

Equity Release Funding (No.2) plc

Registered in England No. 4414548, Registered Office: C/O Wilmington Trust SP Services (London) Limited, Tower 42 (Level 11), International Financial Centre, 25 Old Broad Street, London, EC2N 1HQ

Directors and Officers

Directors

M McDermott

J Fairrie

Wilmington Trust SP Services (London) Limited (formerly SPV Management Limited)

Secretary

Wilmington Trust SP Services (London) Limited (formerly SPV Management Limited)

Auditor

Ernst & Young LLP

1 More London Place

London

SE1 2AF



Equity Release Funding (No.2) plc

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Equity Release Funding (No.2) plc

Directors' report

The directors present their annual report and audited financial statements for Equity Release Funding (No.2) plc (the Company) for the year ended 31 December 2005.

Principal activity

The principal activity of the Company is investment in Lifetime mortgage loans secured by first charges over properties within the United Kingdom and to raise/borrow money and to grant security over its assets. The directors consider that this will continue unchanged into the foreseeable future.

Operations and new business

Details of the results are given in the income statement on page 10.

Dividends

The directors do not recommend the payment of a dividend for the year (2004: *£nil*).

Directors

The names of the present directors of the Company appear on page 1.

On 19 December 2005, SPV Management Limited changed its name to Wilmington Trust SP Services (London) Limited.

M McDermott, J Fairrie and Wilmington Trust SP Services (London) Limited served as directors of the Company throughout the year.

Directors' interests

During the year J Fairrie and Equity Release Holdings Limited jointly held one share in the Company. Wilmington Trust SP Services (London) Limited jointly held one share with M McDermott and also held one fully paid share in the parent company, Equity Release Holdings Limited. The directors had no other interest in the share capital or loan stock of the Company during the year.

Equity Release Funding (No.2) plc

Directors' report (continued)

Statement of directors' responsibilities

The directors are required to prepare financial statements for each accounting period that comply with the relevant provisions of the Companies Act 1985 and of the International Financial Reporting Standards (IFRS) as adopted by the European Union, and which present fairly the financial position, financial performance and cash flows of the Company at the end of the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the directors to:

- select suitable accounting policies and verify they are applied consistently in preparing the financial statements, on a going concern basis unless it is inappropriate to presume that the Company will continue in business;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- state that the Company has complied with applicable IFRS, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Company. They are also ultimately responsible for the systems of internal control maintained for safeguarding the assets of the Company and for the prevention and detection of fraud and other irregularities.

Directors' statement as to disclosure of information to auditors

The directors who were members of the board at the time of approving the Directors' report are listed on page 1 of these financial statements. Having made enquiries of fellow directors and of the Company's auditors, each of these directors confirms that:

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

Auditors

In accordance with section 385 of the Companies Act, 1985, Ernst & Young LLP have indicated their willingness to continue in office and the directors will place a resolution before the annual general meeting to re-appoint them as auditors for the ensuing year.

By order of the Board



Wilmington Trust SP Services (London) Limited *Secretary*

29 JUN 2006

Equity Release Funding (No.2) plc

Auditors' report

Independent auditors' report to the shareholders of Equity Release Funding (No.2) plc

We have audited the Company's financial statements for the year ended 31 December 2005 which comprise the Income Statement, Balance Sheet, Statement of Changes in Equity, Cash Flow Statement and the related notes 1 to 18. These financial statements have been prepared under the accounting policies set out on pages 6 to 9.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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. It also includes an assessment of the significant estimates and judgments 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 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, in accordance with IFRS as adopted by the European Union, of the state of the Company's affairs as at 31 December 2005 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

Ernst + Young LLP

Ernst & Young LLP
Registered Auditor
London

29 JUN 2006

Equity Release Funding (No.2) plc

Accounting policies

Equity Release Funding (No.2) plc (the Company), a company incorporated and domiciled in the United Kingdom (UK), invests in Lifetime mortgage loans.

The principal accounting policies adopted in the preparation of these financial statements are set out below.

(A) Basis of presentation

This is the Company's first set of full year results prepared in accordance with International Financial Reporting Standards (IFRS) accounting policies and its previously reported 2004 financial statements have accordingly been restated to comply with IFRS, with the date of transition to IFRS being 1 January 2004. The principal effects of the adoption of IFRS have been reflected within note 1 on first time adoption.

The financial statements have been prepared in accordance with IFRS applicable at 31 December 2005. The International Accounting Standards Board (IASB) issued an amendment to IAS 39, *The Fair Value Option*, in June 2005. Its requirements are applicable for accounting periods beginning on or after 1 January 2006, but the Company has decided to adopt them early and reflect their impact in these financial statements.

In August 2005, the IASB issued IFRS 7, *Financial Instruments: Disclosures*, and amendments to IAS 1, *Capital Disclosures*, and IAS 39/IFRS 4, *Financial Guarantee Contracts*. Their requirements are applicable for accounting periods beginning on or after 1 January 2007 for the first two and, for the third, 1 January 2006. The Company has decided not to adopt any of the standards early in these financial statements but the impact of adopting them is not expected to have a material effect on the results of the Company. IFRS 7 will result in amendments to the disclosure of financial assets and liabilities, whilst the amendments to IAS 1 bring the capital disclosures into line with IFRS 7. The amendments to IAS 39 and IFRS 4 will not affect the Company. In addition, IFRS 6 has been issued during 2005 but is not relevant to the activities of the Company.

Unless otherwise noted, the amounts shown in these financial statements are in thousands of pounds sterling (£'000).

(B) Use of estimates

The preparation of financial statements requires the Company to make estimates and assumptions that affect items reported in the balance sheet and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements. Although these estimates are based on management's best knowledge of current facts, circumstances and to, some extent, future events and actions, actual results ultimately may differ from those estimates, possibly significantly.

(C) Segment reporting

In compliance with IAS 14 Segment Reporting, the Company must report financial information by segment. The Company operates in only one business and geographical segment, therefore segment reporting is not disclosed in the notes to the financial statements.

(D) Net investment income

Investment income consists of interest receivable for the year, movements in amortised cost, realised gains and losses, and unrealised gains and losses on financial assets at fair value through profit and loss (as defined in accounting policy F). Interest income is recognised as it accrues, taking into account the effective yield on the investment.

The realised gain or loss on disposal of an investment is the difference between the proceeds received, net of transaction costs, and its original cost or amortised cost as appropriate. Unrealised gains and losses represent the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year, less the reversal of previously recognised unrealised gains and losses in respect of disposals made during the year.

Equity Release Funding (No.2) plc

Accounting policies (continued)

(E) Impairment of non-financial assets

Non-financial assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

(F) Financial investments

The Company has taken advantage of the revised fair value option, presenting the lifetime mortgages and the associated liabilities and derivative financial instruments at fair value through profit and loss (FV), since they are managed as a portfolio on a fair value basis, and presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised.

The FV category has two sub-categories – those that meet the definition as being held for trading and those the Company chooses to designate as FV (referred to in this accounting policy as 'other than trading'). Derivative financial instruments are classified as trading. All other securities in the FV category are classified as other than trading.

Purchases and sales of investments are recognised on the trade date, which is the date that the Company commits to purchase or sell the assets, at their fair values less transaction costs. Investments classified as trading and other than trading are subsequently carried at fair value. Changes in the fair value of trading and other than trading investments are included in the income statement in the period in which they arise. The fair values of investments are based on quoted bid prices or amounts derived from cash flow models.

(G) Derivative financial instruments

Derivative financial instruments include interest rate swaps and other financial instruments that derive their value mainly from underlying interest rates. All derivatives are initially recognised in the balance sheet at their fair value, which usually represents their cost. They are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative.

Derivative contracts may be traded on an exchange or over-the-counter (OTC). Exchange-traded derivatives are standardised and include certain futures and option contracts. OTC derivative contracts are individually negotiated between contracting parties and include forwards, swaps, caps and floors. Derivatives are subject to various risks including market, liquidity and credit risk, similar to those related to the underlying financial instruments.

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities on the balance sheet as they do not represent the potential gain or loss associated with such transactions. These amounts are disclosed in note 17.

Interest rate swaps

Interest rate swaps are contractual agreements between two parties to exchange periodic payments in the same currency, each of which is computed on a different interest rate basis, on a specified notional amount. Most interest rate swaps involve the net exchange of payments calculated as the difference between the fixed and floating rate interest payments. Exposure to gain or loss on interest rate swap contracts will increase or decrease over their respective lives as a function of maturity dates, interest, and the timing of payments.

Equity Release Funding (No.2) plc

Accounting policies (continued)

(H) Loans

Lifetime mortgages are designated at fair value through profit and loss, since they are managed as a portfolio on a fair value basis, and presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised.

Other loans are held at amortised cost, using the effective interest rate method. To the extent that a loan is uncollectible, it is written off as impaired. Subsequent recoveries are credited to the income statements.

(I) Cash and cash equivalents

Cash and cash equivalents consist of cash at banks and in hand and deposits held at call with banks.

(J) Provisions

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Where the Company expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is more probable than not.

The Company recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

(K) Income taxes

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years. Taxable profits are computed using UK GAAP as it was up to 31 December 2004, in accordance with the provisions of current UK tax. Tax, including tax relief for losses if applicable, is allocated over profits before taxation and amounts charged or credited to reserves as appropriate.

Provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the liability method, on all material temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

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

(L) Borrowings

Loan notes backed by mortgages are designated at fair value through profit and loss, since they are managed as a portfolio on a fair value basis, and presentation at fair value provides more relevant information and ensures that any accounting mismatch is minimised.

Other borrowings are recognised initially at their issue proceeds less transaction costs incurred. Subsequently, borrowings are stated at amortised cost, and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest rate method.

Equity Release Funding (No.2) plc

Accounting policies (continued)

(M) Share Capital

Equity instruments

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all its liabilities. Accordingly, a financial instrument is treated as equity if:

- (i) there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on terms that may be unfavourable; and
- (ii) the instrument will not be settled by delivery of a variable number of shares or is a derivative that can be settled other than for a fixed amount of cash, shares or other financial assets.

Equity Release Funding (No.2) plc
Income statement
For the year ended 31 December 2005

	Note	2005 £'000	2004 £'000
Income			
Net investment income	2 & D	30,015	22,511
Fee and commission income	2	471	86
Other operating income	2	705	457
		31,191	23,054
Expenses			
Fee and commission expense	3	(1,259)	(1,272)
Other operating costs	3	(12,119)	(3,863)
Finance costs	3	(17,811)	(17,917)
		(31,189)	(23,052)
Profit for the year		2	2

The accounting policies (identified alphabetically) on pages 6 to 9 and notes (identified numerically) on pages 14 to 24 are an integral part of these financial statements.

Equity Release Funding (No.2) plc
Balance sheet
As at 31 December 2005

	Note	2005 £'000	2004 £'000
Assets			
Loans	H & 6	339,069	315,060
Receivables and other financial assets	8	28	13
Prepayments and accrued income		99	109
Cash and cash equivalents	I	23,942	25,117
Total assets		363,138	340,299
Equity			
Ordinary share capital	M & 9	13	13
Retained earnings	10	7	5
Total equity		20	18
Liabilities			
Provisions	J & 12	22,381	10,270
Borrowings	L & 13	337,314	327,648
Payables and other financial liabilities	G & 14	3,423	2,363
Total liabilities		363,118	340,281
Total equity and liabilities		363,138	340,299

Approved by the Board on 29 June 2006

Lurid Hassan

Wilmington Trust SP Services (London) Limited *Director*

The accounting policies (identified alphabetically) on pages 6 to 9 and notes (identified numerically) on pages 14 to 24 are an integral part of these financial statements.

Equity Release Funding (No.2) plc
Statement of changes in equity
For the year ended 31 December 2005

	2005	2004
	£'000	£'000
Balance at 1 January	18	16
Profit for the year	2	2
Balance at 31 December	20	18

The accounting policies (identified alphabetically) on pages 6 to 9 and notes (identified numerically) on pages 14 to 24 are an integral part of these financial statements.

Equity Release Funding (No.2) plc
Cash flow statement
For the year ended 31 December 2005

The cash flows presented in this statement cover all the Company's activities.

	Note	2005 £'000	2004 £'000
Cash flows from operating activities			
Cash generated from operations	15(a)	17,966	19,401
Net cash from operating activities		17,966	19,401
Cash flows from financing activities			
Net repayment of borrowings	13(b)	(2,188)	(2,220)
Interest paid on borrowings	3	(16,953)	(17,033)
Net cash from financing activities		(19,141)	(19,253)
Net (decrease)/increase in cash and cash equivalents		(1,175)	148
Cash and cash equivalents at 1 January		25,117	24,969
Cash and cash equivalents at 31 December	15(b)	23,942	25,117

The accounting policies (identified alphabetically) on pages 6 to 9 and notes (identified numerically) on pages 14 to 24 are an integral part of these financial statements.

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005

1. First time adoption of International Financial Reporting Standards

(a) The Company has adopted International Financial Reporting Standards (IFRS) for these financial statements for the year ended 31 December 2005. In order to show comparative balances, the year ended 31 December 2004 is also shown under IFRS. The date of transition to IFRS is, therefore, 1 January 2004.

In general, a Company is required to determine its IFRS accounting policies and apply these retrospectively to determine its opening balance sheet under IFRS. However, International Financial Reporting Standard 1, *First time adoption of International Financial Reporting Standards*, (IFRS 1) allows a number of exemptions to this general principle upon adoption of IFRS.

(i) Comparatives

The Company has not taken advantage of the exemption that allows comparative information presented in the first year of adoption of IFRS not to comply with IAS 32, *Financial Instruments: Disclosure and Presentation*, IAS 39, *Financial Instruments: recognition and Measurement*, and IFRS 4, *Insurance Contracts*.

(ii) Estimates

Where estimates had previously been made under UK GAAP, consistent estimates (after adjustments to reflect any difference in accounting policies) have been made for the same date on transition to IFRS (i.e. judgements affecting the Company's opening balance sheet have not been revisited for the benefit of hindsight).

(b) The following tables show the effect of adopting IFRS on the statements that have previously been reported under UK GAAP for the year ending 31 December 2004.

(i) Reconciliation of equity reported under UK GAAP to equity reported under IFRS

	Note	1 January 2004		31 December 2004	
		£'000	£'000	£'000	£'000
Equity as reported under UK GAAP			16		18
Adjusted for:					
Investment valuation	1	(4,074)		(5,296)	
Other items	2	4,074		5,296	
		-	-	-	-
Equity as reported under IFRS			16		18

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005 (continued)

(ii) Notes to the analysis of adjustments, to the balance sheets as at 1 January and 31 December 2004 as a result of the transition to IFRS

The UK GAAP balance sheet has been presented in a format consistent with IFRS.

The basis for the material adjustments between UK GAAP and IFRS is as follows:

(1) Investment valuation

The adjustments in respect of investment valuation arise from the following:

	1 January 2004 £'000	31 December 2004 £'000
Change in valuation of derivatives	(1,614)	(1,928)
Change in valuation of mortgages	23,400	24,962
Change in valuation of loan notes	(25,860)	(28,330)
	(4,074)	(5,296)

The principal changes are discussed further below:

Under UK GAAP the derivatives were not marked to market, but a debtor was recognised for accrued interest receivable and a creditor for accrued interest payable. Under IFRS, derivatives are shown at fair value through profit and loss and recognised as a derivative asset or liability as appropriate. Any movement in fair value is shown through the income statement.

Under UK GAAP the mortgages were shown at the lower of cost and net realisable value. The discount on the purchase of the mortgages was capitalised and accreted based on the expected redemption profile of the underlying transaction. The discount on substitution was capitalised and accreted over the expected lifetime of the mortgages. Under IFRS, the mortgages are shown at fair value through profit and loss. The mortgage discount and substitution discount form part of the fair value.

Under UK GAAP the loan notes are shown in the financial statements at net issue proceeds. The discount and issue costs associated with the issuing of the loan notes were capitalised and accreted/amortised over the expected redemption profile of the loan notes. Under IFRS the loan notes are shown at fair value through profit and loss and the discount and issue costs form part of the fair value.

The net impact to shareholders' funds is a reduction of £4,074,000 at 1 January and £5,296,000 at 31 December 2004.

(2) Other items

The other change that arises as a result of the transition to IFRS which together with the investment valuations will have no impact on shareholders' funds is the provision for deferred consideration. Adjustments made in relation to investment valuations as a result of the transition to IFRS will have an offsetting effect on the provision for deferred consideration. Under the terms of the agreement for the purchase of the mortgage loans the Company has a liability to pay deferred consideration when surplus funds become available under the priority of payments.

The net impact to shareholders' funds is an increase of £4,074,000 at 1 January and £5,296,000 at 31 December 2004.

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005 (continued)

(iii) Reconciliation of profit and loss reported under UK GAAP to profit and loss reported under IFRS

	For the year ended 31 December 2004 £'000
Profit for the year as reported under UK GAAP	2
Adjusted for:	
Investment valuations	(1,222)
Other items	1,222
Profit for the year as reported under IFRS	2

2. Details of income

	2005 £'000	2004 £'000
Net investment income		
Interest and similar income	23,960	23,733
Other income from investments classified as trading:		
Unrealised losses	(632)	(314)
Other income from investments classified as other than trading:		
Unrealised gains/(losses)	6,687	(908)
	<u>30,015</u>	<u>22,511</u>
Fee and commission income	471	86
Other operating income		
Reinsurance rebates	83	130
Substitution income	622	327
	<u>705</u>	<u>457</u>
Total income	<u>31,191</u>	<u>23,054</u>

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005 (continued)

3. Details of expenses

	2005 £'000	2004 £'000
Fee and commission expenses	1,259	1,272
Other operating expenses		
Audit fees	8	8
Deferred consideration	12,111	3,855
	12,119	3,863
Finance cost		
Interest expense on:		
Securitised mortgage loan notes	16,953	17,033
Other similar charges	858	884
	17,811	17,917
Total expenses	31,189	23,052

4. Directors' emoluments

Wilmington Trust SP Services (London) Limited received fees of £16,111 (2004: £16,335) including VAT during the year to 31 December 2005, in respect of structuring and management services.

5. Auditors' remuneration

The total remuneration payable by the Company, including VAT, to its principal auditors, Ernst & Young LLP, in respect of the audit of these financial statements is shown below.

	2005 £'000	2004 £'000
Audit services		
Statutory audit	8	8

6. Loans

(a) Carrying amounts

The carrying amounts of loans at 31 December were as follows:

	2005 £'000	2004 £'000
Lifetime mortgage loans (note 7)	339,069	315,060

Of the above total, £339,069,000 (2004: £315,060,000) is expected to be paid more than one year after the balance sheet date.

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005 (continued)

(b) Movements during the year

	2005 £'000	2004 £'000
At 1 January	315,060	310,533
Amounts redeemed	(17,347)	(19,533)
Interest receivable on mortgages	22,815	22,498
Fair value movements	18,541	1,562
At 31 December	339,069	315,060

7. Lifetime mortgages and related assets

On 11 June 2002, the Company purchased £276 million of mortgage assets at market value from Norwich Union Equity Release Limited (NUERL), a wholly owned subsidiary of Norwich Union Life & Pensions Limited. These assets are a portfolio of UK Lifetime fixed rate residential mortgages, wholly secured on properties in the UK. In order to fund the purchase of these mortgage assets, the Company issued a series of mortgage backed notes. Under the terms of this arrangement, the rights of the providers of the finance for this transaction are limited to the mortgage assets purchased and any related income generated by the portfolio, and are without recourse to NUERL.

NUERL is not obliged to support any losses, which may arise in respect of the mortgage assets. During the term of this transaction, any amounts realised from the mortgage portfolio in excess of that due to the providers of the funding, less any related administrative costs, will be payable to NUERL in the form of deferred consideration.

NUERL administers the mortgage portfolio.

8. Receivables and other financial assets

	2005 £'000	2004 £'000
Reinsurance rebates	28	13

9. Ordinary share capital

Details of the Company's ordinary share capital at 31 December are as follows:

	2005 £	2004 £
The authorised share capital of the Company was: 50,000 (2004: 50,000) ordinary shares of £1 each	50,000	50,000
The allotted, called up and fully paid share capital of the Company was: 2 (2004: 2) ordinary shares of £1 each	2	2
The allotted, called up and partly paid share capital of the Company was: 49,998 (2004: 49,998) ordinary shares of £1 each (25p paid per share)	12,500	12,500
	12,502	12,502

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005 (continued)

10. Retained earnings

	2005 £'000	2004 £'000
Balance at 1 January	5	3
Profit for the year	2	2
Balance at 31 December	7	5

11. Tax liabilities

(a) General

Tax liabilities payable in more than one year are £nil (2004: £nil) respectively.

(b) Deferred taxes

The company had no recognised or unrecognised deferred tax balances at the year end (2004: £nil).

12. Provisions

	2005 £'000	2004 £'000
Balance at 1 January	10,270	6,415
Provision made in the year	12,111	3,855
Balance at 31 December	22,381	10,270

Under the terms of the agreement for the purchase of mortgage loans, the Company has a liability to pay deferred consideration when surplus funds become available under the priority of payments. Provision has been made to pay deferred consideration in any period in which surplus income accrues, which will ultimately be paid out by way of deferred consideration.

Of the above total, £22,381,000 (2004: £10,270,000) is expected to be paid more than one year after the balance sheet date.

Equity Release Funding (No.2) plc
Notes to the financial statements
For the year ended 31 December 2005 (continued)

13. Borrowings

(a) Carrying amount

The following table provides information about the maturity periods and effective interest rates of the Company's borrowings.

Borrowings are considered current if the contractual repricing or maturity dates are within a year.

	Contractual repricing or maturity date over 5 years	2005 Effective interest rate	Contractual repricing or maturity date over 5 years	2004 Effective interest rate
	£'000	%	£'000	%
Securitised mortgage loan notes	329,476	5.87	322,049	5.81
Amounts owed to credit institutions	7,838	5.90	5,599	5.90
	337,314		327,648	

(b) Movements during the year

	2005 £'000	2004 £'000
Carrying amount		
At 1 January	327,648	327,398
New borrowings drawn down, net of expenses	2,240	2,240
Repayment of borrowings	(4,428)	(4,460)
Net cash outflow	(2,188)	(2,220)
Fair value movements	11,854	2,470
Movements in the year	9,666	250
At 31 December	337,314	327,648

(c) On 11 June 2002, the Company issued £300 million of mortgage backed loan notes (class A1 and A2 notes) in order to fund the purchase of a mortgage portfolio. The balance of these notes at 31 December 2005 is shown at fair value.

The loan notes are secured over a portfolio of mortgage loans secured by first charges over residential properties in the UK. The mortgages were purchased from NUERL.

The A1 notes were issued at par and the A2 notes were issued at 99.724%.

Interest on the notes is payable quarterly in arrears, unpaid interest is capitalised quarterly. Interest payable on the notes is as follows:

The notes are listed on the London Stock Exchange.

£300 m Mortgage Backed Loan Notes	Capital Balance Outstanding At End of Year	Credit Rating (S&P, Moody's)	Up to May 2012	From May 2012
Class A1 (£45 m)	£34,290,000	AAA, Aaa	LIBOR + 0.44%	LIBOR + 1.50%
Class A2 (£255 m)	£255,000,000	AAA, Aaa	5.88%	5.88%

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The A1 and A2 notes ("the senior notes") rank pari passu in point of payment and security without preference or priority amongst themselves. A1 notes are to be redeemed as funds become available. Liquidity has been provided through the swap agreement (see note 17) and borrowing facility with the intention that the A1 notes will be redeemed in full in May 2012, unless redeemed prior to this date. A2 notes are to be redeemed according to a redemption schedule commencing in August 2016, although the Company will be obliged to redeem (in full or in part) if certain early redemption conditions are satisfied.

Unless previously redeemed in full, each class of notes will mature at its principal amounts outstanding on the interest payment date falling in:

A1 Notes	May 2027
A2 Notes	May 2032

The Company may, at its option, redeem all (but not some only) of the notes at their principal amounts outstanding in the event of certain tax changes affecting the notes or the swap agreement (see note 17).

The Company has entered into a contract, the purpose of which is to both protect the Company from interest rate risk on the floating rate notes, and to provide liquidity to the Company.

This contract is a non-derivative host contract (the fixed rate loan) with an embedded derivative (the interest rate swap). As the loan element of this contract is not directly funding the mortgages, it is shown as a liability under borrowings and valued at amortised cost. The interest rate swap element has been separated and accounted for as a derivative, at fair value through profit and loss (Note 17).

At 31 December 2005, the Company had a committed but undrawn 364 day borrowing facility of £70 million.

14. Payables and other financial liabilities

	2005	2004
	£'000	£'000
Derivative financial liabilities	2,560	1,928
Interest payable	839	415
Other financial liabilities	24	20
	3,423	2,363

Of the above total, £2,560,000 (2004: £1,928,000) is expected to be paid more than one year after the balance sheet date (see note 17).

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15. Cash flow statement

(a) The reconciliation of profit before tax to the net cash inflow from operating activities is:

	2005 £'000	2004 £'000
Profit before tax	2	2
Adjustments for:		
Fair value (gains)/losses on investments	(6,055)	1,222
Interest receivable on mortgage loans	(22,815)	(22,498)
Interest expense on borrowings	16,953	17,033
Interest payable on derivatives contracts	428	272
Changes in working capital:		
(Increase)/decrease in receivables and other financial assets	(15)	1
Decrease/(Increase) in prepayments and accrued income	10	(19)
Increase in other provisions	12,111	3,855
Cash received from redemptions	17,347	19,533
Cash generated from operations	17,966	19,401

Redemptions of mortgages are included within operating cash flows as they represent the operating activities of the Company.

(b) Cash and cash equivalents in the Cash flow statement at 31 December comprised:

	2005 £'000	2004 £'000
Cash at bank and in hand	23,942	25,117

16. Risk management policies

Management of financial and non-financial risks

The Company has established a number of policies focusing on the management of financial and non-financial risks. Further details as to the operation of these policies and committees are provided by risk area below.

(i) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet commitments associated with financial instruments, if the cash flows from the mortgages differ from that expected. Such differences would arise from mortality, morbidity and voluntary prepayment risks. Liquidity is provided to the Company through the swap agreement and the Company has a committed but undrawn 364 day borrowing facility of £70m which has been sized to cover significant stress on mortgage cashflows.

(ii) Interest rate risk

The fair value or net asset value of the Company's investments is exposed to potential fluctuations in interest rates. Exposure to interest rate risk is managed through ensuring the interest rate characteristics of assets and

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liabilities are similar. Where this is not possible, interest rate swaps are utilised to mitigate any residual interest rate risk.

The matching of the assets and liabilities of the Company is maintained by utilising higher than expected mortgages redemptions to redeem liabilities early. Mortgage redemptions which are significantly higher or lower than expected will result in interest rate risk. This risk has been allowed for in the initial stress testing of the cashflows of the Company

(iii) Credit risk

Credit risk is the risk of loss in the value of financial assets due to counterparties not being able to meet their obligations as they fall due.

Mortgage loans are secured on the borrower's property by a first charge. Credit risk on mortgages is the risk that the net proceeds of the property are insufficient to discharge the loan in full. This may be as a result of an extension in longevity, or an underperformance of house prices. The risk of such credit losses emerging is managed through the lending criteria for the mortgages which include low initial loan to property value. The Company also has the benefit of an insurance policies, which insure any un-discharged portion of a loan where a sale has occurred as a result of death, or the need for long term care of the relevant borrower. The Company is solely exposed to the UK property market.

The credit risk on the Company's bankers and liquidity providers is managed through the credit rating dependent collateral arrangements.

(iv) Prepayment Risk

Prepayment risk is the risk that loans will be repaid prior to their expected maturity. This risk is mitigated by the early repayment charges which apply to the loans and has been allowed for in the initial stress testing of the cash flows of the company

17. Derivative financial instruments

(a) The Company uses non-hedge derivatives to mitigate risk, as detailed below:

	2005			2004		
	Contract/ notional amount	Fair value asset	Fair value liability	Contract/ notional amount	Fair value asset	Fair value liability
	£'000	£'000	£'000	£'000	£'000	£'000
Interest rate contracts						
Interest swaps	45,000	-	(2,560)	45,000	-	(1,928)

(b) Future Commitments

In June 2002, the Company entered into an interest rate swap agreement, the purpose of which is to protect the Company from interest rate risk in respect of the floating rate notes. The notional amount outstanding as at 31 December 2005 was £45 million and the swap had an expiry date of May 2027. Under the terms of the swap the Company receives interest of three month LIBOR and pays interest of 0.55%, of the notional amount per annum payable quarterly. In addition to the 0.55% interest payments, the Company is committed to make a series of scheduled payments under the swap arrangement totalling £140.8m commencing in May 2028. The Company may terminate the swap prior to expiry and receive an early termination payment. The market value of this early termination payment has been hedged by the Company through a second 'termination swap'.

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18. Related party transactions

(a) The members of the Board of Directors are listed on page 1 of these financial statements.

(b) Expenses payable to related parties

	2005	2004
	Expense	Expense
	incurred	incurred
	in year	in year
	£'000	£'000
Due to NUERL	13,336	5,094

The Company paid fees to Norwich Union Equity Release Limited during the course of the year of £1,225,000 (2004: £1,239,000) in respect of portfolio administration and cash handling services.

(c) Payable at year end

	2005	2004
	£'000	£'000
Due to NUERL	22,381	10,270

(d) Key management compensation

Information concerning directors' share interests is given on page 3.

Wilmington Trust SP Services (London) Limited received fees of £16,111 (2004: £16,335) including VAT during the year to 31 December 2005, in respect of structuring and management services.

There are no amounts receivable from or payments due to members of the Board of Directors.

(e) Parent entity

The immediate holding Company is Equity Release Holdings Limited, a Company registered in England.

(f) Ultimate controlling entity

The ultimate controlling entity is Aviva plc, a Company registered in England. Its Group financial statements are available on application to the Group Company Secretary, Aviva plc, St. Helen's, 1 Undershaft, London EC3P 3DQ.