
Movement in relation to own shares (note 34)	**5.8**	(3.3)	**5.8**	(3.3)
Increase in staff costs during year	**(0.1)**	(0.2)	**(0.1)**	–
Reduction in shareholders' funds – end of year	**(42.3)**	(48.0)	**(41.6)**	(47.3)
The reduction in shareholders' funds comprises:				
Reduction in other assets	**(42.3)**	(48.8)	**(42.3)**	(48.8)
Reduction in other liabilities	**–**	0.8	**0.7**	1.5
	(42.3)	(48.0)	**(41.6)**	(47.3)

The cumulative difference in the amount credited through the Group profit and loss account in the period up to 31 December 2003 amounted to £0.3m.

3. Other interest receivable and similar income

	2004	2003
	£m	£m
On secured advances	**1,348.2**	983.3
On other lending	**412.1**	296.6
	1,760.3	1,279.9

4. Interest payable

	2004	2003
	£m	£m
On retail customer accounts	**689.7**	559.5
On other deposits and loans	**760.6**	514.6
On subordinated liabilities	**85.5**	62.0
On reserve capital instruments	**19.8**	17.3
On tier one notes	**13.0**	11.4
Total interest payable on subordinated liabilities	**118.3**	90.7
	1,568.6	1,164.8

5. Sale of credit card portfolio

On 30 May 2003, the Group sold its credit card portfolio to The Co-operative Bank. The surplus on sale amounted to £7.3m and is recorded in other income. The credit card portfolio comprised approximately 90,000 accounts with outstanding balances of £217m. As part of the agreement Northern Rock offers credit cards, issued by The Co-operative Bank, to Northern Rock customers under the Northern Rock brand.

6. Administrative expenses

	2004	2003 (as restated)
	£m	£m
Wages and salaries	**101.4**	85.3
Social security costs	**8.9**	7.0
Other pension costs	**9.0**	8.7
Total staff costs	**119.3**	101.0
Other administrative expenses	**105.8**	96.3
Non-recurring expenses – see below	**–**	5.6
	225.1	202.9
Other administrative expenses include the following:		
Hire of equipment	**5.5**	5.4
Property rentals	**3.1**	2.8

6. Administrative expenses (continued)

		2004	2003
		£m	£m
Remuneration of auditors:	statutory audit	1.1	0.9
	further assurance services	1.0	0.4
		2.1	1.3

Remuneration of auditors for audit work for the Company amounted to £0.7m (2003 £0.6m). Further assurance services comprises services provided in respect of International Financial Reporting Standards, securitisation transactions and the raising of wholesale funding.

Non-recurring expenses	£m	£m
Wages and salaries	–	0.5
Social security costs	–	0.1
Total staff costs	–	0.6
Other administrative expenses	–	5.0
	–	5.6

Non-recurring costs in 2003 represents costs incurred in relation to the closure of certain branches.

	2004		2003	
	Full time	Part time	Full time	Part time
Average number of staff (including Executive Directors) employed by the Group	3,916	1,064	3,448	952

7. Pension commitments

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 contracted-in 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 plc.

The Company has continued to account for pensions in accordance with SSAP 24. FRS 17 "Retirement Benefits" was issued in November 2000 but requires only phased transitional disclosures for the Company until the year ending 31 December 2005. These disclosures, to the extent not given in (a), are set out in (b) below.

(a) The most recent triennial valuation of the Scheme was performed as at 5 April 2003 by Watson Wyatt LLP, consulting actuaries, using the projected unit method. The principal actuarial assumptions adopted in that valuation were that, over the long term, the rate of return on existing and future investments will exceed pension increases by 3.50% per annum and increases in pensionable earnings by 2.25% per annum. At 5 April 2003, the market value of the fund was £158.6m which represented 97.3% of the market value of the benefits that had accrued to the valuation date. The next full actuarial valuation is due to be carried out as at 5 April 2006.

During 2004, the Company paid employer's contributions of 15.9% of basic pensionable earnings throughout the year (2003 14.8% until 5 April 2003 and 15.9% thereafter) in respect of the defined benefit section of the Scheme. In addition, members of the defined benefit section of the Scheme paid employee contributions of 5% (2003 5%). During 2004, the Company paid employer's contributions in respect of the defined contribution section of the Scheme at an average rate of 6.0% (2003 6.0%). Additional National Insurance costs were also incurred as a result of the defined contribution section of the Scheme being contracted-in to SERPS. In addition, members of the defined contribution section of the Scheme paid contributions at an average rate of 4.3% (2003 4.3%).

The total pensions charge to the Group profit and loss account for 2004, as calculated by Watson Wyatt LLP, independent qualified actuaries, in respect of employer's contributions to the Northern Rock Pension Scheme, was £8.9m (2003 £8.6m), of which £7.1m was in respect of the defined benefit scheme (2003 £7.0m) and £1.8m in respect of the defined contribution scheme (2003 £1.6m). The charge for the defined benefit scheme in 2004 includes £3.7m arising from the underfunding of the Scheme adjusted for the level of prepayment (2003 £3.6m). In accordance with SSAP 24, surpluses and deficiencies, adjusted for the level of prepayment, are being amortised over the average remaining service lives of the employees in the defined benefit scheme, estimated at 13 years.

The prepayment in relation to the Scheme at 31 December 2004 was £28.9m (2003 £30.6m).

(b) The valuation used for FRS 17 disclosures has been based on the most recent triennial actuarial valuation at 5 April 2003 and updated by Watson Wyatt LLP to take account of the requirements of FRS 17 in order to assess the liabilities of the Scheme at 31 December 2004. Scheme assets are stated at their market value at 31 December 2004.

The financial assumptions used to calculate Scheme liabilities under FRS 17 are:

	2004	2003	2002
Discount rate	5.30%	5.40%	5.60%
Inflation rate	2.75%	2.65%	2.30%
Pensions in payment increases	3.10%	3.00%	3.00%
Deferred pensions increases	2.75%	2.65%	2.30%
Salary increases	4.50%	4.40%	4.05%

7. **Pension commitments** (continued)

The assets in the Scheme and the expected rate of return were:

	Long-term rate of return expected at 31 Dec 2004	**Market value at 31 Dec 2004 £m**	Long-term rate of return expected at 31 Dec 2003	Market value at 31 Dec 2003 £m	Long-term rate of return expected at 31 Dec 2002	Market value at 31 Dec 2002 £m
Equities	**8.1%**	**106.2**	8.1%	96.0	8.6%	79.6
Bonds	**5.0%**	**80.4**	5.1%	74.9	4.5%	66.6
Property	**6.7%**	**12.0**	6.8%	7.4	6.5%	7.6
Cash	**4.8%**	**1.1**	3.8%	1.2	4.0%	0.4
Total	**6.7%**	**199.7**	6.8%	179.5	6.7%	154.2

	31 Dec 2004 £m	31 Dec 2003 £m
Scheme deficit:		
Total market value of assets	**199.7**	179.5
Present value of Scheme liabilities	**(251.4)**	(226.1)
Deficit in the Scheme	**(51.7)**	(46.6)
Related deferred tax asset	**15.5**	14.0
Net pension liability	**(36.2)**	(32.6)

Proforma reserves:	**31 Dec 2004 £m**	31 Dec 2003 (as restated) £m
Profit and loss reserve	**1,403.9**	1,201.9
Pension liability	**(36.2)**	(32.6)
Less SSAP24 pension fund prepayment net of related deferred tax asset of £8.7m (2003 £9.2m)	**(20.2)**	(21.4)
Proforma profit and loss reserve if FRS 17 adopted	**1,347.5**	1,147.9

The position shown represents the funded status of the Scheme based on market conditions at 31 December 2004. Market related calculations such as these are subject to daily variations. The deficit disclosed does not represent a debt on the employer. Contributions to the Scheme will continue to be determined in accordance with the Trustees' funding valuation, the next one being due in April 2006, or any interim valuations undertaken by the Trustees or the Company. The rules of the Northern Rock Pension Scheme (final salary section) permit both employer and employee pensions contributions to be increased to meet part of any deficit.

The following disclosures show the amounts that would have been chargeable to the profit and loss account and to the statement of total recognised gains and losses in respect of the non-money purchase benefits provided by the Scheme if FRS 17 had been fully implemented in 2004.

Analysis of the amount chargeable to administrative expenses

	2004 £m	2003 £m
Current service cost	**8.4**	6.8
Past service cost	-	-
Total chargeable to administrative expenses	**8.4**	6.8

Analysis of the amount chargeable to interest receivable

	2004 £m	2003 £m
Expected return on pension scheme assets	**12.3**	10.5
Interest on pension scheme liabilities	**(12.3)**	(10.3)
Net return	-	0.2

Analysis of the amount recognisable in the statement of total recognised gains and losses

	2004 £m	2003 £m
Actual return less expected return on pension scheme assets	**4.3**	10.0
Experience gains and losses arising on Scheme liabilities	**3.0**	(5.0)
Changes in assumptions underlying the present value of Scheme liabilities	**(10.0)**	(23.4)
Actuarial loss recognisable in statement of total recognised gains and losses	**(2.7)**	(18.4)

7. Pension commitments (continued)

Movement in deficit during the year

	2004	2003
	£m	£m
Deficit in Scheme at 1 January	**(46.6)**	(27.5)
Movement in year:		
Contributions paid by the Company	**6.0**	5.9
Current service cost	**(8.4)**	(6.8)
Past service cost	**–**	–
Net return	**–**	0.2
Actuarial loss	**(2.7)**	(18.4)
Deficit in Scheme at 31 December	**(51.7)**	(46.6)

History of experience gains and losses

	2004	2003	2002
Difference between expected and actual return on Scheme assets			
Amount (£m)	**4.3**	10.0	(28.3)
Percentage of Scheme assets	**2.2%**	5.6%	(18.4%)
Experience gains and losses on Scheme liabilities			
Amount (£m)	**3.0**	(5.0)	1.0
Percentage of present value of Scheme liabilities	**1.2%**	(2.2%)	0.6%
Total amount recognisable in statement of total recognised gains and losses			
Amount (£m)	**(2.7)**	(18.4)	(31.4)
Percentage of present value of Scheme liabilities	**(1.1%)**	(8.1%)	(17.3%)

8. Directors' emoluments

Full details of the Directors' remuneration and shareholdings are included in the Directors' Remuneration Report set out on pages 18 to 31.

9. Provisions for bad and doubtful debts

	On advances secured on residential property	On other secured advances	On unsecured loans	Total
Group	£m	£m	£m	£m
At 1 January 2004:				
Specific provision	3.1	1.9	27.4	32.4
General provision	31.7	8.7	28.5	68.9
	34.8	10.6	55.9	101.3
Profit and loss account:				
Increase in provisions during the year:				
Specific provision	5.0	0.3	41.9	47.2
General provision	1.4	2.5	8.3	12.2
Adjustment to provisions resulting from recoveries:				
Specific provision	(0.9)	(0.1)	(1.9)	(2.9)
	5.5	2.7	48.3	56.5
Transfers				
General provision	(0.2)	–	0.2	–
Amounts written off during the year:				
Specific provision	(3.8)	(1.1)	(26.0)	(30.9)
At 31 December 2004:				
Specific provision	3.4	1.0	41.4	45.8
General provision	32.9	11.2	37.0	81.1
	36.3	12.2	78.4	126.9
Company				
At 1 January 2004:				
Specific provision	3.1	1.9	31.5	36.5
General provision	31.7	8.7	28.5	68.9
	34.8	10.6	60.0	105.4
At 31 December 2004:				
Specific provision	3.4	1.0	45.5	49.9
General provision	32.9	11.2	37.0	81.1
	36.3	12.2	82.5	131.0

9. Provisions for bad and doubtful debts (continued)

Interest has been suspended on impaired loans as follows:

	Group and Company		
	On advances secured on residential property £m	On other secured advances £m	Total £m
Interest suspended at 1 January 2004	1.9	3.9	5.8
Movement in suspended interest during the year:			
Interest suspended	1.3	0.6	1.9
Receipts of interest previously suspended	(0.6)	–	(0.6)
Amounts written off	(0.2)	(0.5)	(0.7)
Interest suspended at 31 December 2004	2.4	4.0	6.4

	Group and Company	
	2004 £m	2003 £m
Advances on which interest has been suspended totalled:		
Before provisions	**18.3**	17.8
After provisions	**15.4**	15.3

10. Tax on profit on ordinary activities

	2004 £m	2003 £m
The tax charge for the year comprises:		
UK corporation tax		
Current tax on profits for the year	**115.5**	102.4
Adjustments in respect of prior years	**(3.3)**	(5.8)
Total current tax	**112.2**	96.6
Increase in deferred taxation	**12.8**	15.6
	125.0	112.2

A reconciliation of current tax on profit on ordinary activities at the standard UK corporation tax rate to the Group's actual current tax charge for the years ended 31 December 2004 and 2003 is shown as follows:

	2004 £m	2003 £m
Profit on ordinary activities before tax multiplied by the standard rate of corporation tax in the UK of 30% (2003 30%)	**129.4**	116.0
Effects of:		
Net (non taxable income)/non deductible expenses for tax purposes	**(1.5)**	0.5
Current tax effect of timing differences	**(12.4)**	(14.1)
Adjustments to tax charge in respect of previous periods	**(3.3)**	(5.8)
Current tax charge for period	**112.2**	96.6

Note 38 discloses the book and fair values for some of the Group's financial instruments. The net deficit which would arise from recording these financial instruments at their fair value instead of their book value of £174.8m (2003 £65.4m) has not been recognised in the accounts. Accordingly no provision for the corresponding deferred tax asset of £52.4m (2003 £19.6m) has been made.

11. Profit on ordinary activities after taxation

Of the profit on ordinary activities after taxation attributable to ordinary shareholders, £262.7m (2003 £227.3m) has been dealt with in the accounts of the Company. As permitted by section 230 of the Companies Act 1985, the Company's profit and loss account has not been presented separately.

12. Dividends

	2004 pence per share	2003 pence per share	2004 £m	2003 £m
Ordinary Shares:				
Interim (paid)	**8.5**	7.5	**35.2**	31.6
Final (proposed)	**18.0**	15.8	**74.8**	66.2
less paid and payable to ESOP trusts (see note 34)			**–**	(1.5)
	26.5	23.3	**110.0**	96.3

13. Earnings per ordinary share

Earnings per Ordinary Share have been calculated by dividing the profit attributable to the holders of Ordinary Shares in Northern Rock plc of £306.2m (2003 (as restated) £274.4m) by the weighted average number of Ordinary Shares in issue of 413.0m (2003 412.3m).

The weighted average number of Ordinary Shares in issue has been determined after excluding shares held in trust for employee share schemes.

Fully diluted earnings per Ordinary Share have been calculated using the weighted average number of shares in issue together with 3.6m (2003 3.6m) potentially dilutive shares resulting from options granted under employee share schemes.

14. Loans and advances to banks

	Group		Company	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Repayable:				
On demand	**268.9**	973.3	**255.8**	964.1
In not more than three months	**3,017.0**	2,469.9	**2,952.1**	2,366.7
In more than three months but not more than one year	**19.5**	7.0	**14.5**	7.0
	3,305.4	3,450.2	**3,222.4**	3,337.8

The Company is required to maintain balances with the Bank of England, which at 31 December 2004 amounted to £44.0m (2003 £36.3m).

15. Loans and advances to customers

	Group		Company	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Advances secured on residential property	**27,000.7**	23,179.7	**27,000.3**	23,179.1
Other secured advances	**1,278.1**	939.5	**1,278.1**	939.5
Unsecured loans	**4,590.5**	3,236.6	**4,590.5**	3,236.6
Amounts due from subsidiary undertakings	**–**	–	**32.0**	37.4
	32,869.3	27,355.8	**32,900.9**	27,392.6
Repayable:				
On demand	**3.5**	2.2	**39.6**	26.6
In not more than three months	**220.9**	232.0	**220.9**	232.0
In more than three months but not more than one year	**681.9**	619.1	**681.9**	636.2
In more than one year but not more than five years	**4,831.5**	4,241.9	**4,831.5**	4,241.9
In more than five years	**27,258.4**	22,361.9	**27,258.0**	22,361.3
Less provisions (note 9)	**(126.9)**	(101.3)	**(131.0)**	(105.4)
	32,869.3	27,355.8	**32,900.9**	27,392.6

16. Securitisation

Loans and advances to customers include portfolios of residential and commercial mortgage loans which are subject to non-recourse financing arrangements. The loans have been purchased by special purpose vehicles, which have primarily issued mortgage backed fixed and floating rate notes to finance the purchases.

The Group is not obliged to support any losses in respect of these mortgages, except as described below, nor does it intend to do so. This is clearly stated in the agreements with noteholders.

Northern Rock plc has made interest bearing subordinated loans to the special purpose vehicles, the repayments of which are subordinated to the claims of the noteholders. In addition, mortgage indemnity guarantee (MIG) insurance is provided on certain loans to the vehicles purchasing residential mortgage loans by a subsidiary of Northern Rock plc. Since 1 January 2003, Northern Rock plc has not taken out MIG insurance in respect of new loans. Existing cover remains in force. Northern Rock plc does not guarantee the liabilities of this subsidiary. In the Group accounts, a separate presentation of assets and liabilities has been adopted to the extent of the insurance cover provided by the subsidiary.

16. **Securitisation** (continued)

Northern Rock plc has an option to sell further mortgage loans to the special purpose vehicles where at the end of any interest period the rate of repayment of principal in the vehicle exceeds the level agreed at the date of sale of the loans. Northern Rock plc has no right or obligation to repurchase the benefit of any securitised loan except to the extent that the loan breaches representations and warranties given at the date of sale. It does, however, have the option to repurchase loans from the vehicles, on being offered the opportunity to do so by the vehicles, where the borrower requests a further advance or a change in product type.

Northern Rock plc has entered into a number of interest rate swaps with the vehicles. These convert interest flows from the mortgage loans into LIBOR based interest flows to match the interest flows payable on the floating rate notes.

During the year, Northern Rock plc assigned portfolios of residential mortgage loans with a book value of £16.7 billion to Granite Finance Trustees Limited. Granite Finance Funding Limited acquired, at book value, an interest in the trust property vested in Granite Finance Trustees Limited. This beneficial interest was acquired in three separate transactions, the first on 28 January 2004 for £3.5 billion, the second on 26 May 2004 for £3.6 billion and the third on 22 September 2004 for £4.0 billion. Granite Finance Funding Limited funded its acquisitions through borrowings from its subsidiary companies, Granite Mortgages 04-1 plc, Granite Mortgages 04-2 plc and Granite Mortgages 04-3 plc. These companies principally funded their loans to Granite Finance Funding Limited through the issue of mortgage backed fixed and floating rate notes.

The balances of assets subject to securitisation and the associated non-recourse finance at 31 December 2004 are set out below.

Securitisation company	Date of securitisation	Gross assets securitised	Non-recourse finance	Subordinated loans made by the Group
Residential:		£m	£m	£m
Granite Mortgages 99-1 plc	1 October 1999	105.0	95.3	–
Granite Mortgages 00-1 plc	1 March 2000	280.1	267.0	–
Granite Mortgages 00-2 plc	25 September 2000	576.4	512.2	4.4
Granite Mortgages 01-1 plc	26 March 2001	867.3[1]	848.6	5.4
Granite Mortgages 01-2 plc	28 September 2001	963.6[1]	934.0	9.9
Granite Mortgages 02-1 plc	20 March 2002	1,664.5[1]	1,634.6	28.0
Granite Mortgages 02-2 plc	23 September 2002	2,032.3[1]	1,997.3	26.0
Granite Mortgages 03-1 plc	27 January 2003	2,262.7[1]	2,246.1	29.5
Granite Mortgages 03-2 plc	21 May 2003	1,931.7[1]	1,881.5	24.5
Granite Mortgages 03-3 plc	24 September 2003	1,823.1[1]	1,768.9	17.5
Granite Mortgages 04-1 plc	28 January 2004	2,928.1[1]	2,827.0	49.4
Granite Mortgages 04-2 plc	26 May 2004	3,297.0[1]	3,213.0	64.1
Granite Mortgages 04-3 plc	22 September 2004	3,885.7[1]	3,786.8	49.4
		22,617.5	22,012.3	308.1
Retained interest in Granite Trustees Limited		826.9	–	–
Less cash deposits held with Northern Rock plc		(1,396.0)	–	–
Total residential		22,048.4	22,012.3	308.1
Commercial:				
Dolerite Funding No. 1 plc	24 June 2002	238.5	216.4	19.1
Retained interest in Dolerite Trustees Limited		52.3	–	–
Total commercial		290.8	216.4	19.1
Maximum extent of insurance cover provided by subsidiary			(125.0)	
Total		22,339.2	22,103.7	327.2

[1] Represents the interest in the trust property at book value held by Granite Finance Funding Limited relating to the debt issued by these companies.

No subordinated debt was issued by Granite Mortgages 01-1 plc to Northern Rock plc in relation to the funding of a first loss reserve fund. However, Granite Mortgages 01-1 plc's parent company, Granite Finance Funding Limited, retained £20 million from the proceeds of debt issuance to fund this reserve. This amount is repayable only after full repayment of the notes.

Interest income earned by Northern Rock plc in respect of the retained interest in Granite Trustees Limited and Dolerite Trustees Limited is recorded in the profit and loss account within "other interest receivable and similar income".

Northern Rock plc does not own directly or indirectly any of the share capital of these companies or of their parent. The Group receives administration fees for servicing the mortgage portfolios together with any residual income arising after the claims of the bondholders and other creditors are met.

At 31 December 2004 the special purpose companies had cash deposits with Northern Rock plc amounting to £1,396.0m. At 31 December 2003 such deposits were held by other third party banks. As such the total gross assets securitised available to meet non-recourse finance amount to £23,735.2m (2003 £15,678.7m).

An aggregated summary of the results for the years ended 31 December 2004 and 2003, and summarised balance sheets as at 31 December 2004 and 2003 for the above companies are set out below.

16. Securitisation (continued)

	2004	2003
	£m	£m
Interest receivable	**998.5**	696.0
Interest payable	**(953.9)**	(538.3)
Interest receivable on cash deposits with Northern Rock	**46.9**	-
Fixed rate swaps payable to Northern Rock	**(1.7)**	(65.4)
Other swaps and net interest payable to Northern Rock	**31.4**	(34.7)
Net interest receivable	**121.2**	57.6
Other income net of administrative and other expenses payable to third parties	**19.8**	9.0
Administrative expenses payable to Northern Rock	**(141.0)**	(66.6)
Profit for the financial period	**-**	-
Loans and advances to banks	**423.9**	1,200.4
Cash deposits held with Northern Rock	**1,396.0**	-
Loans and advances to customers	**21,021.1**	14,130.3
Amounts owed by Group companies	**18.6**	4.2
Other assets	**16.1**	-
Total assets	**22,875.7**	15,334.9
Debt securities in issue	**22,228.7**	14,983.3
Amounts owed to Group companies	**645.9**	338.3
Other liabilities	**1.1**	13.3
Total liabilities	**22,875.7**	15,334.9

The interest attributable to the Northern Rock Group is included in the Group profit and loss account under the heading,"Interest receivable". The other income and expenses are included within "Other operating income". The securitisation companies are accounted for as quasi subsidiaries (see note 1).

The balance sheets above reconcile to the linked presentation in the Group balance sheet as follows:

	2004	2003
	£m	£m
Loans and advances to banks	**423.9**	1,200.4
Loans and advances to customers	**21,021.1**	14,130.3
Other assets	**16.1**	-
Other liabilities	**(1.1)**	(13.3)
Retained interest in Granite Trustees Limited and Dolerite Trustees Limited	**879.2**	361.3
	22,339.2	15,678.7
Debt securities in issue	**22,228.7**	14,983.3
Maximum extent of insurance cover provided by subsidiary (included in other creditors – note 27)	**(125.0)**	(150.9)
	22,103.7	14,832.4

In addition to the transactions above which are accounted for under linked presentation, Northern Rock assigned a portfolio of unsecured loans amounting to £749.7m to Flint Receivables Trustees Limited on 8 December 2003. Flint Consumer Loans No. 1 Limited purchased an interest amounting to £595.0m in the trust property on the same date, funded by the issue of asset backed notes. The noteholders have a proportionate interest in each balance in the portfolio, and at 31 December 2004 this interest amounted to £595.0m (2003 £595.0m). This securitisation does not qualify for linked presentation and therefore the total portfolio is included within unsecured loans as part of loans and advances to customers not subject to securitisation. The funding giving rise to the noteholders' interests is included within debt securities in issue.

Included within loans and advances to customers not subject to securitisation are £1,977.6m of mortgage advances assigned to a bankruptcy remote special purpose vehicle. These loans provide security to an issue of covered bonds of €2.0 billion (£1,340.8m equivalent) made by Northern Rock on 4 May 2004, which are included within debt securities in issue. Northern Rock retains substantially all the risks and rewards associated with these loans and therefore this transaction does not qualify for linked presentation or sale treatment.

17. Debt securities

Group	2004 Book value £m	2004 Market value £m	2003 Book value £m	2003 Market value £m
Investment securities				
Issued by public bodies:				
Government securities	**1,289.0**	**1,312.4**	1,143.2	1,162.6
Issued by other issuers:				
Bank and building society certificates of deposit	**456.2**	**455.3**	330.2	330.2
Other debt securities	**2,997.0**	**3,009.9**	2,712.1	2,726.1
	4,742.2	**4,777.6**	4,185.5	4,218.9
Listed	**4,261.0**	**4,297.4**	3,804.0	3,837.4
Unlisted	**481.2**	**480.2**	381.5	381.5
	4,742.2	**4,777.6**	4,185.5	4,218.9

Company	2004 Book value £m	2004 Market value £m	2003 Book value £m	2003 Market value £m
Investment securities				
Issued by public bodies:				
Government securities	**1,221.8**	**1,243.4**	1,079.7	1,098.7
Issued by other issuers:				
Bank and building society certificates of deposit	**436.2**	**435.3**	308.2	308.2
Other debt securities	**2,920.6**	**2,933.4**	2,644.4	2,658.7
	4,578.6	**4,612.1**	4,032.3	4,065.6
Listed	**4,117.4**	**4,151.9**	3,672.8	3,706.1
Unlisted	**461.2**	**460.2**	359.5	359.5
	4,578.6	**4,612.1**	4,032.3	4,065.6

Included in Group and Company debt securities are assets valued at £nil (2003 £nil) that are subject to sale and repurchase agreements.

	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Due within one year	**761.9**	655.4	**741.9**	625.1
Due one year and over	**3,980.3**	3,530.1	**3,836.7**	3,407.2
	4,742.2	4,185.5	**4,578.6**	4,032.3
Unamortised premiums and discounts	**42.7**	34.1	**37.9**	27.1

17. Debt securities (continued)

The movement on debt securities during the year was as follows:

	Group £m	Company £m
Cost:		
At 1 January 2004	4,190.5	4,037.3
Additions	9,467.0	9,331.6
Disposals	(8,878.7)	(8,754.1)
Premiums net of discounts charged in the year	(9.6)	(9.2)
Exchange adjustments	(25.0)	(25.0)
At 31 December 2004	4,744.2	4,580.6
Provisions:		
At 1 January 2004	5.0	5.0
Released in year	(3.0)	(3.0)
At 31 December 2004	2.0	2.0
Net book amount:		
At 31 December 2004	4,742.2	4,578.6
At 31 December 2003	4,185.5	4,032.3

All debt securities are held with the intention of use on a continuing basis in the Group's activities and are classified as financial fixed assets.

18. Equity shares and other variable yield securities

Group	2004 Book value £m	2004 Market value £m	2003 Book value £m	2003 Market value £m
Investment securities				
Listed	**539.4**	**554.9**	390.3	398.0
Unlisted	**36.2**	**36.2**	20.5	20.5
	575.6	**591.1**	410.8	418.5

Company	2004 Book value £m	2004 Market value £m	2003 Book value £m	2003 Market value £m
Investment securities				
Listed	**421.9**	**433.1**	299.4	306.9
Unlisted	**36.2**	**36.2**	20.5	20.5
	458.1	**469.3**	319.9	327.4

The movement on equity shares and other variable yield securities during the year was as follows:

	Group £m	Company £m
Cost:		
At 1 January 2004	412.3	321.4
Additions	193.3	148.0
Disposals	(19.3)	(0.6)
Exchange adjustments	(10.7)	(10.7)
At 31 December 2004	575.6	458.1
Provisions:		
At 1 January 2004	1.5	1.5
Released in year	(1.5)	(1.5)
At 31 December 2004	–	–
Net book amount:		
At 31 December 2004	575.6	458.1
At 31 December 2003	410.8	319.9

All equity shares and other variable yield securities are held with the intention of use on a continuing basis in the Group's activities and are classified as financial fixed assets.

19. Shares in group undertakings

	Company £m
Cost:	
At 1 January 2004	217.2
Distribution from subsidiary	(92.4)
At 31 December 2004	124.8
Provisions:	
At 1 January 2004 and 31 December 2004	4.3
Net book amount:	
At 31 December 2004	120.5
At 31 December 2003	212.9

The Company's interest in subsidiary undertakings are analysed as follows:

	2004 £m	2003 £m
Credit institutions	**50.0**	50.0
Other	**70.5**	162.9
	120.5	212.9

The principal subsidiaries of Northern Rock plc at 31 December 2004 are listed below, all of which are directly held and wholly owned by the Company, and all of which operate in their country of incorporation or registration.

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

In addition, Granite Mortgages 99-1 plc, Granite Mortgages 00-1 plc, Granite Mortgages 00-2 plc, Granite Mortgages 01-1 plc , Granite Mortgages 01-2 plc, Granite Mortgages 02-1 plc, Granite Mortgages 02-2 plc, Granite Mortgages 03-1 plc, Granite Mortgages 03-2 plc, Granite Mortgages 03-3 plc, Granite Mortgages 04-1 plc, Granite Mortgages 04-2 plc, Granite Mortgages 04-3 plc and Dolerite Funding No. 1 plc, all companies incorporated in England and Wales, and Granite Finance Funding Limited, Granite Finance Trustees Limited and Dolerite Mortgages Trustee Limited, all companies incorporated in Jersey, have been accounted for as quasi-subsidiaries (see note 1).

Northern Rock acquired all the issued share capital of Legal & General Bank Limited (renamed Northern Rock Holdings No. 1 Limited) and Legal & General Mortgage Services Limited (renamed Northern Rock Holdings No. 2 Limited) on 1 August 2002. On 9 November 2002 the assets and undertakings of each of these companies were transferred to Northern Rock plc, and neither have any continuing operations. During 2003, Northern Rock Holdings No. 1 Limited surrendered its permission under Part IV, Financial Services and Markets Act 2000 to accept deposits and is therefore no longer regarded as a credit institution. During 2004 Northern Rock Holdings No. 1 Limited paid a capital distribution to Northern Rock plc of £92.4m.

20. Intangible fixed assets

Goodwill	
Cost:	£m
At 1 January 2004 and 31 December 2004	35.8
Amortisation:	
At 1 January 2004	5.1
Charged for the year	3.6
At 31 December 2004	8.7
Net book amount:	
At 31 December 2004	27.1
At 31 December 2003	30.7

21. Tangible fixed assets

Group	Freehold £m	Land and buildings Long leasehold £m	Land and buildings Short leasehold £m	Plant, equipment, fixtures, fittings & vehicles £m	Assets in the course of construction £m	Total £m
Cost:						
At 1 January 2004	82.2	12.0	5.5	150.4	5.7	255.8
Additions	3.0	7.3	0.1	31.7	18.3	60.4
Transfers	0.3	0.6	(0.6)	0.6	(0.9)	–
Disposals	(4.2)	–	–	(1.5)	–	(5.7)
At 31 December 2004	81.3	19.9	5.0	181.2	23.1	310.5
Depreciation and amortisation:						
At 1 January 2004	8.7	5.3	4.8	57.9	–	76.7
Charged in year	0.8	0.4	–	26.3	–	27.5
Adjustments arising on disposals	(0.6)	–	(0.2)	(1.1)	–	(1.9)
At 31 December 2004	8.9	5.7	4.6	83.1	–	102.3
Net book amount:						
At 31 December 2004	72.4	14.2	0.4	98.1	23.1	208.2
At 31 December 2003	73.5	6.7	0.7	92.5	5.7	179.1

Net book amount of land and buildings occupied for own use: 2004 £86.4m (2003 £78.9m).

Company	Freehold £m	Land and buildings Long leasehold £m	Land and buildings Short leasehold £m	Plant, equipment, fixtures, fittings & vehicles £m	Assets in the course of construction £m	Total £m
Cost:						
At 1 January 2004	43.9	46.4	5.5	126.7	3.9	226.4
Additions	2.7	3.1	0.1	32.3	17.9	56.1
Transfers	0.6	0.6	(0.6)	–	(0.6)	–
Disposals	(4.2)	–	–	(1.5)	–	(5.7)
At 31 December 2004	43.0	50.1	5.0	157.5	21.2	276.8
Depreciation and amortisation:						
At 1 January 2004	8.1	0.9	4.8	56.1	–	69.9
Charged in year	0.6	0.9	–	25.0	–	26.5
Adjustments arising on disposals	(0.6)	–	(0.2)	(1.1)	–	(1.9)
At 31 December 2004	8.1	1.8	4.6	80.0	–	94.5
Net book amount:						
At 31 December 2004	34.9	48.3	0.4	77.5	21.2	182.3
At 31 December 2003	35.8	45.5	0.7	70.6	3.9	156.5

Net book amount of land and buildings occupied for own use: 2004 £83.0m (2003 £80.0m).

22. Other assets

	Group 2004 £m	Group 2003 (as restated) £m	Company 2004 £m	Company 2003 (as restated) £m
Deferred taxation	–	–	**18.4**	16.6
Dividends receivable	–	–	**6.9**	7.2
Other assets	**69.6**	76.6	**61.0**	61.5
	69.6	76.6	**86.3**	85.3

22. Other assets (continued)

The full movement on deferred taxation (payable)/recoverable was as follows:

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
At 1 January	**(19.0)**	(3.4)	**16.6**	13.3
(Charge)/credit for year	**(12.8)**	(15.6)	**1.8**	3.3
At 31 December	**(31.8)**	(19.0)	**18.4**	16.6

The amounts (payable)/recoverable in respect of deferred taxation relate to:

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Excess of capital allowances over depreciation	**(9.3)**	(8.8)	**(8.9)**	(8.5)
Other timing differences	**(22.5)**	(10.2)	**27.3**	25.1
	(31.8)	(19.0)	**18.4**	16.6

23. Prepayments and accrued income

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Deferred mortgage incentives	**279.3**	236.9	**279.3**	236.9
Accruals on derivatives	**163.1**	111.5	**163.1**	111.5
Accrued interest	**79.7**	65.5	**77.2**	63.2
Pension fund prepayment	***28.9***	*30.6*	***28.9***	*30.6*
Other	**195.9**	120.3	**291.0**	255.9
	746.9	564.8	**839.5**	698.1
Included above:				
Deferred mortgage incentives chargeable to the profit and loss account in more than one year	**114.3**	99.9	**114.3**	99.9

The movements on deferred mortgage incentives were as follows:

	Group and Company	
	2004	2003
	£m	£m
At 1 January	**236.9**	257.5
Additions	**482.5**	327.1
Amortisation	**(440.1)**	(347.7)
At 31 December	**279.3**	236.9

Additions to deferred mortgage incentives in the year is the amount that would have been charged to the profit and loss account for the year if incentives were not being amortised.

24. Deposits by banks

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Amount due to subsidiaries	–	–	**1,866.0**	1,876.1
Other deposits	**1,201.6**	1,461.5	**1,201.6**	1,461.5
	1,201.6	1,461.5	**3,067.6**	3,337.6
Repayable:				
On demand	**–**	–	**1,866.0**	1,876.1
In not more than three months	**847.7**	1,157.3	**847.7**	1,157.3
In more than three months but not more than one year	**193.6**	125.9	**193.6**	125.9
In more than one year but not more than five years	**4.0**	22.0	**4.0**	22.0
In more than five years	**156.3**	156.3	**156.3**	156.3
	1,201.6	1,461.5	**3,067.6**	3,337.6

25. Customer accounts

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Retail funds and deposits	**17,238.5**	16,342.8	**15,367.4**	14,467.5
Amounts due to subsidiaries	**-**	-	**2.0**	94.4
Other customer accounts	**3,103.5**	2,454.5	**3,103.5**	2,454.5
	20,342.0	18,797.3	**18,472.9**	17,016.4
Repayable:				
On demand	**7,103.9**	6,576.7	**6,323.5**	5,813.6
In not more than three months	**5,341.3**	4,710.6	**5,156.2**	4,494.6
In more than three months but not more than one year	**5,988.8**	5,493.9	**5,277.6**	4,918.1
In more than one year but not more than five years	**1,908.0**	2,016.1	**1,715.6**	1,790.1
	20,342.0	18,797.3	**18,472.9**	17,016.4

The above amounts include balances on accounts on which an interest penalty option is available to investors requiring immediate withdrawals as follows:

In not more than three months	**2,969.3**	2,734.6	**2,784.2**	2,518.6
In more than three months but not more than one year	**5,351.1**	5,115.4	**4,639.9**	4,540.6
In more than one year but not more than five years	**1,659.1**	1,740.7	**1,487.6**	1,551.3

26. Debt securities in issue

	Group and Company	
	2004	2003
	£m	£m
Bonds and medium term notes	**9,552.9**	7,141.2
Other debt securities in issue	**7,228.7**	5,918.9
	16,781.6	13,060.1
Debt securities in issue are repayable as follows:		
Bonds and medium term notes		
In not more than three months	**1,055.9**	1,596.4
In more than three months but not more than one year	**1,928.2**	1,844.2
In more than one year but not more than two years	**1,895.7**	889.0
In more than two years but not more than five years	**4,373.8**	2,507.6
In more than five years	**299.3**	304.0
	9,552.9	7,141.2
Other debt securities in issue		
In not more than three months	**5,621.7**	4,590.9
In more than three months but not more than one year	**1,582.8**	1,315.0
In more than one year but not more than two years	**4.0**	11.0
In more than two years but not more than five years	**20.2**	2.0
	7,228.7	5,918.9

Included within bonds and medium term notes is £1,840.8m (2003 £500.0m) that is secured by certain portfolios of loans in relation to the Group's covered bond programme and the securitisation of unsecured loans. See note 16 for further details.

27. Other liabilities

	Group		Company	
	2004	2003 (as restated)	**2004**	2003 (as restated)
	£m	£m	**£m**	£m
Amounts falling due within one year:				
Income tax on interest	**17.6**	10.1	**17.6**	10.1
Corporation tax	**60.0**	53.8	**58.2**	51.7
Other taxation and social security	**6.1**	4.9	**6.1**	4.9
Dividends payable	**74.7**	65.3	**74.8**	66.2
Other creditors	**177.2**	204.7	**77.3**	77.6
	335.6	338.8	**234.0**	210.5

28. Accruals and deferred income

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Accrued interest	**488.3**	383.3	**499.2**	390.9
Accruals on derivatives	**15.3**	29.7	**15.3**	29.7
Deferred income	**13.7**	32.9	**10.6**	19.2
Other accruals	**22.5**	29.4	**19.8**	24.4
	539.8	475.3	**544.9**	464.2

29. Subordinated liabilities

	Group and Company	
	2004	2003
	£m	£m
Dated		
5.625% Subordinated bonds due 2015	**300.0**	300.0
11.734% Subordinated loan 2016	**20.0**	20.0
5.75% Subordinated bonds due 2017	**250.0**	250.0
$10\frac{3}{8}$% Subordinated bonds due 2018	**50.0**	50.0
$9\frac{3}{8}$% Subordinated bonds due 2021	**149.3**	149.2
Undated		
$12\frac{5}{8}$% Perpetual subordinated notes	**19.8**	19.8
8% Undated subordinated notes	**61.5**	61.5
6.75% Fixed rate step-up undated subordinated notes	**200.0**	200.0
Floating rate undated subordinated notes	**69.0**	69.0
5.6% Undated subordinated notes	**396.1**	–
	1,515.7	1,119.5

The 5.625% subordinated bonds due 2015 are not redeemable in the ordinary course of business before 13 January 2010.

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 $10\frac{3}{8}$% subordinated bonds due 2018 are not redeemable in the ordinary course of business before 25 March 2018.

The $9\frac{3}{8}$% subordinated bonds due 2021 are not redeemable in the ordinary course of business before 17 October 2021.

The $12\frac{5}{8}$% perpetual subordinated notes were created 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 subsequently be redeemed in the ordinary course of business on coupon dates which fall on 15 March, 15 June, 15 September and 15 December.

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.

All subordinated liabilities, other than the 8% undated subordinated notes, the floating rate undated subordinated notes and the 5.6% undated subordinated notes are denominated in sterling. All are ranked equally between and within issues.

Redemptions of any dated subordinated notes prior to their final maturity date and any undated subordinated notes 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.

The dated subordinated liabilities are repayable as follows:

	Group and Company	
	2004	2003
	£m	£m
In more than five years	**769.3**	769.2

30. Reserve capital instruments

The reserve capital instruments were issued for a value of £200m on 21 September 2000 and are undated. A further £100m was issued in May 2001. 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, at Northern Rock's option, will be achieved either by the payment of cash directly, or by the issue of Ordinary Shares in Northern Rock which, when sold by a trustee in the market, will produce an amount equal to the cash payment. 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. Deferred coupons and any interest accruing thereon can only be satisfied through the issue of shares. The coupon has been swapped into a variable rate payment.

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

31. 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. 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. Deferred coupons can only be satisfied through the issue of Ordinary Shares.

The coupon has been swapped into a variable rate payment.

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.

32. Called up share capital

	Ordinary Shares of 25p each *Number*	Foundation Shares of 25p each *Number*	Total *Number*	Ordinary Shares of 25p each *£m*	Foundation Shares of 25p each *£m*	Total *£m*
Authorised:						
At 31 December 2004 and 31 December 2003	614.0m	104.5m	718.5m	153.5	26.1	179.6
Issued and fully paid:						
At 31 December 2004 and 31 December 2003	421.2m	74.4m	495.6m	105.3	18.6	123.9

The Foundation Shares are held by The Northern Rock Foundation. These shares carry no rights to dividends but rank pari passu with the Ordinary Shares in respect of other distributions and in the event of a winding up. Because they carry no rights to dividends, they have been omitted in the calculation of earnings per share (see note 13). These shares do not confer any rights in relation to attendance or voting at any general meeting of the Company.

The following options to acquire Ordinary Shares were outstanding at 31 December 2004 under savings related share option schemes:

- 30,921 (31 December 2003 36,444) at an option price of 381p per share exercisable during 2005
- 1,345,521 (31 December 2003 1,394,391) at an option price of 215p per share exercisable on various dates up to 2007
- 825,588 (31 December 2003 912,660) at an option price of 598p per share exercisable on various dates up to 2010

At 31 December 2004, options to acquire 569,770 Ordinary Shares (31 December 2003 945,565) were outstanding under the Northern Rock Employee Share Option Scheme at an option price of 618p per share. These options became exercisable on 1 June 2001 and may be exercised until 2008.

At 31 December 2004, options to acquire 2,985,000 Ordinary Shares (31 December 2003 3,369,000) were outstanding under the Northern Rock Employee Share Option Scheme at an option price of 641p per share. These options are exercisable between 2005 and 2012.

33. Reserves

	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
Group			
At 1 January 2004			
As previously reported	6.8	7.3	1,249.9
Prior year adjustment re own shares	–	–	(48.0)
As restated	6.8	7.3	1,201.9
Movements in relation to own shares (see note 34)	–	–	5.8
Retained profit	–	–	196.2
At 31 December 2004	6.8	7.3	1,403.9

33. Reserves (continued)

	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
Company			
At 1 January 2004			
As previously reported	6.8	7.3	1,143.4
Prior year adjustment re own shares	–	–	(47.3)
As restated	6.8	7.3	1,096.1
Movements in relation to own shares (see note 34)	–	–	5.8
Retained profit	–	–	152.7
At 31 December 2004	6.8	7.3	1,254.6

34. Own shares

The amounts deducted from the profit and loss reserve in respect of own shares, which are held at cost, are as follows:

	Group and Company	
	2004	2003
	£m	£m
Own shares in relation to employee share schemes	**55.3**	58.2

Movements in the amount deducted from reserves in respect of own shares have been as follows:

At 1 January	**58.2**	53.9
Purchase of shares	**6.0**	15.5
Use of shares on exercise of employee options and for other employee share plans	**(8.9)**	(11.2)
	(2.9)	4.3
Closing shareholders' funds	**55.3**	58.2
The credit/(charge) to the profit and loss account reserve has been as follows:		
Surplus on transactions in own shares	**2.9**	1.0
Net decrease/(increase) in cost of own shares	**2.9**	(4.3)
	5.8	(3.3)

Northern Rock plc sponsors The Northern Rock Employee Trust, The Northern Rock Employee Profit Sharing Scheme and The Northern Rock Qualifying Employee Share Ownership Trust which are discretionary trusts for the benefit of employees and former employees of Northern Rock plc. The Company has provided funds to the trustees to enable them to purchase Northern Rock plc Ordinary Shares, which are used to satisfy options granted by the Company or to meet commitments arising under other employee share schemes. The cost of providing these shares is charged to the profit and loss account on a systematic basis over the period that the employees are expected to benefit. In accordance with the rules of The Northern Rock Qualifying Employee Share Ownership Trust, dividends on shares held by that trust are waived. At 31 December 2004 this trust held 2,054,261 shares (2003 2,056,063). With effect from the 2004 interim payment, dividends on shares held by The Northern Rock Employee Trust are waived. At 31 December 2004 this trust held 5,779,139 shares.

At 31 December 2004, a total of 8,344,641 shares were held by the trustees (2003 9,239,017) with a market value of £65.2m (2003 £66.1m). These shares are excluded from the weighted average number of Ordinary Shares when calculating earnings per Ordinary Share (see note 13).

35. Reconciliation of movements in shareholders' funds

	Group		Company	
	2004	2003 (as restated)	**2004**	2003 (as restated)
	£m	£m	**£m**	£m
Profit retained	**196.2**	178.1	**152.7**	129.5
Net addition to shareholders' funds	**196.2**	178.1	**152.7**	129.5
Opening shareholders' funds as previously reported	**1,339.9**	1,209.6	**1,234.1**	1,151.9
Prior year adjustment re own shares				
Reduction in shareholders' funds prior to 1 January 2003	–	*(44.5)*	–	*(44.0)*
Movement in relation to own shares (see note 34)	–	(3.3)	–	(3.3)
	–	(47.8)	–	(47.3)
Movement in relation to own shares (see note 34)	**5.8**	–	**5.8**	–
Closing shareholders' funds	**1,541.9**	1,339.9	**1,392.6**	1,234.1

36. Guarantees and other financial commitments

(i) The Company has an obligation under the Building Societies Act 1986, as successor company to Northern Rock Building Society, to honour the financial commitments of its subsidiaries and associated bodies linked by resolution, incurred prior to 11 June 1996 insofar as those bodies are unable to discharge them out of their own assets. The Company has agreed to continue this obligation in respect of liabilities of Northern Rock (Guernsey) Limited.

(ii) The Company has given indemnities to the National House Building Council in respect of certain of its house building operations.

(iii) Capital commitments at 31 December in respect of authorised expenditure were as follows:

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Contracted for	**6.2**	24.1	**3.2**	3.0

(iv) Leasing commitments at 31 December in respect of annual commitments under operating leases are as follows:

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Land and buildings				
Leases which expire:				
Within one year	**0.1**	0.2	**0.1**	0.2
In one to five years	**0.8**	0.4	**0.8**	0.4
Over five years	**2.0**	2.7	**3.1**	3.8
	2.9	3.3	**4.0**	4.4
Other operating leases				
Leases which expire:				
Within one year	**0.4**	0.2	**0.4**	0.2
In one to five years	**4.8**	5.1	**4.8**	5.1
	5.2	5.3	**5.2**	5.3

(v) Memorandum items

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Commitments:				
Irrevocable undrawn loan facilities	**1,488.5**	1,018.5	**1,488.5**	1,018.5
Unpaid share capital of subsidiary company	**–**	–	**15.5**	15.5
	1,488.5	1,018.5	**1,504.0**	1,034.0

37. Derivatives and other financial instruments

The Group's approach to risk management and the related use of derivative instruments is described below.

Risk management

Management of risk is fundamental to the business of banking and is an integral part of the Group's strategic focus. The Group's risk management governance structure begins with oversight responsibility by the Board of Directors. Assisting the Board, the Audit Committee of Non-Executive Directors advises the Board on all matters relating to regulatory, prudential and accounting requirements that may affect the Group and reports to the Board on both financial and non-financial controls. The Risk Committee comprising three Non-Executive and the Executive Directors reviews the key risks inherent in the business and the system of control necessary to manage such risks.

In addition, the Management Board Asset and Liability Committee, which comprises the Executive Directors, the Company Secretary and ten other senior executives, has been delegated the responsibility to oversee the management and review of the balance sheet risk and liquidity profiles. The Management Board Asset and Liability Committee is supported by the director of Risk.

The director of Risk reports on and monitors risks throughout the Group and assists operational business areas in the formulation and implementation of appropriate risk management policies, methodologies and infrastructure. Each business area is responsible for the identification and quantification of their particular operational and credit risk exposures and implementing risk management policies and procedures agreed by the Board.

Credit risk

Credit risk is the potential risk of financial loss arising from the failure of a customer or counterparty to settle its financial and contractual obligations.

The overall day-to-day management of credit risk is delegated to individual business areas. Each business area utilises various qualitative and quantitative techniques to measure and manage their respective credit risk exposures. This includes the use of various credit risk mitigation techniques such as netting.

The customer loan risk management process incorporates sophisticated credit scoring systems to differentiate the credit risk associated with residential mortgage loans and unsecured loans, both at individual transaction and portfolio levels.

Credit exposure limits for corporates and financial institutions are primarily based on the credit ratings assigned by the rating agencies. Credit limits are monitored by the Management Board Asset and Liability Committee to ensure they remain within authorised counterparty credit limits as detailed in the Credit Risk Policy Statement approved by the Board of Directors.

Liquidity risk

Liquidity risk arises from the mismatch in the cash flows generated from on balance sheet assets and liabilities, and the interest flows of off balance sheet instruments.

The Board of Directors has approved a Liquidity Policy statement which is compliant with the supervisory framework set by the Financial Services Authority ("FSA"). These policies ensure that the Group is able to meet retail deposit withdrawals – either on demand or at contractual maturity – to repay wholesale borrowings as they mature and to meet current lending objectives. This is achieved by managing a diversified portfolio of high quality liquid assets, and a balanced maturity profile of wholesale and retail funds. Regular reports are made to the FSA detailing the Group's sterling stock liquidity.

Operational risk

Operational risk is the potential risk of financial loss or impairment to reputation arising from failures in operational processes or the systems that support them. To minimise operational risk, the Group maintains a system of control commensurate with the characteristics of the business and markets in which the Group operates, best practice principles and regulatory considerations. Where necessary, the Management Board Asset and Liability Committee will establish a project team, comprising senior business line managers, to devise and implement a suitable action plan to mitigate specific operational risk exposures.

Market risk

Market risk is the risk to earnings arising from changes in interest rates, foreign exchange rates and the price of financial securities.

(i) Interest rate risk

As a UK based mortgage institution, Northern Rock offers numerous banking, mortgage and savings products with varying interest rate features and maturities which create potential interest rate exposures.

The Board of Directors has approved a Balance Sheet Structural Risk Management and Hedging Policy Statement that details the policies, procedures and controls for managing risk, including interest rate risk and the use of derivatives. This policy is reviewed regularly by the Management Board Asset and Liability Committee which is responsible for ensuring that balance sheet exposures are managed within the Group's policies and operational limits.

All structural interest rate risk positions and interest rate sensitivity tests are reported to the Management Board Asset and Liability Committee on a regular basis.

(ii) Currency risk

In addition to raising funds through the sterling money markets, capital markets and domestic retail savings market, the Group raises funds through issuing Euro Commercial Paper, US Dollar Commercial Paper, non-sterling denominated medium-term debt securities (including covered bonds) and non-sterling denominated retail funds. The Group's policy is to fully hedge any exchange rate exposures by using cross-currency swaps and forward foreign exchange contracts, or to match exposures with assets denominated in the same currency. Any non-sterling denominated assets are also fully hedged in this manner or matched with non-sterling denominated liabilities.

Derivatives

The Board of Directors 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 Northern Rock is to hedge risk exposure, and the Group takes no trading positions in derivatives.

For the purpose of reducing interest rate risk and currency risk, the Group uses a number of derivative instruments. These comprise interest rate swaps, interest rate options, forward rate agreements, interest rate and bond futures, currency swaps and forward foreign exchange contracts. The objective, when using any derivative instrument, is to ensure that the risk to reward profile of any transaction is optimised. Where either an off balance sheet derivative instrument or an on 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 which optimises the following conditions:

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

The benefits of using off balance sheet derivative instruments are measured by examining the anticipated consequences of not hedging the perceived risk in terms of revenue or capital loss.

37. **Derivatives and other financial instruments** (continued)

The following table summarises activities undertaken by Northern Rock, the related risks associated with such activities and the types of derivatives used in managing such risks. Such risks may also be managed using on balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the return on variable rate assets	Reduced profitability due to falls in short-term interest rates	Receive fixed interest rate swaps Purchase interest rate options Sell forward rate agreements Purchase interest rate futures
Fixed-rate lending	Sensitivity to increases in interest rates Sensitivity to decreases in medium/long term interest rates, resulting in prepayment	Pay fixed interest rate swaps Purchase interest rate caps Impose early repayment penalty charges
Fixed-rate retail and wholesale funding	Sensitivity to falls in short-term interest rates	Receive fixed interest rate swaps
Fixed-rate asset investments	Sensitivity to increase in interest rates	Pay fixed interest rate swaps
Re-financing of wholesale funding	Sensitivity to increase in interest rates	Sell bond futures Purchase forward rate agreements Sell interest rate futures
Investment in foreign currency assets	Sensitivity to strengthening of sterling against other currencies	Cross-currency swaps Foreign currency funding
Issuance of bonds in foreign currencies	Sensitivity to weakening of sterling against other currencies	Cross-currency swaps
Interest earned on foreign currency denominated debt securities	Sensitivity to strengthening of sterling against other currencies	Forward foreign exchange contracts Purchase currency options

Derivatives which are combinations of more basic transactions (such as swaps with embedded option features), or which have leverage features, may be used in circumstances where the underlying position being hedged contains the same risk features, for example medium-term note issues based on equity indices or a multiple of an underlying floating market rate. In such cases the derivative used will be structured to match the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore fully hedged. Credit risk on these contracts is monitored within tightly defined risk limits on the basis of the contractual terms of the instruments, rather than the face or contract amount.

The vast majority of the Group's derivatives activity is contracted with banks and other financial institutions.

The table below shows the underlying principal amount and positive and negative book and fair values of derivatives by type of contract.

Group and Company 2004	Underlying principal amount £m	Positive book values £m	Negative book values £m	Positive fair values £m	Negative fair values £m
Interest rate contracts:					
Interest rate swaps					
1 year or less	18,886.7	–	–	30.8	7.5
1-5 years	17,651.9	–	–	39.3	95.9
over 5 years	2,602.8	–	–	93.0	13.2
Equity index swaps					
1 year or less	1.0	–	–	–	–
1-5 years	179.0	–	–	4.9	4.4
over 5 years	–	–	–	–	–
Forward rate agreements					
1 year or less	35.3	–	–	–	–
1-5 years	50.0	–	–	–	–
over 5 years	–	–	–	–	–
Exchange traded futures					
1 year or less	211.3	–	–	–	1.4
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
Caps, floors and options					
1 year or less	–	–	–	–	–
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
	39,618.0	–	–	168.0	122.4

37. Derivatives and other financial instruments (continued)

Group and Company	Underlying principal amount £m	Positive book values £m	Negative book values £m	Positive fair values £m	Negative fair values £m
Exchange rate contracts:					
Cross currency swaps					
1 year or less	1,574.3	9.1	111.4	9.1	102.8
1-5 years	5,907.9	215.0	268.2	242.4	255.9
over 5 years	710.0	21.0	60.7	20.8	61.2
Forward foreign exchange					
1 year or less	2,552.4	11.0	76.5	18.8	59.0
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
	10,744.6	256.1	516.8	291.1	478.9
2003					
Interest rate contracts:					
Interest rate swaps					
1 year or less	10,744.2	–	–	11.1	16.4
1-5 years	18,054.0	–	–	105.3	68.5
over 5 years	2,876.0	–	–	84.9	16.9
Equity index swaps					
1 year or less	6.4	–	–	–	0.2
1-5 years	266.8	–	–	3.4	5.0
over 5 years	–	–	–	–	–
Forward rate agreements					
1 year or less	5.0	–	–	–	–
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
Exchange traded futures					
1 year or less	385.5	–	–	–	8.4
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
Caps, floors and options					
1 year or less	15.0	–	–	–	–
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
	32,352.9	–	–	204.7	115.4
Exchange rate contracts:					
Cross currency swaps					
1 year or less	1,588.3	26.7	190.9	25.2	155.6
1-5 years	3,446.8	124.7	112.5	121.0	148.8
over 5 years	285.5	20.3	18.5	19.7	19.4
Forward foreign exchange					
1 year or less	2,471.1	2.6	126.4	1.9	112.1
1-5 years	–	–	–	–	–
over 5 years	–	–	–	–	–
	7,791.7	174.3	448.3	167.8	435.9

The positive fair values above represent the gross replacement cost of the Group's derivatives and hence equate to the maximum gross loss it would incur if any party to the derivatives contract failed to perform to its terms. At 31 December 2004 the potential credit exposure after allowing for collateral received was £269.1m (2003 £194.0m).

In addition to the derivatives disclosed above, there are a number of derivatives that have been entered into by the securitisation companies (see note 16). These consist of interest rate swaps and cross currency swaps all with a term of over 5 years. The underlying principal amounts at 31 December 2004 were £1,636.1m and £14,810.2m (2003 £1,257.1m and £10,365.4m). Positive book values amounted to £nil and £270.6m (2003 £nil and £192.5m) and negative book values amounted to £nil and £1,368.5m (2003 £nil and £1,057.8m). Positive fair values were £42.7m and £275.4m (2003 £19.6m and £192.1m) and negative fair values were £0.3m and £1,367.1m (2003 £0.1m and £1,042.6m).

37. Derivatives and other financial instruments (continued)

The following table gives an analysis of the re-pricing 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 re-pricing date and the residual maturity date.

2004	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							
Loans and advances to banks	3,246.9	12.0	2.5	–	–	44.0	3,305.4
Loans and advances to customers	2,691.7	4,682.7	6,290.9	18,010.7	1,428.8	–	33,104.8
Investment securities	3,422.2	33.0	76.3	1,012.5	773.8	–	5,317.8
Other assets	–	–	–	–	–	1,062.0	1,062.0
Total assets	9,360.8	4,727.7	6,369.7	19,023.2	2,202.6	1,106.0	42,790.0
Liabilities							
Deposits by banks	1,024.0	106.1	67.5	4.0	–	–	1,201.6
Customer accounts	12,735.3	2,185.1	3,518.8	1,902.8	–	–	20,342.0
Debt securities in issue	13,525.7	1,230.3	368.2	1,457.4	200.0	–	16,781.6
Subordinated liabilities	68.3	457.7	–	–	1,489.7	–	2,015.7
Other liabilities	–	–	–	–	–	907.2	907.2
Shareholders' equity	–	–	–	–	–	1,541.9	1,541.9
Total liabilities	27,353.3	3,979.2	3,954.5	3,364.2	1,689.7	2,449.1	42,790.0
Off balance sheet items affecting interest rate sensitivity	(14,121.4)	812.0	976.4	12,662.1	(329.1)	–	–
	13,231.9	4,791.2	4,930.9	16,026.3	1,360.6	2,449.1	42,790.0
Interest rate sensitivity gap	(3,871.1)	(63.5)	1,438.8	2,996.9	842.0	(1,343.1)	–
Cumulative interest rate sensitivity gap	(3,871.1)	(3,934.6)	(2,495.8)	501.1	1,343.1	–	–
2003							
Assets							
Loans and advances to banks	3,406.9	7.0	–	–	–	36.3	3,450.2
Loans and advances to customers	7,410.1	2,423.6	4,216.7	12,480.4	1,671.3	–	28,202.1
Investment securities	3,119.8	26.4	120.3	1,248.6	81.2	–	4,596.3
Other assets	–	–	–	–	–	862.8	862.8
Total assets	13,936.8	2,457.0	4,337.0	13,729.0	1,752.5	899.1	37,111.4
Liabilities							
Deposits by banks	1,350.1	107.4	2.0	2.0	–	–	1,461.5
Customer accounts	12,582.1	1,302.5	3,001.9	1,910.8	–	–	18,797.3
Debt securities in issue	11,539.4	1,492.6	23.0	5.1	–	–	13,060.1
Subordinated liabilities	1,168.3	281.5	–	–	169.7	–	1,619.5
Other liabilities	–	–	–	–	–	833.1	833.1
Shareholders' equity	–	–	–	–	–	1,339.9	1,339.9
Total liabilities	26,639.9	3,184.0	3,026.9	1,917.9	169.7	2,173.0	37,111.4
Off balance sheet items affecting interest rate sensitivity	(13,027.1)	882.7	93.4	10,703.7	1,347.3	–	–
	13,612.8	4,066.7	3,120.3	12,621.6	1,517.0	2,173.0	37,111.4
Interest rate sensitivity gap	324.0	(1,609.7)	1,216.7	1,107.4	235.5	(1,273.9)	–
Cumulative interest rate sensitivity gap	324.0	(1,285.7)	(69.0)	1,038.4	1,273.9	–	–

The above table has been restated to reflect the prior year adjustment arising from the introduction of UITF 38 (see note 2).

37. Derivatives and other financial instruments (continued)

Gains and losses on hedging derivatives

	2004 Gains £m	2004 Losses £m	2004 Net £m	2003 Gains £m	2003 Losses £m	2003 Net £m
Unrecognised gains and losses on hedges						
At 1 January	**225.2**	**(130.0)**	**95.2**	219.4	(292.6)	(73.2)
Arising in previous years recognised in 2004 (2003)	**(63.9)**	**50.4**	**(13.5)**	(42.5)	137.8	95.3
Brought forward gains and losses not recognised in 2004 (2003)	**161.3**	**(79.6)**	**81.7**	176.9	(154.8)	22.1
Arising in 2004 (2003) not recognised in 2004 (2003)	**86.7**	**(49.9)**	**36.8**	48.3	24.8	73.1
At 31 December	**248.0**	**(129.5)**	**118.5**	225.2	(130.0)	95.2
Of which:						
gains and losses expected to be recognised in 2005 (2004)	**96.3**	**(36.7)**	**59.6**	63.9	(50.4)	13.5
gains and losses expected to be recognised in 2006 (2005) or later	**151.7**	**(92.8)**	**58.9**	161.3	(79.6)	81.7

	2004 Gains £m	2004 Losses £m	2004 Net £m	2003 Gains £m	2003 Losses £m	2003 Net £m
Realised gains and losses held in the balance sheet						
At 1 January	**6.1**	**(14.5)**	**(8.4)**	16.0	–	16.0
Realised gains and losses brought forward recognised in income in 2004 (2003)	**(6.1)**	**7.7**	**1.6**	(16.0)	–	(16.0)
Brought forward realised gains and losses not recognised in income in 2004 (2003)	**–**	**(6.8)**	**(6.8)**	–	–	–
Realised gains and losses in 2004 (2003) not recognised in income in 2004 (2003)	**2.0**	**(9.6)**	**(7.6)**	6.1	(14.5)	(8.4)
At 31 December	**2.0**	**(16.4)**	**(14.4)**	6.1	(14.5)	(8.4)
Of which:						
gains and losses expected to be recognised in 2005 (2004)	**2.0**	**(16.4)**	**(14.4)**	6.1	(14.5)	(8.4)
gains and losses expected to be recognised in 2006 (2005) or later	**–**	**–**	**–**	–	–	–

The above tables show the gains and losses on off balance sheet derivative instruments used for hedging by the Group. The gains and losses do not therefore represent absolute gains or losses expected by the Group as they will be substantially offset by corresponding losses or gains from on balance sheet instruments.

Currency risk

No analysis has been provided of the Group's structural currency exposures on the grounds of materiality. Where the Group has transactional currency exposures, it uses a variety of derivative products to eliminate this risk and therefore has no material transactional currency risk.

38. Fair values of financial instruments

The table set out below details the book and fair values for some of the Group's financial instruments. This analysis excludes those financial assets which are not listed or publicly traded, and for which no liquid and active market exists. It therefore excludes loans and advances to customers, retail deposits and certain other balance sheet items.

	2004		2003	
	Book value £m	**Fair value £m**	Book value £m	Fair value £m
Assets				
Cash and balances at central banks	**10.2**	**10.2**	11.6	11.6
Loans and advances to banks	**3,305.4**	**3,305.4**	3,450.2	3,450.2
Debt securities	**4,743.5**	**4,777.6**	4,186.7	4,218.9
Equity shares and other variable yield securities	**575.6**	**591.1**	410.8	418.5
Liabilities				
Deposits by banks	**1,218.3**	**1,219.5**	1,480.6	1,480.4
Customer accounts – other customer accounts	**3,103.5**	**3,104.0**	2,454.5	2,454.5
Debt securities in issue	**16,557.1**	**16,633.4**	12,785.9	12,769.4
Subordinated liabilities	**1,955.0**	**2,219.9**	1,601.0	1,818.2
Other				
Derivatives receivable	**254.6**	**459.1**	174.3	372.5
Derivatives payable	**(515.3)**	**(601.3)**	(448.3)	(551.3)

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale and excludes accrued interest. Where available, clean market prices have been used to determine fair values for securities converted at the spot rate of exchange where appropriate. For short term and floating rate borrowings the book value approximates to fair value because of short maturities and reset periods. For longer dated fixed rate borrowings where a market price is unavailable, the fair value has been estimated by adjusting the book value to reflect the effect of related hedging derivatives. The fair values of derivatives have been estimated by calculating the present value of estimated future cash flows.

In addition to the financial instruments above, there are a number of financial instruments within the securitisation companies (see note 16) for which the above disclosures are appropriate, which are currently contained within the linked presentation. These are debt securities in issue with a book value of £21,023.6m (2003 £14,023.9m) and a fair value of £21,123.2m (2003 £14,043.1m), derivatives receivable with a book value of £270.6m (2003 £192.5m) and a fair value of £318.1m (2003 £211.7m) and derivatives payable with a book value of £1,368.5m (2003 £1,057.8m) and a fair value of £1,367.4m (2003 £1,042.7m).

39. Non-sterling assets and liabilities

The aggregate amount of all assets and liabilities included in the balance sheet denominated in a currency other than sterling was as follows:

	Group		Company	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Assets	**2,966.5**	2,362.3	**2,955.0**	2,351.0
Liabilities	**13,496.2**	9,463.9	**13,495.3**	9,463.7

The above assets and liabilities denominated in currencies other than sterling do not indicate the Group's exposure to foreign exchange risk. The Group has no material net currency exposures as all borrowings in foreign currencies are either hedged with cross currency swaps or forward foreign exchange agreements, or are matched by assets denominated in the same currency.

40. Related party transactions

(i) At the end of the year the aggregate amounts outstanding from Directors, their connected persons and Officers, in relation to loans from and other credit transactions with the Company, and the number of persons concerned, were as follows:

	Directors		Officers	
	2004	2003	**2004**	2003
Number of persons	**5**	6	**15**	13
Aggregate amount	**£2.0m**	£2.7m	**£2.4m**	£1.9m

(ii) The Company's total contribution payable under deed of covenant to The Northern Rock Foundation for the year ended 31 December 2004 amounted to £21.6m (2003 £19.3m). At 31 December 2004 the commitment in respect of amounts not yet paid was £11.6m (2003 £10.0m).

(iii) Except for the contribution to The Northern Rock Foundation, the Company has made no promotional and benevolent donations to organisations in which certain Directors and their connected persons hold positions of influence such as Directors, Trustees and Governors (2003 £nil).

(iv) The Company has mortgage loans receivable from its related companies. Movements in these loans and provisions in respect of them during the year were as follows:

	£m
Cost:	
At 1 January 2004 and 31 December 2004	0.1
Provisions:	
At 1 January 2004 and 31 December 2004	0.1
Net book amount:	
At 31 December 2004 and 31 December 2003	-

(v) Northern Rock plc is a listed company and its shares are held by a large number of investors. No investor acting individually has the ability to control the activities of the Company. Consequently it is considered that there is no ultimate controlling party as defined in FRS 8 "Related Party Transactions".

41. Reconciliation of operating profit to net operating cash inflows

	2004	2003 (as restated)
	£m	£m
Profit on ordinary activities before tax	**431.2**	386.6
(Increase)/decrease in prepayments and accrued income	**(182.1)**	37.9
Increase in accruals and deferred income	**57.2**	28.1
Provisions for bad and doubtful debts	**56.5**	48.7
Loans and advances written off	**(30.9)**	(30.3)
Depreciation and amortisation	**22.6**	20.1
Interest on subordinated liabilities	**85.5**	62.0
Interest on reserve capital instruments	**19.8**	17.3
Interest on tier one notes	**13.0**	11.4
Other non-cash movements	**9.6**	14.7
Net cash inflow from trading activities	**482.4**	596.5
Net increase in loans and advances to banks and customers	**(12,813.8)**	(9,631.9)
Net increase in deposits by banks and customer accounts	**1,369.1**	1,147.7
Net increase in debt securities in issue	**11,007.3**	8,794.5
Net decrease in other assets	**7.0**	2.6
Net decrease in other liabilities	**(18.8)**	(63.6)
Net cash inflow from operating activities	**33.2**	845.8

42. Gross cash flows

		2004 £m	2003 £m
(i)	Returns on investments and servicing of finance		
	Interest paid on subordinated liabilities	**78.7**	58.2
	Interest paid on reserve capital instruments	**19.7**	17.2
	Interest paid on tier one notes	**12.6**	11.5
		111.0	86.9
(ii)	Capital expenditure and financial investment		
	Purchase of investment securities	**9,670.3**	4,633.4
	Sales and maturities of investment securities	**(8,900.9)**	(4,256.8)
	Purchase of tangible fixed assets	**60.4**	43.6
	Sale of tangible fixed assets	**(12.3)**	(0.7)
		817.5	419.5
(iii)	Financing		
	Issue of subordinated liabilities	**396.1**	-
		396.1	-

43. Analysis of the balances of cash as shown in the balance sheet

	As at 1 Jan 04 £m	Cashflow £m	*As at* 31 Dec 04 £m	*As at* 1 Jan 03 £m	Cashflow £m	*As at* 31 Dec 03 £m
Cash and balances at central banks	**11.6**	**(1.4)**	**10.2**	10.7	0.9	11.6
Loans and advances to other banks repayable on demand	**973.3**	**(704.4)**	**268.9**	601.4	371.9	973.3
	984.9	**(705.8)**	**279.1**	612.1	372.8	984.9

44. Analysis of changes in financing during the year

				2004				2003
	Share capital £m	**Loan capital £m**	**Reserve capital instruments £m**	**Tier one notes £m**	Share capital £m	Loan capital £m	Reserve capital instruments £m	Tier one notes £m
At 1 January	**123.9**	**1,119.5**	**300.0**	**200.0**	123.9	1,119.5	300.0	200.0
Cash inflow from financing	**-**	**396.1**	**-**	**-**	-	-	-	-
Amortisation	**-**	**0.1**	**-**	**-**	-	-	-	-
At 31 December	**123.9**	**1,515.7**	**300.0**	**200.0**	123.9	1,119.5	300.0	200.0

FIVE YEAR SUMMARY OF RESULTS

31 December 2004

Results for 2000 have been restated to reflect the early introduction of FRS 19 in 2001. Results for 2000 and 2001 have been restated to reflect the prior year adjustment in relation to changes in classification of RCIs and the corresponding coupon payable introduced in 2002. Results for 2000 – 2002 have been restated to reflect the reallocation of securitisation net interest from other income and charges to net interest receivable. Results for 2000 – 2003 have been restated to reflect the prior year adjustment arising from the introduction of UITF 38 in 2004.

		2000	2001	2002	2003	2004
Net interest receivable	£m	288.7	346.1	391.2	450.7	466.9
Other income and charges	£m	120.9	130.3	169.8	209.0	264.0
Total income	£m	409.6	476.4	561.0	659.7	730.9
Operating expenses – ongoing	£m	130.4	148.0	169.8	194.5	222.5
Operating expenses – non-recurring[1]	£m	–	–	2.3	5.6	–
Operating expenses – amortisation of goodwill	£m	–	–	1.5	3.6	3.6
Covenant to The Northern Rock Foundation	£m	12.5	14.8	16.3	19.3	21.6
Provisions for bad and doubtful debts	£m	16.9	34.5	43.1	48.7	56.5
Amounts written off fixed asset investments	£m	1.0	1.5	2.6	1.4	(4.5)
Provision for loss on disposal of care homes	£m	3.1	–	–	–	–
Profit on ordinary activities before tax	£m	245.7	277.6	325.4	386.6	431.2
Tax on profit on ordinary activities	£m	66.0	83.7	96.5	112.2	125.0
Profit on ordinary activities after tax	£m	179.7	193.9	228.9	274.4	306.2

		2000	2001	2002	2003	2004
Total assets under management	£m	24,852	31,090	41,875	51,944	64,894
Growth in total assets under management	%	20	25	35	24	25
Average interest earning assets	£m	22,588	27,524	36,036	46,435	57,071
Mean assets under management	£m	22,774	27,971	36,482	46,909	58,419
Retail deposits	£m	12,052	13,370	15,336	16,343	17,239
Shareholders' funds	£m	917	1,037	1,165	1,340	1,542
Risk asset ratio – overall	%	13.6	12.9	15.5	14.3	14.0
Risk asset ratio – tier 1	%	9.0	8.2	9.1	9.0	8.7
Gross lending	£m	6,362	8,853	12,584	17,315	23,342
Net lending	£m	3,621	5,127	6,697	8,514	12,932
Loan balances acquired	£m	–	–	1,544	–	–
Increase in retail balances	£m	963	1,318	773	1,007	896
Retail balances acquired	£m	–	–	1,193	–	–
Increase in profit after tax[2]	%	11	12	18	20	12
Net interest margin	%	1.28	1.26	1.09	0.97	0.82
Total income : mean assets	%	1.92	1.95	1.90	1.89	1.83
Total income : mean assets under management	%	1.80	1.70	1.54	1.41	1.25
Operating expenses[3] : total income[4]	%	31.8	31.1	30.3	29.8	30.4
Operating expenses[3] : mean assets under management	%	0.57	0.53	0.47	0.41	0.38
Provisions : mean advances to customers	%	0.10	0.18	0.19	0.19	0.18
Return on equity[2]	%	19.1	19.8	20.8	21.9	21.3
Post-tax return on mean assets under management[2]	%	0.76	0.69	0.63	0.58	0.52

1. Non-recurring costs represent

   2002 – non-recurring costs incurred in relation to the acquisition of the banking subsidiaries of Legal & General

   2003 – non-recurring costs incurred in relation to the closure of certain branches

2. Before the post-tax effect of provision for loss on the disposal of care homes
3. Before non-recurring costs
4. Before surplus on sale of credit card portfolio

FINANCIAL CALENDAR

2005

26 January 2005	Preliminary results for year ended 31 December 2004
26 April 2005	Annual General Meeting
27 April 2005	Ex-dividend date for final dividend for 2004
29 April 2005	Record date for final dividend
27 May 2005	Payment date for final dividend
28 July 2005	Interim results for half year to 30 June 2005
28 September 2005	Ex-dividend date for interim dividend for 2005
30 September 2005	Record date for interim dividend
28 October 2005	Payment date for interim dividend

2006

25 January 2006	Preliminary results for year ended 31 December 2005
25 April 2006	Annual General Meeting
26 April 2006	Ex-dividend date for final dividend for 2005 (provisional)
28 April 2006	Record date for final dividend (provisional)
26 May 2006	Payment date for final dividend
19 July 2006	Interim results for half year to 30 June 2006
27 September 2006	Ex-dividend date for interim dividend for 2006 (provisional)
29 September 2006	Record date for interim dividend (provisional)
27 October 2006	Payment date for interim dividend

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