

Northern Rock (Asset Management) plc Annual Report & Accounts 2010

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NRAM

Registered in England and Wales No 3273685

Our Mission is:

**‘maximising value
for the taxpayer’**

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Chairman's statement

On 1 October 2010 UK Asset Resolution Ltd ('UKAR') was established as the holding company for Northern Rock (Asset Management) plc ('NRAM') and Bradford & Bingley plc ('B&B'), bringing together the two companies under shared management and a common Board of Directors

This is the first annual report of NRAM since its combination with B&B under the ownership of UKAR. There is no legal requirement to produce consolidated UKAR accounts this year due to the short accounting period covered so we have only produced separate accounts for NRAM and B&B, saving taxpayers' money. However, my report and the Chief Executive Officer's ('CEO') report, and a number of other sections of these accounts, cover both companies.

UKAR and its two component firms share a common Board of Directors. This is an efficient and cost effective way of working but we have to ensure that each firm operates independently as there are two distinct and separate pools of creditors. We are managing an orderly wind-down, so we have to be very careful to maintain the correct hierarchy of creditors and ensure conflicts of interest are properly managed.

In addition to myself, the Board of UKAR comprises three Non-Executive Directors from NRAM – Kent Atkinson, Sue Langley and Keith Morgan together with three Non-Executive Directors from B&B – Michael Buckley, Louise Patten and John Tattersall. There is one Executive Director, Richard Banks, our Chief Executive. Richard, assisted by a management team drawn from the two firms, has done a good job setting up UKAR. The new Board comprises strong banking, risk and operational expertise which will be essential to oversee the activities of the Company.

Bob Davies, previously a NRAM Non-Executive Director, stood down from the Board on 31 December 2010 and I thank him for his contribution to the businesses throughout the year. On 1 October 2010 Philip Remnant, who served as a Non-Executive Director of NRAM, stood down together with the Chief Executive, Gary Hoffman, and Chief Operating Officer, Andy Tate. I would like to take this opportunity to thank all three for their efforts in leading the NRAM business during the year.

UKAR has, in total, an £80bn book of residential mortgage assets and running this down will take many years. The NRAM book comprises mainly residential mortgages and has a faster run-off rate than B&B which comprises a majority of buy-to-let mortgages. Very few of our mortgages would be written on their current terms by any financial institution today. Either the loan to value or earnings multiple would be considered too high, or the pricing would be viewed as too cheap.

However, the vast majority of customers are up to date with their payments – in NRAM 87% and in B&B 91%. In terms of 3+ months arrears, B&B has made good progress during the year. This reflects tight management of collection activity and, for buy-to-let customers the advantageous borrowing rate is less than the rental yield. Customers more than 3 months in arrears including possessions fell from 5.5% to 4.1%. In NRAM arrears rose from 4.7% to 6.6% reflecting the transfer of £10.3bn mortgages to Northern Rock plc ('NR') on 1 January 2010, the declining total book and the nature of the mortgages in the book, which have high loan to value ratios and do not have the benefit of the lower interest rates applicable to the majority of B&B buy-to-let customers.

Some of our customers have many challenges to face and the role of our customer service teams is to treat them fairly and take account of their individual circumstances. We employ around 2,400 colleagues in total of which around 1,000 are engaged in dealing with customers in arrears or facing payment difficulties.

The faster redemption rate of NRAM mortgages enabled our Government loan balances to be reduced by £1.1bn by the year end. B&B did not draw any additional borrowing from the Government. In total the two firms either directly or indirectly owe the taxpayer £48.7bn and repaying this in full is the major focus of the UKAR team.

Both firms benefited from the low cost of funding provided by the Government and this enabled profits to be achieved. Underlying profits at NRAM were £277.4m and at B&B were £200.1m. In addition, profits were generated from liability management exercises whereby debt capital instruments issued by both companies were purchased back from holders at a market value below their par value. This generated extra shareholder equity of £951m for NRAM and £566m for B&B which together with the retained profits has left both firms with high quality capital resources at the year end.

Chairman's statement (continued)

2010 was a year of progress for NRAM and B&B and, looking forward to 2011, there are some challenging targets to achieve. These include NRAM's final separation from NR which is a project involving the transfer of around 400,000 mortgage accounts and 150,000 associated unsecured loan accounts to the B&B IT platform and the integration of NRAM and B&B operations, which will provide opportunities for significant cost savings benefiting the taxpayer and creditors of both organisations.

In line with the commitment made when NRAM was first taken into public ownership, £15m was paid by NRAM to The Northern Rock Foundation in 2010. However, given our focus on repayment of our Government loans we feel that it is inappropriate for the Company to continue to make such substantial donations to a single charity. For 2011, UKAR has a modest budget that enables us to support our colleagues in carrying out charitable and volunteer work in the communities in which they live and work. In addition, we will be maintaining our focus on preventing and alleviating the causes of homelessness through continued support to both the Business Action on Homelessness programme, part of Business in the Community, and the debt advice agencies.

UKAR is a unique institution involved in a complex run-off. The team of colleagues assembled to undertake this task are seasoned and mature professionals conscious of their responsibilities to taxpayers, creditors and customers. I would like to thank everyone for their efforts in 2010 and the Board looks forward to the continued successful implementation of our strategies in 2011.

Richard Pym

Chairman

30 March 2011

Chief Executive Officer's review

Introduction

I am pleased to report that both NRAM and B&B made good progress against their business objectives and met all of the financial objectives agreed with our Shareholder for 2010. Throughout the year we worked closely with UK Financial Investments ('UKFI') and the Financial Services Authority ('FSA') in preparation for NRAM's separation from NR and the integration of NRAM and B&B into UKAR. This has gone extremely well and I thank the UKAR executive team and all our colleagues for their tremendous efforts and support throughout the year.

Business and objectives

The combination of NRAM and B&B under the UKAR holding company brings together two businesses with combined assets of £112bn. Included within this total are £80bn of residential mortgages, £1bn of commercial mortgages and £3bn of unsecured loans. The business is now operating over three main sites in the North of England with around 2,400 employees. We have a unique opportunity to deliver value to the Shareholder, the UK's taxpayers, by managing this business effectively as the assets wind-down, or are recovered.

Since bringing the UKAR companies together we have focused on developing a clear sense of direction. Objectives for the business were agreed by the Board in October 2010 with the overall aim to maximise value for the taxpayer. This will be achieved by focusing on key activities and themes based on each of the following four objectives:

- Reduce, protect and optimise the Balance Sheet,
- Integrate our operations in NRAM and B&B and minimise unit costs through continuous improvement,
- Maintain and develop excellence in debt management,
- Create a great place to work.

These objectives will be underpinned by the need to treat customers and creditors fairly.

Customers

In total, UKAR has almost 850,000 customers, 726,000 mortgage accounts and 351,000 unsecured personal loan accounts. In the main, these loans are performing well and our operating activities are focused on providing effective and straightforward services to these customers. Given the current economic circumstances we are also dealing with a significant number of customers with difficulties meeting their repayments. We continue to work closely with those customers offering a wide range of solutions to help them manage their finances.

In 2009, arrears in both NRAM and B&B increased significantly and this rate of increase has been arrested in 2010 with the number for B&B actually falling. Whilst arrears at NRAM have continued to increase, this is at a slower rate. As at the end of 2010 there were 13,096 cases of B&B mortgages 3 or more months in arrears including possessions, a fall of 32% compared to the end of 2009. For NRAM, the equivalent figure was 25,419 cases, up by 3%, a much reduced rate of increase compared to the 18% experienced in 2009.

In dealing with customers in arrears, we seek to exhaust all reasonable efforts to repair and recover the loans rather than resorting to repossession proceedings, which we use only as a last resort. Unfortunately, in some cases, this is the only outcome. During 2010, UKAR made over 44,000 mortgage arrangements and account modifications to assist customers with their repayments and continue their existing mortgage.

The number of properties in possession for B&B has fallen from 962 in 2009 to 623 at the end of 2010. For NRAM the numbers of properties in possession fell from 2,061 in 2009 to 1,984 at the end of 2010.

Community

We support a number of charities and are particularly concerned to focus this support on organisations that assist people in financial difficulties.

In the North East in 2010, we adopted Samaritans as our corporate charity and many of our colleagues have staged events to raise funds and provide practical support for this vital service. From April 2011, we will be adopting Shelter as our chosen charity. In West Yorkshire, in particular the Aire Valley, we continue to support organisations such as Business Action on Homelessness, part of Business in the Community.

Chief Executive Officer's review (continued)

Colleagues

We are extremely conscious of the huge task that lies ahead for UKAR as we fully integrate the operations of B&B and NRAM in order to minimise unit costs. We are committed to ensuring that UKAR is a great place to work, and that all our colleagues have the training and development they need to do their jobs well and to give them the confidence and skills to adapt to the changing needs of the business.

Outlook

The outlook for the UK economy remains uncertain with further contraction a possibility.

The current low level of the Bank of England base rate means that loan repayments remain affordable for many, therefore, increases in interest rates could be detrimental to the performance of both NRAM and B&B given the focus of our business on mortgage loans.

The level of loan impairments remains largely driven by the performance of the economy and, in particular, the rates of unemployment and households' disposable incomes. We expect that dealing with arrears and poor performing loans will remain a significant focus of our activities during the coming year given the uncertain economic outlook.

The NRAM book in particular is continuing to prove challenging with many customers being more vulnerable to changes in environmental factors. The impact of higher taxation and increases in unemployment combined with the prospect of higher interest rates and higher inflation, is likely to mean that more customers will fall into arrears during 2011.

In these somewhat gloomy circumstances we will maintain our strong relationships with debt advisory agencies. We will continue to help our customers through short term difficulties wherever possible and assist those with more fundamental problems to make an orderly sale of their property.

Mortgage market

The attention to risk management across the sector and consequent tightening of mortgage lending conditions is likely to continue to dampen activity in the housing and mortgage markets. We expect demand to remain subdued with house prices flat at best but more likely to fall slightly in the coming year. As a result, the number of our customers who are able to find alternative mortgage providers will remain limited and we expect redemption rates to continue at the current low levels.

Conclusion

It has been an extremely challenging but rewarding year for me, both as Managing Director ('MD') of B&B and now as CEO of UKAR, NRAM and B&B. I have been impressed by the professionalism and dedication of all my colleagues at our offices in the North East, Yorkshire and London who have risen to the challenges we have faced whilst continuing to look after our customers well. In particular I thank the Chairman, Richard Pym, the Board of Directors and my executive management team for their support to me personally and for their continued commitment to ensuring UKAR is successful.

Looking forward, I believe we have the right strategic plans and people in place to achieve our mission of maximising value for the taxpayer.

Richard Banks

Chief Executive Officer
30 March 2011

Overview of 2010

As reported last year, the EC approved the Government's State aid package for the former Northern Rock in October 2009. A requirement of State aid approval for NRAM in 2010 was to separate from NR. Subsequently, it was agreed that NRAM would merge with B&B and management time has been focused on progressing the merger with B&B and implementing the Business Plan.

On 1 January 2010 certain balance sheet assets and liabilities were transferred from NRAM to NR. NRAM also ceased to offer new lending products from this date. The transfer to NR included all staffing and infrastructure so, although the NRAM business was legally separated from NR, the servicing and the infrastructure support required by NRAM was provided by NR under a service agreement.

NRAM's primary objective is to repay the Government funding as soon as market conditions allow, protecting and creating value for taxpayers, whilst treating customers and creditors fairly. In 2010, NRAM repaid £1.1bn in this respect.

At the start of the year, the FSA approved NRAM's application for MIPRU regulatory status, in recognition that NRAM is a provider of mortgage services rather than a bank.

In June, NRAM successfully completed an exercise to repurchase certain debt capital instruments with a face value of £1,083m. This resulted in a net gain of £780m which, reflecting the nature of the instruments, was accounted for in shareholder funds and was not included in the reported profit for the year. The Company launched a further liability management exercise tendering for £520m of debt capital and subordinated liabilities on 9 November. A 46% take-up was achieved. This resulted in a net gain of £171m, £60m of which was accounted for as profit in the Income Statement.

During the second half of the year NRAM have, along with UKFI, focused on the merger and integration of the operations of the two Government owned mortgage books in wind-down. The new holding company, UKAR, was created on 1 July and on 1 October the shares of each of NRAM and B&B were transferred into UKAR.

On 1 November, NRAM largely completed its physical separation from NR, with colleagues working on NRAM business being transferred to B&B under TUPE regulations and segregation and access controls put in place in December on NR's IT systems to separate NRAM's business and customer data from NR's data. NRAM currently accesses its data on NR's IT system under a transitional services agreement.

The statutory profit before tax for 2010 was £400.5m (2009: £257.5m loss). This represents the first full year results for NRAM following the legal and capital restructure of the former Northern Rock on 1 January 2010. The comparative year's information included within the Income Statement is as previously published and covers the whole of the former NR business and has not been restated to reflect the transfer resulting from the legal and capital restructure. There were several significant year-on-year movements relating to unique items accounted for in 2009 and not repeated in 2010 and vice-versa.

The commentary below focuses on the underlying performance of the business, excluding the effects of items that management do not regard as ongoing, or routine, business activity. This approach to analysing underlying profit differs to that previously adopted in relation to the treatment of non-recurring costs and The Northern Rock Foundation donation. The definition has been aligned to that deemed appropriate for UKAR going forwards. Underlying performance also excludes unique items, including the repurchase of debt capital instruments and unrealised movements in fair value and hedge ineffectiveness relating to financial instruments which are expected to be held to maturity as opposed to being traded. Excluding these items underlying profit before tax was £277.4m (2009: £313.4m loss) mainly due to lower loan impairment in the unsecured loan book, lower funding costs following the transfer of retail deposit balances to NR and the lower cost of funds in relation to LIBOR linked funding. Analysis of the difference between the statutory accounting measure of profit and the underlying profit of NRAM is provided on page 11.

The ongoing cost/assets ratio reduced to 0.23% (2009: 0.28%) whilst the statutory cost/assets ratio increased to 0.43% (2009: 0.35%) mainly as a consequence of the level of one-off costs incurred in relation to the integration and restructure.

Total capital resources are £178m lower than 2009, although equity attributable to the shareholder is £1,157m higher, largely due to the repurchase of debt capital instruments and liability management exercises that took place in June and November.

Key performance indicators ('KPIs')

In addition to the primary Financial Statements, we have adopted the following KPIs in managing the business' performance in the context of its strategic priorities

Strategic priorities	Financial measures	2010	2009	Commentary
Financial performance	Underlying profit/(loss) before tax £m*	277.4	(313.4)	The underlying profit/(loss) of the business excludes non-recurring costs, particularly those associated with the integration with B&B and other one-off items including the repurchase of capital instruments, provision for customer redress and State aid claw-back in 2009. The year-on-year improvement is primarily due to reduced unsecured personal loan impairment, lower funding costs following the transfer of retail deposits to NR, and lower administrative expenses.
	Statutory profit/(loss) before tax £m	400.5	(257.5)	The year-on-year movement in statutory profit/(loss) before tax is primarily due to movements described above. In addition, the year-on-year impact of several significant unique items including an increased provision for customer redress in 2010 and State aid interest and fees clawback in 2009 are largely offset by fair value movements.
	Net interest margin % Underlying %*	1.99 1.99	1.51 1.24	The underlying margin improved primarily because of the change in the funding mix following the transfer of retail deposits to NR. Mortgage asset yield also increased due to lengthening of mortgage lives. Statutory net interest income in 2009 included clawback of £224m from HM Treasury.
Run down the Balance Sheet	Wholesale asset balances £bn	11.3	14.3	As part of the legal and capital restructuring £1.3bn transferred to NR. The remainder of the fall is made up of £1.1bn reduction in collateral cash, £0.4bn of maturities and reduced closing cash balances.
	Total lending balances £bn Secured £bn Unsecured £bn	47.8 44.7 3.1	64.3 60.4 3.9	In addition to the £10.3bn transfer of mortgage balances to NR, customer repayments reduced balances by £6.2bn (11%) during the year. Unsecured lending balances reduced by £0.8bn primarily due to repayments and the lack of new lending. Unsecured balances include both the Together and Standalone unsecured loan books.
	Residential loan redemptions £bn	4.3	7.4	Residential redemptions of £4.3bn were £3.1bn lower than last year reflecting the reduced size of the mortgage book following the transfer of balances to NR and the inability of customers to remortgage to other lenders.
	Loans from HM Treasury £bn	21.7	14.3	Loans increased by £8.5bn on 1 January 2010 as part of the legal and capital restructuring. £1.1bn of repayments have been made since that time.
Minimise impairment and losses **	Residential arrears over 3 months and possessions total mortgage balance %	0.37	0.24	The value of missed payments continued to rise in 2010 but at a slower rate than in 2009.
	Residential arrears over 3 months and possessions as % of the book - by value - by number of accounts	7.98 6.58	5.64 4.67	There was deterioration in both the value and number of accounts in arrears but the rate of increase was slower than in 2009 and balances of performing loans reduced due to the transfer to NR.
	Impairment provisions £m Assets cover % Unsecured £m Cover % Residential secured £m Cover %	542.3 14.8 1,013.0 2.23	564.3 12.6 596.1 0.98	The unsecured impairment charge in the year was significantly reduced but asset coverage increased to 14.8% and Balance Sheet provisions held at broadly the same level. Residential secured cover increased to 2.23% from 0.98%.
	Loan impairment charge £m Comprising Secured £m Unsecured £m	812.8 631.5 181.3	1,044.8 546.7 498.1	The loan loss impairment charge started to reduce in the second half of 2009. This has continued in 2010, although the second half impairment charge reflects alignment to UKAR provisioning methodology. The charge on secured loans increased by 16% whilst on unsecured personal loans the charge reduced by 64%.

Key performance indicators ('KPIs') (continued)

Strategic priorities	Financial measures	2010	2009	Commentary
Restructure and realign the business	Total costs £m Ongoing costs £m***	303 6 165 2	335 5 265 6	Both total and ongoing costs in 2010 cannot be directly compared to those of 2009 as NRAM has moved from incurring costs directly to being recharged by B&B and NR for services provided and in 2009 costs reflect the whole of NR. In general, cost reductions reflect the reduced size of NRAM following the transfer out of NR and cost efficiencies in terms of staffing and infrastructure.
	Cost : assets ratio** statutory % ongoing %***	0.43 0 23	0 35 0 28	The absolute value of costs in 2010 reduced on both a statutory and ongoing basis by £31.9m and £100.4m respectively. On an asset ratio basis both of these performances are adversely distorted by the transfer out of NR assets on 1 January 2010.

* Underlying results exclude certain items that are not expected to recur on an ongoing basis. An analysis of the difference between statutory and underlying profit/(loss) is provided on page 11. An analysis of the difference between statutory and underlying net interest income is provided on page 12.

**The transfer of assets on 1 January 2010 adversely impacts year-on-year arrears, impairment and cost ratios relative to assets on the book.

***Ongoing costs exclude certain items that are not expected to recur on an ongoing basis. An analysis of items excluded from ongoing costs is provided on page 15.

Financial review

Performance

Underlying net operating income was 27.5% higher in the year at £1,270.4m (2009: £996.3m), driven mainly by the reduction in cost of funds due to Government Funding replacing retail deposits upon the separation of NRAM and NR. Underlying net interest income at £1,259.9m (2009: £1,035.2m) was 21.7% higher, whilst underlying non interest income at £10.5m (2009: £38.9m charge) was better by £49.4m. Ongoing administrative expenses fell £100.4m to £165.2m (2009: £265.6m). Impairment losses on loans and advances to customers reduced by £232.0m to £812.8m (2009: £1,044.8m) and investment impairment losses at £15.0m (2009: £0.7m reversal) increased by £15.7m on 2009.

Income Statement

For the year ended 31 December

	2010 £m	2009 £m
Underlying net interest income	1,259.9	1,035.2
Underlying non interest income*	10.5	(38.9)
Underlying net operating income	1,270.4	996.3
Ongoing administrative expenses	(165.2)	(265.6)
Impairment on loans and advances to customers	(812.8)	(1,044.8)
Net impairment on investment securities	(15.0)	0.7
Underlying profit / (loss) before taxation	277.4	(313.4)
Unrealised fair value movements on financial instruments	417.7	106.0
Hedge ineffectiveness	(65.0)	(101.7)
Other net administrative expenses	(138.4)	–
Exceptional operating expenses	–	(39.9)
State aid clawback	–	200.0
Gain on repurchase of capital instruments	59.7	–
Provision for customer redress	(160.0)	(78.5)
The Northern Rock Foundation donation	–	(30.0)
Defined benefit pension scheme curtailment	9.1	–
Statutory profit / (loss) before taxation	400.5	(257.5)

*Underlying non interest income includes net fee and commission income/(expense), net realised gains less losses on investment securities and other operating income.

Net interest income

Underlying net interest income at £1,259.9m (2009: £1,035.2m) was 21.7% up on 2009.

Interest-earning assets fell by £20.0bn to £63.4bn (2009: £83.4bn). This reduction was partly driven by the transfer of assets (£12.5bn) to NR on 1 January 2010. The value of interest-earning assets transferred amounted to £11.6bn. The rest of the reduction of £8.4bn is due to residential mortgage and unsecured lending repayments and redemptions with fewer wholesale assets also a contributing factor.

The yield on interest-earning assets improved by 0.05% to 2.75% (2009: 2.70%), despite a fall in average underlying base rates, reflecting an adjustment made to the Effective Interest Rate ('EIR') calculation to reflect the lengthening lives of mortgages. The adjustment made more accurately accounts for EIR income, recognising the current inertia within the mortgage book.

The underlying cost of interest-bearing funding fell by 0.70% to 0.79% (2009: 1.49%), largely as a consequence of the change in funding mix following the transfer of retail deposits to NR. In addition, falls in average base rate and 1 month LIBOR had a positive impact on the cost of funding, because of the volume of funding where interest rates are linked to these indices.

Financial review (continued)

Statutory net interest income in 2009 included the benefit of clawback by NRAM of £223.9m on the previously incurred cost of Government net funding and HM Treasury guarantees, following approval for State aid by the EC in October 2009. This was partially offset by an additional fee of £23.9m, relating to the same period, resulting in the net benefit of £200.0m as shown on the face of the summary Income Statement above.

This was in effect a credit for a funding subsidy (the State aid) not provided until EC approval was given.

Net interest income	2010	2009
For the year ended 31 December	£m	£m
Interest receivable and similar income		
On secured advances	1,537.5	1,914.7
On other lending	131.0	170.1
On investment securities and deposits	73.3	164.4
Underlying interest receivable and similar income	1,741.8	2,249.2
Interest expense and similar charges		
On retail customer accounts	–	(323.4)
On other deposits including loans from HM Treasury	(191.1)	(324.3)
Other	(290.8)	(566.3)
Underlying interest expense and similar charges	(481.9)	(1,214.0)
Underlying net interest income	1,259.9	1,035.2
Average balances		
Interest-earning assets ('IEA')	63,425	83,396
Financed by		
- Interest-bearing funding	61,314	81,541
- Interest-free funding	2,111	1,855
Average rates %	%	%
Gross yield on average IEA	2.75	2.70
Cost of interest-bearing funding	(0.79)	(1.49)
Interest spread	1.96	1.21
Contribution of interest-free funding	0.03	0.03
Underlying net interest margin on average IEA	1.99	1.24
Annual average Bank Base Rate	0.50	0.65
Annual average 1-month LIBOR	0.56	0.83
	£m	£m
Underlying net interest income	1,259.9	1,035.2
Add back: State aid clawback	–	223.9
Statutory net interest income	1,259.9	1,259.1
Statutory net interest margin on average IEA %	1.99	1.51

Financial review (continued)

The contribution from interest-free funding was unchanged at 0.03% (2009: 0.03%) with average interest-free funding balances growing from £1.9bn in 2009 to £2.1bn in 2010.

Non interest income

Underlying non interest income at £10.5m (2009: £38.9m charge) was better than last year by £49.4m. The most material component was £21m of lower charges due to the removal of the retail deposit guarantee and fees, following the transfer of retail deposits to NR. NRAM for the first time received £7m of rental income from NR relating to the Gosforth office site.

Non interest income / (expense)	2010	2009
For the year ended 31 December	£m	£m
Underlying non interest income*	10.5	(38.9)
Unrealised fair value movements on financial instruments	417.7	106.0
Hedge ineffectiveness	(65.0)	(101.7)
HM Treasury fees	–	(23.9)
Provision for customer redress	(160.0)	(78.5)
Statutory non interest income	203.2	(137.0)

*Underlying non interest income includes net fee and commission income / (expense), net realised gains less losses on investment securities and other operating income.

Accounting volatility on derivative financial instruments

Volatility in reported results arises from the accounting treatment of derivative financial instruments that hedge risk exposure on an economic basis. Such accounting volatility, which is largely a timing effect that will offset over time, arises due to fair value movements on designated hedges or because effective hedge accounting has not been adopted or is not achievable on certain transactions, for example, hedging of equity instruments. NRAM manages its risk exposures on an economic basis and, therefore, does not include such accounting volatility in the assessment of underlying performance or in assessing the effectiveness of its derivative positions in any one financial period.

NRAM enters into derivative financial instruments for economic hedging purposes. Some of these are designated and accounted for as IAS 39 compliant fair value or cash flow hedge relationships. Where effective fair value hedge relationships can be established, the movement in the fair value of the derivative is offset in full or in part by opposite movements in the fair value of the instrument being hedged. Any ineffectiveness arising from different movements in fair value will offset over time. The charge for ineffectiveness in 2010 was £65.0m (2009: £101.7m).

Where derivatives are economically effective for hedging purposes but cannot be included within effective IAS 39 compliant accounting hedge relationships, for example where the underlying economically hedged instruments are included in equity, the movement in their fair value is recorded in non interest income. The same treatment applies to the revaluation at the balance sheet date of economically hedged foreign currency assets and liabilities. Fair value movements and hedge ineffectiveness, in total, benefited non interest income by £352.7m (2009: £4.3m) in the year due to the nature of movements in exchange rates and interest rates.

The major elements of these movements are a result of swaps held to hedge equity instruments, the covered bond and securitisation programmes.

Derivatives hedging subordinated debt instruments were terminated in June 2010 when the subordinated notes were repurchased, however their movement in the first 6 months of the year (due to movements in exchange rates between GBP and USD and in interest rates), resulted in a gain of £110.9m.

Financial review (continued)

The covered bond programmes (denominated in EUR and USD) have a GBP notional value of c. £9bn. These bonds and their associated derivatives are set-up as fair value hedges; thus the movement on the fixed interest rate cash flow of the derivative is mirrored by the movement on the bond. However, due to the size of the derivatives, a significant amount of volatility can still be derived from the LIBOR related cash flow of the swaps. A key contributor to this volatility is the movement in the cross currency basis spreads, which resulted in an increase in value for the year of £103.7m.

The disparity in accounting treatments between the bonds within the economic hedges of the securitisation programme, which are held at amortised cost and translated into sterling at spot prices, and the derivatives, which are fair valued on a daily basis and translated, generated an increase in value of £118.2m. The factors which drive the derivative valuations include relative movements between interest rates in GBP, EUR and USD.

HM Treasury fees

An additional fee of £23.9m was charged in 2009 as part of the overall State aid clawback. There was no similar adjustment in 2010.

Provision for customer redress

As at 31 December 2009, NRAM held a provision in respect of customer compensation of £72.4m, of which £71.4m related to claims for compensation from customers regarding Payment Protection Insurance ('PPI'), and £1.0m related to other general customer claims. During the year, the level of customer complaints regarding PPI sales has increased significantly with 14,600 (2009: 8,000) received in the year, of which 8,800 were made in the second half. Of the opening provision, £29.3m has been utilised in 2010 and based on the increase in claims, our root cause analysis and follow-up work into the selling processes adopted by NR in the past, a further provision of £155.0m has been made to cover the cost of the claims anticipated in the future. In addition to PPI, claims for other mis-sold products, such as endowments, continue, albeit much fewer than PPI, and a further provision of £5.0m is made for these general claims. We expect future claims to be settled over the next few years. The exact amounts and timing of the settlements will depend upon the level and value of future claims which could differ from the estimates used in the establishment of this provision and could also be impacted by the outcome of the ongoing judicial review into the FSA's policy statement PS 10/12 on PPI.

Ongoing administrative expenses

With effect from 1 January 2010, all employees of the former Northern Rock transferred to NR and, with effect from 1 November 2010, staff who were servicing the requirements of NRAM transferred from NR to B&B under the TUPE regulations. NRAM, therefore, did not directly employ any staff during 2010. Instead, NRAM was charged for services provided, the charges being governed by service agreements put in place with each service provider. Consequently, these arrangements have a significant bearing on the composition of administrative expenses in 2010.

Ongoing administrative expenses totalled £165.2m (2009: £265.6m), with the ratio of costs to assets improving to 0.23% (2009: 0.28%). The reduction in 2010 costs and improvement in the cost/asset ratio were mainly the result of the separation of NRAM from the former Northern Rock and efficiencies built into the set-up of NRAM commensurate with its ongoing objectives to run-down the loan book. The reduction in cost not only related to staffing but all other administrative expenses incurred in respect of supporting the business, with much of the NRAM office complex in Gosforth now being occupied by NR, for which rent is received.

The UKAR Group has incentive schemes in place which have been agreed with UKFI. These enable staff to earn bonuses which are aligned to Company and individual performance. For 2010, bonuses, including those of the Executive Director, of £5.5m were earned. £4.7m of these will be paid in 2011, and the remainder will be deferred and paid in future years. All deferred bonuses are subject to clawback terms.

Financial review (continued)

Administrative expenses	2010	2009
For the year ended 31 December	£m	£m
Administrative expenses directly incurred	39.4	265.6
Recharges	125.8	–
Ongoing (underlying) administrative expenses	165.2	265.6
The Northern Rock Foundation donation	–	30.0
Exceptional operating expenses	–	39.9
Other net administrative expenses		
– Impairment of goodwill	30.7	–
– Accelerated depreciation	51.8	–
– Transformation costs	47.2	–
– Restructure costs	8.7	–
Total other net administrative expenses	138.4	–
Total administrative expenses	303.6	335.5
Ratio of ongoing costs to assets %	0.23	0.28
Ratio of costs to assets %	0.43	0.35

Other net administrative expenses

Other net administrative expenses include transformation and restructuring costs of £55.9m relating to the costs of restructuring and separation from NR, the goodwill impairment charge of £30.7m in respect of acquired mortgage businesses now fully written down because NRAM can no longer originate new loans, and a charge of £51.8m in respect of a revaluation of a proportion of the office complex in Gosforth which is currently leased to NR and was, consequently, reclassified as an investment property during the year.

In 2009, exceptional costs of £39.9m were mainly in respect of activities undertaken in relation to the separation of the former Northern Rock business into NRAM and NR. These costs are similar to those incurred in 2010 in relation to transformation costs but nevertheless were classified as exceptional.

The former Northern Rock made a charge of £30.0m in the 2009 Income Statement in respect of the contribution of £15.0m paid in that year and £15m paid in 2010 to The Northern Rock Foundation. NRAM has no continuing commitment to The Foundation.

Impairment on loans and advances to customers

As expected during an economic downturn, arrears levels increased during the year with 23,435 (2009: 22,564) accounts more than 3 months in arrears representing 6.07% (2009: 4.28%) of all accounts. This compares to 5.32% on 1 January 2010 following the transfer of £10.3bn residential loans to NR. The impact of transferring out the NR balances means that the level of arrears as a proportion of a reduced balance increases.

The arrears performance of the unsecured loan book deteriorated in respect of the number of accounts over 3 months in arrears. In total, arrears in the Together unsecured loan book experienced an increase to 9.61% (2009: 6.09%) and the Standalone unsecured loan book saw an increase to 5.73% (2009: 3.63%).

Financial review (continued)

Arrears and loan impairment: secured residential loans

As reported last year, the loan loss impairment charge started to reduce in the second half of 2009. This has continued in 2010, albeit the second half impairment charge reflects an amount for house price deflation expected in 2011 and, given the current outlook for the UK housing market to remain depressed for the foreseeable future, this is considered to be an appropriate position to take.

In respect of the secured residential book, the level of provision as at 31 December 2010 amounted to £1,013.0m compared to £596.1m at the end of 2009. As a proportion of residential assets this represented 2.23% compared to 0.98% for 2009. Coverage of arrears and possessions increased to 28.63% from 17.59% for 2009. The transfer of asset and liability balances comprising the NR business on 1 January 2010 did not materially affect the arrears and possession asset values, but does significantly affect the provision as a proportion of total residential assets because assets transferred to NR had negligible arrears.

Secured residential loans arrears and possessions

At 31 December	2010	2009
Arrears over 3 months		
– number of cases	23,435	22,564
– % of total cases	6.07	4.28
– value of cases in arrears (£m)	3,284.4	3,135.0
– % of book	7.41	5.22
Possessions		
– number of cases	1,984	2,061
– % of total cases	0.51	0.39
– value (£m)	254.1	254.6
– % of book	0.57	0.42
Total arrears over 3 months and possessions		
– number of cases	25,419	24,625
– % of total cases	6.58	4.67
– value (£m)	3,538.5	3,389.6
– % of book	7.98	5.64
Payments overdue		
total value of payments overdue (£m)	162.7	145.9
– % of total book	0.37	0.24
Residential loan impairment allowance		
Impairment allowance (£m)	1,013.0	596.1
– % of residential assets	2.23	0.98
– % of arrears and possessions	28.63	17.59

Financial review (continued)

Loan impairment: unsecured loans

In respect of unsecured loans, the total balance sheet provision was broadly the same at £542.3m (2009: £564.3m). As a proportion of the unsecured book, this represented 14.8% (2009: 12.6%), up on the level evident at the end of 2009.

The charge for loan impairment in 2010 was much reduced at £181.3m (2009: £498.1m), an improvement of £316.8m.

Unsecured loans impairment	2010	2009
At 31 December	£m	£m
Asset value before impairment provision	3,656.1	4,476.9
Balance sheet impairment provision	(542.3)	(564.3)
Asset value net of impairment provision	3,113.8	3,912.6
Total asset coverage %	14.8%	12.6%

Net impairment on investment securities

In the first half of 2010, there were impairment losses on loans and receivables of £7.3m and available-for-sale securities of £8.1m. This position has not changed materially at the year end. The impairment losses on available-for-sale securities moved to the 'net impairment on investment securities' caption. The total level of impairment in the year was therefore £15.0m (2009: £0.7m reversal).

Gain on repurchase of capital instruments

The repurchase of capital instruments in 2010 with a carrying value of £1,343.0m resulted in total gains of £950.7m. Of this value, £59.7m was recognised through the Income Statement in respect of instruments classified as liabilities. The balance of the gain, £891.0m arising from instruments classified as equity, was recognised in Shareholder equity.

Defined benefit pension scheme curtailment

Closure of the defined benefit pension scheme as a result of the transfer of all employees to NR at the beginning of 2010 resulted in a one-off £9.1m curtailment gain.

Taxation

A credit of £9.1m of tax for the year is reported. Current year profits have been offset by brought forward tax losses resulting in no current tax charge for the year. Prior year adjustments relate to the settlement of certain previously outstanding items with HMRC resulting in the credit of £9.1m.

Deferred tax liabilities have been offset against relevant deferred tax assets in the year. Further deferred tax assets have not been recognised due to the uncertainty over interest rates chargeable on the loan from HM Treasury, given that this rate may be varied and could, therefore, potentially reduce or eliminate future profit.

Financial review (continued)

Balance Sheet

Balance Sheet summary

At 31 December (unless stated otherwise)

	2010 Statutory £m	01/01/2010 Adjusted £m	Final adjustment £m	Transfer to NR £m	2009 Statutory £m
Loans and advances to customers					
– Residential mortgages	44,332.3	49,724.6		(10,343.1)	60,067.7
– Commercial secured loans	312.4	287.9		–	287.9
– Unsecured lending	3,113.8	3,912.4		(0.2)	3,912.6
Wholesale assets	11,321.2	12,332.7	(668.4)	(1,299.5)	14,300.6
Fair value adjustments on portfolio hedging	539.6	971.3		(160.3)	1,131.6
Derivative financial instruments	6,542.5	7,473.8		–	7,473.8
Other assets	114.9	197.4		(73.9)	271.3
Total assets	66,276.7	74,900.1	(668.4)	(11,877.0)	87,445.5
Loans from HM Treasury	21,713.4	22,821.5	8,506.0	–	14,315.5
Wholesale funding	40,784.1	47,760.7		(235.3)	47,996.0
Customer accounts	–			(20,607.6)	20,607.6
Derivative financial instruments	826.4	1,673.8		–	1,673.8
Other liabilities	1,634.4	1,589.9		(207.6)	1,797.5
Other capital instruments	209.1	1,441.1			1,441.1
Equity	1,109.3	(386.9)		(0.9)	(386.0)
Total liabilities and equity	66,276.7	74,900.1	8,506.0	(21,051.4)	87,445.5

The closing statutory Balance Sheet as at 31 December 2009 reflects the closing position for NRAM before the subsequent transfer out on 1 January 2010 of NR balances as previously disclosed, together with the final settlement adjustments to arrive at a revised Balance Sheet position, which is comparable in composition to that at 31 December 2010. The final settlement adjustments represent a draw-down on HM Treasury funding to maintain NRAM's Balance Sheet and a balancing settlement to NR in cash being the difference between all other assets and liabilities transferred.

Assets

Lending balances, excluding those transferred to NR, reduced by 11% during the year to £47.8bn (January 2010 £53.9bn). This reflected £4.9bn of redemptions and £1.3bn of other repayments, partly offset by £0.4bn of lending to existing customers which we were contractually obliged to uphold. With effect from 1 January 2010 NRAM did not offer new lending products.

Liabilities

Wholesale liabilities reduced by £7.0bn reflecting repayments and changes in exchange rates. The reduction in other capital instruments is a result of the two debt capital tender exercises resulting in the repurchase of £1,343m of instruments.

At the end of 2010, the net amount due to Government, after deducting liquidity deposits held with the Bank of England (excluding deposits relating to swap collateral), was £18.4bn. The gross loan balance, after taking account of the £8.5bn advanced on 1 January 2010 to facilitate the separation of NR, has reduced by £1.1bn since 1 January 2010.

The £8.5bn advanced on 1 January 2010 allowed additional cash resources to be provided to NR in connection with the transfer of its deposit liabilities and enabled NR to continue to increase mortgage lending, supporting mortgage market capacity.

Financial review (continued)

	At 31 December 2010 £bn	At 1 January 2010 £bn	At 31 December 2009 £bn
HM Treasury loan			
Gross amount due to HM Treasury	21.7	22.8	14.3
Liquidity deposit accounts with Bank of England	(3.3)	(2.9)	(3.6)
Net amount due to HM Treasury	18.4	19.9	10.7

Capital

NRAM met its capital requirements in full throughout the year and has received no additional capital from HM Treasury

NRAM is subject to the MIPRU regulatory regime under which the concepts of tier 1 and tier 2 capital are not relevant. The Board consider core equity at a Group level, formerly tier 1 capital, of pre-eminent importance in the capital structure of the business and continue to monitor this, in addition to the total level of capital.

The table below sets out capital resources at 31 December

Capital resources – Company	2010	2009
At 31 December	£m	£m
Total equity attributable to equity Shareholder	1,243.7	87.0
Reserve capital instruments	156.2	299.3
Tier one notes	135.7	233.7
Subordinated notes	52.9	1,141.8
Subordinated liabilities	905.0	909.2
Total available capital resources	2,493.5	2,671.0

Total capital resources are £177.5m lower than 2009, although total equity attributable to the equity Shareholder is £1,156.7m higher, mainly due to the £950.7m gains arising following the repurchase of debt capital instruments.

Under the MIPRU regulatory regime, the minimum capital resource requirement is set at 1% of total Balance Sheet assets and any undrawn commitments. However, this requirement is set at the Company level as opposed to the Group consolidated position.

For the NRAM Company, the total value of Balance Sheet assets and undrawn commitments as at 31 December 2010 amounted to £62,631m and £2,520m respectively, totalling £65,151m of which 1% is £652m.

The MIPRU rules, as indicated, require a minimum capital resource of 1% of total assets and undrawn commitments, and there is no provision within the MIPRU rules to extend regulatory requirements above this amount. However, the Board still consider that the assessment of capital adequacy requirements should include the full range of material risks that each legal entity faces. Consequently, and in agreement with the FSA, the Board maintains capital levels above the 1% minimum requirement.

Corporate governance

Introduction

On 24 March 2010 the then Chancellor announced the Government's intention to integrate NRAM and B&B under a single holding company and the Shareholder asked Richard Pym, Chairman of the two companies, to chair the new holding company. A Committee comprising Richard Pym together with a Non-Executive Director of NRAM, a Non-Executive Director of B&B and two representatives from UKFI was formed to recruit a Chief Executive. Following a selection process, the Committee's recommendation to appoint Richard Banks was ratified by the Shareholder and received Ministerial approval on 31 March 2010.

On 9 April 2010 UKFI announced the appointment of Richard Pym as Chairman designate and Richard Banks as Chief Executive designate of the single holding company. It was agreed that the three companies, UKAR, NRAM and B&B, would share a common Board of Directors comprising Executive and Non-Executive Directors from both the NRAM and B&B boards and a representative from UKFI. These Non-Executive Directors formed designate Board, Nominations and Remuneration Committees and met at various times from May 2010 to review and agree the progress of establishing the holding company, the structure and senior management appointments for the three companies.

UKAR was formally incorporated on 1 July 2010 and on 1 October 2010 UKFI announced the establishment of UKAR as the new holding company for NRAM and B&B. Richard Pym was formally appointed as Chairman of UKAR and Richard Banks Chief Executive. UKAR's Non-Executive Directors comprised Keith Morgan, Head of Wholly-Owned Investments at UKFI and Non-Executive Directors from NRAM (Kent Atkinson, Bob Davies and Sue Langley) and B&B (Michael Buckley, Louise Patten and John Tattersall). These Board appointments were also made at each of NRAM and B&B in order to achieve a common composition of Directors for the three companies.

The wholly-owned subsidiary companies, NRAM and B&B, remain as separate legal entities with their own Balance Sheets and Government support arrangements whilst having the same Directors.

NRAM intends to operate a governance structure which, as far as practicable, takes appropriate account of best practice for a company listed on the Official List, including where practicable complying with the requirements of the listing rules and the UK Corporate Governance Code of the United Kingdom Listing Authority and the guidance on corporate governance of the Financial Reporting Council.

This corporate governance section summarises:

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

The Financial Review on pages 11 to 19 also address certain governance matters in relation to events in 2010.

Our Board

On 1 October 2010 UKAR was established as the holding company for NRAM and B&B, bringing together the two companies under shared management and a common Board of Directors. The individual profiles included in this section therefore set out the Directorships of each of UKAR and B&B as well as NRAM at 31 December 2010.

Richard Pym - Non-Executive Chairman

Richard became Chairman of UKAR in July 2010 having been appointed Chairman of B&B in November 2008 and NRAM in January 2010. He also chairs the Nominations Committees of all three companies.

Richard is a Non-Executive Director of The British Land Company PLC and Non-Executive Chairman of BrightHouse Group Ltd and Nordax Finans AB. He was Group Chief Executive of Alliance & Leicester plc until July 2007, and prior to that he held a number of financial and general management roles at The Burton Group plc, BAT Industries plc, British Gas and Thomson McIntock & Co. Formerly a Vice President of the British Bankers' Association, a Non-Executive Director of Old Mutual plc and Selfridges plc, and Chairman of Halfords Group plc, Richard is a Fellow of the Institute of Chartered Accountants in England and Wales and a physics graduate of the University of Warwick.

Corporate governance (continued)

Kent Atkinson - Senior Independent Director

Kent joined the Boards of UKAR and B&B in October 2010, and has been a Non-Executive Director of NRAM (previously NR) since August 2008. He is the Senior Independent Director, Chairman of the Audit Committees and a member of the Risk Committees of all three companies.

Kent was previously Group Finance Director of Lloyds TSB Group plc, and subsequently a Non-Executive Director. He is the Senior Independent Director and Chairman of the Audit Committee of Coca-Cola HBC SA. He is a Non-Executive Director, Chairman of the Group Audit and Compliance Committee, and a member of the Risk and Capital Committee and the Investment Committee of Standard Life plc. He is a Non-Executive Director and member of the Audit Committee and the Strategy and M&A Committee of Gernalto NV. He was formerly the Senior Independent Director and Chairman of the Audit Committees of Cookson Group plc and Telent plc (previously Marconi Corporation plc), and a Non-Executive Director of Millicom International Cellular S.A.

Richard Banks - Chief Executive Officer

Richard became Chief Executive Officer of UKAR in July 2010 and was appointed Chief Executive Officer of NRAM and B&B in October 2010.

Before joining the Board of B&B as Managing Director in May 2009, Richard's career has been in retail and commercial banking, he was previously a Director of Alliance & Leicester plc where he was Group Risk Director and before that Managing Director of Commercial Banking. He is also a Non-Executive Director of ICICI Bank UK PLC and a Non-Executive Director of Liverpool Compact, which provides work experience for 14-19 year olds. Richard has a BA in Business Studies, and is an Associate of the Chartered Institute of Banking.

Michael Buckley - Non-Executive Director

Michael has been a Non-Executive Director of B&B since July 2007 and joined the Boards of UKAR and NRAM in October 2010. He is a member of the Audit, Risk and Nominations Committees of all three companies.

Michael is Non-Executive Chairman of DCC plc and a Non-Executive Director of M&T Corporation in the USA. He is also a senior adviser to a number of privately held Irish and US based companies, serves on McKinsey and Company's European Banking Practice Advisory Board and is an Adjunct Professor at the Department of Economics at NUI University College, Cork. He was Group Chief Executive of Allied Irish Banks plc from 2001 to 2005 having earlier served as Managing Director of AIB Capital Markets and AIB Poland. Previously, he was Managing Director of the NCB Group, and a senior public servant in Ireland and the EU.

Sue Langley - Non-Executive Director

Sue joined the Boards of UKAR and B&B in October 2010, having joined the Board of NRAM in January 2010. She is Chairman of the Remuneration Committee and a member of the Nominations Committee of all three companies.

Sue is currently Director of Market Operations for Lloyd's of London, joining in July 2007, and Chairman of Lloyd's Japan. Previously, she was Chief Operating Officer and a member of the Executive team for the Hiscox Group and Board member for Hiscox Syndicates and Hiscox Insurance. Sue is currently a Director of ACORD and Trustee of the Lloyd's Charities Trust. Prior to joining Hiscox, Sue worked for Thomson Tour Operations and PricewaterhouseCoopers LLP, where she was a Principal Consultant specialising in change management.

Keith Morgan - Non-Executive Director

Keith joined the Boards of UKAR and B&B in October 2010, having joined the Board of NRAM in January 2010. He is a member of the Risk and Remuneration committees of all three companies.

Keith is Head of Wholly-Owned Investments at UKFI, responsible for managing the Government's shareholdings in UKAR, B&B, NRAM and NR.

Keith joined UKFI from Banco Santander. Until July 2009, he was a Director of Sovereign Bancorp in the U.S.A. focusing on the integration of Sovereign into Santander. He was previously Director of Strategy & Planning at Abbey National, where he was a member of the Executive Committee, and was also Chairman of Santander's Asset Management and Credit Card businesses in the UK. Before joining Abbey in 2004, Keith spent 18 years at L.E.K. consulting, where he was a partner specialising in financial services.

Corporate governance (continued)

Louise Patten - Non-Executive Director

Louise joined the Boards of UKAR and NRAM in October 2010, and has been a Non-Executive Director of B&B since December 2003. She is a member of the Remuneration Committee and the Nominations Committee of all three companies.

Louise is a Non-Executive Director of Marks and Spencer Group plc as well as senior adviser to Bain & Co. She began her career at Citibank and remained in financial services until 1993, when she joined the management consultancy, Bain & Co, as a partner. Her previous experience as a Non-Executive Director includes the Hilton Group, Brixton plc, Great Universal Stores and Somerfield.

John Tattersall - Non-Executive Director

John joined the Boards of UKAR and NRAM in October 2010, having joined the Board of B&B in April 2010. He is Chairman of the Risk Committees and a member of the Audit Committees of all three companies.

John retired as a partner in PricewaterhouseCoopers LLP in 2009, where he had worked since 1975, latterly as leader of the firm's Financial Services Regulatory Practice and a senior client relationship partner. He started his career in the financial services sector with Kleinwort Benson Limited in 1973. Until 2009 he was Chairman of the Risk and Regulation Committee of the Financial Services Faculty of the Institute of Chartered Accountants in England and Wales, and a member of the faculty board. He is currently a Non-Executive Director of R Raphael & Sons PLC (Raphael's Bank), CCLA Investment Management Limited and the South East Institute for Theological Education and a member of the Independent Commission on Equitable Life payments. He is also a board member of the Gibraltar Financial Services Commission, a member of the court of the Royal Foundation of St Katharine, and a non-stipendiary priest in the Church of England. He acted as Consultant Editor and joint author of two recent books 'A Practitioner's Guide to the Basel Accord' and 'A Practitioner's Guide to FSA Regulation of Banking'.

Details of Board appointments and retirements during 2010 are as follows

Richard Pym	Non-Executive Chairman for the whole year
Kent Atkinson	Director for the whole of 2010
Richard Banks	Appointed 1 October 2010
Michael Buckley	Appointed 1 October 2010
Bob Davies	Director for the whole of 2010, resigned 31 December 2010
Gary Hoffman	Resigned 1 October 2010
Sue Langley	Director for the whole of 2010
Keith Morgan	Director for the whole of 2010
Louise Patten	Appointed 1 October 2010
Philip Remnant	Resigned 1 October 2010
Andy Tate	Resigned 1 October 2010
John Tattersall	Appointed 1 October 2010

Corporate governance (continued)

Board and Committee meetings

During 2010, the number of meetings attended by each Director was as follows

	Board	Audit	Remuneration	Risk
Number of meetings held	15	5	4	5
R A Pym – Chairman	15/15		2/2	
M K Atkinson	15/15	5/5		4/5
R L Banks	4/4			
M D Buckley	4/4	0/1		0/1
R J Davies – resigned 31 December 2010	13/15		4/4	
G A Hoffman – resigned 1 October 2010	11/11		2/2	
S C Langley	15/15		4/4	4/4
K C W Morgan	15/15	4/4	2/2	5/5
L A V C Patten	3/4		2/2	
P J Remnant – resigned 1 October 2010	8/11	4/4		
A M Tate – resigned 1 October 2010	11/11			
J H Tattersall	4/4	1/1		1/1

In addition there was one further Board meeting and four Committee meetings which dealt with specific issues where only a restricted number of Directors attended

There were no meetings of the Nominations Committee in 2010 with all appointment related matters being considered by the Board

Throughout 2010, the Chairman of each Committee was as follows

Audit Committee	Kent Atkinson	1 January 2010 to 31 December 2010
Risk Committee	Keith Morgan	1 January 2010 to 30 September 2010
	John Tattersall	1 October 2010 to 31 December 2010
Remuneration Committee	Bob Davies	1 January 2010 to 31 December 2010
Nominations Committee	Richard Pym	1 January 2010 to 31 December 2010

The current membership of the Committees is set out on pages 26 and 27

Corporate governance (continued)

Governance structure

Since the transfer to public ownership, the governance structure has been determined by a framework document ('the Framework Document') agreed between the Company and its ultimate Shareholder, HM Treasury. The Framework Document has been updated periodically to reflect changing circumstances and most recently was amended to reflect the establishment of the UKAR Group.

UKAR, as the Company's Parent, is responsible for ensuring that it adopts and adheres to the provisions of the Framework Document, where such provisions relate or refer to it.

The Company operates in accordance with the terms of the latest revision to the Framework Document, 'UK Asset Resolution Limited and UK Financial Investments Limited Relationship Framework Document', which sets out how the relationship between the Company and UKFI, acting on behalf of HM Treasury, will work in practice. The terms of this agreement are reflected below and throughout this report.

The Framework Document is intended to ensure that the relationship between the companies in the UKAR Group, UKFI, HM Treasury (as ultimate Shareholder and the provider of financial support) and the FSA (as regulator), operates in the context of the over-arching objective of maximising value for the taxpayer, whilst paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. The Framework Document requires the UKAR Group to deliver a strategic and funding business plan to achieve these objectives.

The principles of the Framework Document

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

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

Board structure and governance

Under the terms of the Framework Document the Board operates the following committees:

- Audit Committee,
- Risk Committee,
- Remuneration Committee, and
- Nominations Committee.

Further details about the Board Committees and their role are provided on pages 26 and 27.

During 2010 and early 2011 the Board reviewed and updated its governance processes in light of changes to the corporate structure, emerging best practice and the requirements of the Plan. Whilst a number of these processes have been outsourced under a service agreement with NR or undertaken by other companies within the UKAR Group, the ultimate responsibility for governance issues rests with the Board.

Corporate governance (continued)

Board appointments and composition

UKFI considers that the composition of the Board is a critical factor and seeks to secure an environment in which it shares a common view about Board composition and succession with the Chairman including size and balance of experience and background. To achieve this and ensure that a common governance approach is applied across the UKAR Group, UKAR and its subsidiary companies (NRAM and B&B) operate under the following principles

- The Chairman and either the Chairman of UKFI or a senior employee nominated by the Chairman of UKFI ('the Nominated Officer'), will discuss and confirm Board composition and succession regularly in the light of performance and the requirements of the Plan,
- UKFI will be entitled to appoint to the Board one or more Non-Executive Directors nominated by UKFI (the 'Shareholder Directors'). Mr Morgan is currently appointed as such a Director. The Company acknowledges that the Shareholder Directors intend to liaise with and report to representatives of UKFI from time to time in relation to the business of the Company and decisions made, or to be made, by the Board in order to assist with the exercise of their powers and duties as Directors of the Company,
- One or more senior representatives of UKFI will, if so requested by UKFI, attend meetings of the Board in an observer capacity,
- The Chairman will discuss with the Nominated Officer any impending changes to Board membership,
- The Chairman of the Nominations Committee will meet with the Nominated Officer as necessary to obtain UKFI's approval to any proposed Board changes before they become subject to the formal appointment/consent procedure. The Company's Articles of Association require that at every Annual General Meeting each Director, other than the Shareholder Directors who are expressly exempt from this provision, shall retire from office and may offer themselves for re-appointment,
- Non-Executive Directors are appointed for a specified term, normally one year, subject to re-appointment in accordance with the above procedures, and
- The Board will ensure that suitably rigorous appraisals are made of the effectiveness of the Chairman and the Board

Board responsibilities

During 2010, the Board was responsible for developing and delivering the Plan to restructure the Company in order to meet the State aid requirements of the European Commission.

The Board is responsible for

- Setting the Company's strategic aims and for developing and recommending revisions to the Plan to deliver the over-arching objective of protecting and creating value for the taxpayer, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition. Any proposed revisions to the Plan will be subject to review and approval by UKFI,
- Delivering the Plan in accordance with the requirements of the Framework Document. In this respect, decisions on the day-to-day running of the Company, subject to the Framework Document and the Company's Articles of Association, rest with the Board in accordance with the Directors' statutory, common law and fiduciary responsibilities. UKFI is committed to giving the Board the freedom necessary to deliver the agreed Plan and will not interfere in day-to-day operational and commercial matters, and
- Ensuring that the necessary financial and human resources are in place for the Company to deliver the agreed Plan, set the Company's values and standards and ensure that its obligations to HM Treasury as ultimate Shareholder are understood and met.

The Board has a written schedule of those matters reserved for its determination and those matters reserved for UKFI, in accordance with the Framework Document.

Balance of Executive and Non-Executive Directors

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

Corporate governance (continued)

Monitoring performance

UKFI will regularly monitor the Company's performance against the Plan by means of the following main mechanisms

- Meetings between the Company and UKFI to review performance to date against the Plan, and
- Monthly (or, at UKFI's request, more frequent) financial and business performance monitoring to track the progress of the Plan and the Company's performance against agreed objectives on a timely, regular and appropriate basis

In addition, UKFI has certain monitoring and information access rights and its approval must be obtained for certain material actions and transactions

Board Committees

The Board operates a number of Committees, each of which has detailed terms of reference setting out its remit and authority. Details of the membership and role of each Committee are set out below.

Audit Committee

The Audit Committee currently comprises Kent Atkinson (Chairman), Michael Buckley and John Tattersall, all of whom are Non-Executive Directors.

The Audit Committee met five times in 2010.

The Committee monitors, reviews and advises the Board on:

- All regulatory, prudential and accounting requirements that may affect the Company,
- The integrity of the Financial Statements and external reporting responsibilities,
- The Company's whistleblowing policy, and
- The results of the external audit and any significant matters identified.

The Committee approves the terms of reference for Internal Audit and reviews the adequacy and effectiveness of the activities undertaken. In addition, the Committee reviews the effectiveness of the system of internal control annually in accordance with the UK Corporate Governance Code.

The Committee received reports at each meeting (other than meetings held specifically to consider the Company's results) from the managers responsible for Audit. These reports highlight existing and emerging matters of significance, areas of concern, planned actions, monitoring procedures and any other matters which are likely to impact on internal controls and financial reports.

The Committee is responsible for recommending the appointment, re-appointment and removal of the external auditors. It reviews the scope and results of the annual external audit, its cost effectiveness and the independence and objectivity of the external auditors. The Committee also reviews the nature and extent of non-audit services provided by the external auditor to ensure that these do not impair the auditor's independence or objectivity.

The external auditors may attend all meetings of the Committee and they have direct access to the Committee and its Chairman at all times. The Head of Internal Audit provides further assurance that the significant risks identified by the business are properly managed. The Head of Internal Audit also has direct access to the Audit Committee and its Chairman. The Committee regularly receives reports of reviews conducted throughout the Company by the Internal Audit function.

In 2010, the 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 2010 Annual General Meeting.

Corporate governance (continued)

Risk Committee

The Risk Committee currently comprises John Tattersall (Chairman), Kent Atkinson, Michael Buckley and Keith Morgan, all of whom are Non-Executive Directors

The Risk Committee met five times during 2010

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

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

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

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

Remuneration Committee

The Remuneration Committee currently comprises Sue Langley (Chairman), Louise Patten and Keith Morgan, all of whom are Non-Executive Directors

The Remuneration Committee met four times in 2010

The Committee has regard to recommendations from the UKAR Remuneration Committee and subject to compliance with the requirements of the Framework Document, the Committee is responsible for advising the Board on the remuneration arrangements for FSA Code employees including Executive Directors. The Committee also reviews and recommends to the Board the remuneration arrangements and policies for those executives directly below Board level and the remuneration policies for all other staff

The Committee takes internal and external professional advice where necessary to discharge its obligations

Nominations Committee

The Nominations Committee currently comprises Richard Pym (Chairman), Michael Buckley, Sue Langley and Louise Patten all of whom are Non-Executive Directors. The Committee did not meet during 2010 with all nominations related matters being considered by the Board

Subject to compliance with the requirements of the Framework Document and oversight by UKFI, the Committee is responsible for reviewing the composition of the Board and preparing succession plans. The Committee is also responsible for identifying potential Executive and Non-Executive Directors and making recommendations to the Board concerning the appointment or re-appointment of Directors, having regard to the requirement for the Board to have the appropriate range of skills and experience

The Committee also reviews the leadership needs of the Company and succession plans for key executive roles

Management Committees

The Company operates a number of Management Committees, including the Executive Committee, details of which are set out on pages 30 to 32

Relationship between the Chairman and the Chief Executive Officer

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

Corporate governance (continued)

Induction and training

The Board requires all newly appointed Directors to undergo a formal induction training programme appropriate to their skills and experience, to ensure that they

- Are fully aware of their role, duties and responsibilities as a Director, and
- Have a good understanding of the operation of the business, so as to contribute effectively

The Board also requires Non-Executive Directors to undertake relevant ongoing training and development to improve their capabilities and thereby contribute more effectively to Board decision making

The Board has a comprehensive thematic training programme

Board evaluation

Following numerous Board changes in 2010 and with a Shareholder representative Director present at Board meetings, it was agreed by the Board that a thorough evaluation process would be deferred until 2011

Board procedures

To ensure that the Board functions effectively, Directors have full and timely access to all information which may be relevant to the discharge of their duties and obligations. All Directors have access to the advice and services of the Company Secretary who is responsible for ensuring that Board procedures and applicable rules are followed. Where necessary, Directors are able to take independent professional advice at the Company's expense.

Internal control and risk management

The Board is responsible for the Company's system of internal control and seeks regular assurance to satisfy itself that the system is functioning effectively in managing risks in the manner which it has approved. Such a system can only provide reasonable, and not absolute, assurance against material misstatement or loss, as it is designed to manage, rather than eliminate the risk of failure to achieve business objectives. Throughout the year ended 31 December 2010, the Company has operated a system of internal control, which includes an ongoing risk management process for identifying, evaluating and managing the significant risks faced by the Company. During the year, the Board has continued to review the effectiveness of the Company's system of financial and non-financial controls including operational and compliance controls, risk management and the Company's most significant risks and mitigating actions.

In addition, as part of the process of preparing this statement, the Board has also performed its annual assessment of the effectiveness of internal controls. The Board of Directors is not aware of any significant failures in internal control that arose in the business of the Company during 2010 that are not being addressed in accordance with the internal control procedures of the Company. Management regularly takes action to improve internal controls, either as a result of its own initiative or in response to reports from Internal Audit and other oversight review functions.

Changes in financial regulation continue within the industry. The Company's risk management processes are kept under regular review to ensure that the Company responds appropriately to both implemented and proposed regulatory changes.

The Company operates a risk management process, producing a Company-wide risk profile. This identifies the Company's significant risks, the probability of those risks occurring and their impact should they occur, and has the prime responsibility for the design and operation of suitable controls and mitigating actions. The risk management process is complemented by a formalised reporting and escalation process for control issues. Internal Audit has a key role in maintaining the control environment by providing independent assurance on the effectiveness of the Company's internal control systems. The Risk Committee and the Audit Committee oversee the risk management process, regularly consider the Company-wide risk profile, and receive monitoring reports to update it on progress.

The Company is committed to developing and maintaining an appropriate risk management framework and culture with the aim of continuing to ensure that management understand the key risks that the business faces. This is achieved through an organisational structure with clear reporting lines and governed by appropriate business monitoring mechanisms, codes of conduct and policy statements.

Corporate governance (continued)

Internal control and risk management (continued)

The system of internal control has been in place throughout 2010 and up to the date of approval of the Annual Report & Accounts

In reviewing the effectiveness of this system, the Board takes into account the work of the Risk Committee which reviews the Company's significant risks and how these are being managed. The Risk Committee also considers reports from Compliance and management on the system of internal control, adherence to regulatory requirements and material control weaknesses, where these exist, together with actions taken to address them. The Audit Committee considers reports from Internal Audit and External Audit on the system of internal control and material control weaknesses, where these exist, together with actions taken to address them.

The Chairmen of the Risk Committee and the Audit Committee report on the outcome of each meeting to the Board, where appropriate, and the Board also receives minutes of these Committee meetings.

Going concern

As set out in note 1 to the Financial Statements, HM Treasury has provided various on-demand facilities to the Company and provided confirmation to the Directors that it is its intention to continue to fund the Company so as to maintain the Company as a going concern, and enable the Company to meet its debts as and when they fall due, for a period up to at least 31 December 2012. Accordingly, the Directors are satisfied at the time of approval of the Financial Statements that the NRAM Group and the Company have adequate resources to continue in business for the foreseeable future. For this reason, the Directors continue to adopt the going concern basis in preparing the Financial Statements.

Risk management and control

Pages 30 to 36 form an integral part of the audited Financial Statements

Introduction

In accordance with the requirements in the Framework Document referred to on page 24, NRAM's approach to risk management is built on formal governance processes and relies on individual responsibility and collective oversight, informed by comprehensive reporting. The following sections describe the approach to risk management. The first section covers the risk governance structure. The second section explains the way in which the Company identifies, categorises and manages the risks it faces.

Other factors could also affect NRAM's results, including economic factors. Therefore, the risks described below should not be considered to represent all of the potential risks and uncertainties which could impact NRAM.

Risk governance

The responsibility for the strategy and approach to risk governance and management lies with the Board. The Board is responsible for determining risk strategy, setting the risk appetite and reviewing the effectiveness of risk and control processes in support of NRAM's strategy. The Board is also responsible for establishing a clearly defined risk management structure with distinct roles and responsibilities. Under that structure, the Risk Committee and Internal Audit provide 'third line of defence' challenge and review of the management of risks within the business. Management committees and the Risk function provide 'second line of defence' oversight, challenge and review, and line managers have 'first line of defence' responsibility for the identification, measurement and management of the risks within their business areas.

The management of the risk framework including oversight and challenge to the business on the effectiveness of their risk management activity, and reporting of Operational and Financial Risk, is performed by specialist teams in the Risk Function. Second line of defence monitoring of the risk management framework is also provided by the Risk Function.

The Board and Management Committees, under the authority delegated by the Board are described below. During the year, the terms of reference and composition of the Management Committees have changed to align with organisational and structural changes within NRAM.

Risk Committee ('RC')

The main role of the RC is to keep under review the effectiveness of NRAM's risk management framework and systems of internal control, which include financial, operational, compliance and risk management controls and to foster a culture that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of NRAM. The RC fulfils this remit through its oversight of the embedding of a supportive culture in relation to the management of risk and by making appropriate recommendations to the Board on all significant matters relating to the Board's risk appetite, strategy and policies.

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

Risk management and control (continued)

Pages 30 to 36 form an integral part of the audited Financial Statements

Executive Committee ('EXCO')

EXCO is an advisory committee which supports the CEO in managing the business to achieve its strategic objectives

The following sub-committees of the Executive Committee have been established

- Executive Risk Committee
- Assets & Liabilities Committee*
- Integration & Change Committee
- Fraud & Professional Negligence Committee
- Retail Credit Risk Committee*
- Operational Risk & Compliance Committee*

*Sub committees of the Executive Committee 1 January 2010 – 31 October 2010 Please see descriptions below for information in respect of composition from 1 November 2010

• Executive Risk Committee

As a result of the restructuring of NRAM Management Committees at the time of the establishment of UKAR the executive Risk Committee was established in November 2010 and is a management sub-committee of EXCO with a reporting line to the RC. The primary objective of the executive Risk Committee is to provide technical oversight of the key financial and operational risk and governance issues including review of the adequacy of risk mitigating actions and cost and capital effectiveness. The Committee supports, advises and makes recommendations to the RC.

• Assets & Liabilities Committee ('ALCO')

The primary objectives of ALCO are to support, advise and make recommendations to the executive Risk Committee on asset and liability management (including interest rate and currency risk management, basis risk, margin compression and investment assets), related wholesale credit, and capital and liquidity adequacy risks and issues. In November 2010, ALCO was re-structured as a management sub-committee of the executive Risk Committee.

• Integration & Change Committee

As a result of the restructuring of NRAM Management Committees at the time of the establishment of UKAR the Integration & Change Committee (formerly the Change Development Committee) was established in November 2010. The Committee monitors and reviews major projects to ensure appropriate returns are received from investment in change, and prioritises projects and initiatives.

• Fraud and Professional Negligence Committee

The Fraud & Professional Negligence Committee determines and oversees the implementation of the strategy to mitigate the impacts of fraud and/or professional negligence and ensures that recoveries are maximised.

• Retail Credit Risk Committee ('RCRC')

RCRC was established in January 2010 as a management sub-committee of EXCO, through which all aspects of Retail Credit Risk were monitored, reported and controlled. RCRC developed and recommended a Retail Credit Risk Appetite for approval by EXCO and the Board. It also reviewed and approved Credit Risk Strategy and Policy. In November 2010, the RCRC was absorbed into the executive Risk Committee (see above).

• Operational Risk and Compliance Committee ('ORCC')

ORCC was established in January 2010 as an executive level committee through which all aspects of the high level operational risk and control environment were monitored. ORCC developed and recommended the Operational Risk Policies and Risk Appetite for approval by EXCO and the Board. ORCC regularly reviewed all operational losses in line with risk appetite and budgets, and reviewed other significant risk events and failures in order to enhance operational risk management. Throughout the year, ORCC also developed and recommended compliance policies and considered new/revised regulatory requirements. In November 2010, ORCC was renamed the Operational Risk Committee (see below) and the Compliance element of ORCC was absorbed into the executive Risk Committee (see above).

Risk management and control (continued)

Pages 30 to 36 form an integral part of the audited Financial Statements

The following is a sub-committee of the executive Risk Committee

- **Operational Risk Committee (ORC)**

In November 2010, the operational risk responsibilities of the ORCC (see above) were transferred to the ORC

Principally, ORC supports the executive Risk Committee in its oversight of the business' adherence to the Operational Risk Framework, Operational Risk Strategy and Policy. ORC also provides challenge to the business on the accuracy, robustness and reliability of operational risk information and reports

Risk control

The Risk Control function comprises a team of risk management specialists with responsibility for the embedding and oversight of financial and strategic risk management across the business, and analysis and reporting of risk matters to the Board, and Board and Management Committees. Key functional responsibilities comprise

- Development of a risk management strategy, enterprise-wide risk management framework and policies for financial and strategic risk management, aligned with business requirements,
- Provision of support to NRAM in the implementation of the framework,
- Aggregation of analyses of risk concentrations and sensitivities across NRAM,
- Acting as a point of reference for risk and control matters, providing advice to management, sharing best practice and carrying out risk assurance reviews as directed by the executive Risk Committee and the Chief Risk Officer (CRO), and
- Performing ongoing independent credit model validation across retail & wholesale, retail application & behavioural scorecards, forecasting and debt management areas

Compliance

The role of Compliance is to

- Provide assurance to the Board and Executive, through the RC, that control processes are in operation to manage all prudential and non-prudential regulatory risks across the business,
- Contribute to the continuous improvement of the regulatory environment through provision of advice to the business, and
- Oversee and co-ordinate liaison with the FSA on a day-to-day basis to promote open and co-operative relationships

Internal audit

For the first ten months of 2010, the Internal Audit function of NRAM was performed by NR Internal Audit and managed through the Internal Services Agreement between NR and NRAM. Following the establishment of UKAR, Internal Audit responsibilities for NRAM were transferred to Ernst & Young LLP, including the provision of a seconded Head of Internal Audit. This person is required to be approved for the position by the FSA and by the Board. However, the oversight of the Internal Audit function remains firmly with NRAM. The Head of Internal Audit reports through to the Chairman of the Audit Committee and to the CEO.

The prime objective of the Internal Audit department is to provide reliable, valued and timely assessment to the Board and Executive Management on the effectiveness of the system of internal controls mitigating current and evolving key risks and in doing so, assist the organisation in enhancing the effectiveness of the approach to risk management within the organisation.

Business and support activities of NRAM are included in the scope of Internal Audit's responsibility and are subject to regular and appropriate internal audit review in accordance with Internal Audit's risk based Audit Plan.

Risk management and control (continued)

Pages 30 to 36 form an integral part of the audited Financial Statements

Risk categorisation

NRAM categorises risk under the following headings

(i) Credit risk

Credit risk is the potential financial loss caused by a retail customer or wholesale counterparty failing to meet their obligations to the Company as they become due. As the Company is no longer making any material loans, the absolute level of credit risk is expected to decline as NRAM's loan assets mature.

Credit risk is the largest risk the Company faces and the monitoring of the recoverability of loans and amounts due from counterparties is inherent across most of the Company's activities. The Company is firmly committed to the management of credit risk in both its retail and wholesale loan books. The Company employs credit behaviour scoring and fraud detection techniques to support loss minimising strategies. As no new lending is now being undertaken, the focus of credit risk activities is on:

- A proactive approach to the identification and control of loan impairment in the Residential and Commercial Credit Risk and Credit Control areas,
- Fraud and professional negligence investigation, and
- The use of credit behaviour scoring and other techniques to monitor the risk profile of the existing book.

Adverse changes in the credit quality of borrowers or a general deterioration in UK economic conditions could affect the recoverability and value of the Company's assets and therefore its financial performance. As credit risk is the main risk to the Company, a credit risk framework has been established as part of the overall governance framework to measure, mitigate and manage credit risk within the Company's risk appetite. To a lesser degree, the Company is exposed to other forms of credit risk such as those arising from settlement activities where the risk is a consequence of a transaction, rather than a driver of it.

The extent of credit risk in the Company's Balance Sheet is shown by the following table of provisions for mark-downs on impaired assets:

	Balance Sheet value 31 December 2010 £m	Provision 31 December 2010 £m	Balance Sheet value 1 January 2010 £m	Provision 1 January 2010 £m
Residential mortgages	44,332	1,013	49,725	596
Commercial mortgages	312	30	288	13
Unsecured personal loans	3,114	542	3,912	564
Treasury assets	11,321	461	12,333	556

The Company's ability to influence the structure of its credit risk profile, in the absence of asset sales, is largely restricted to the degree of control which it has over risk strategy, loan redemptions and credit collections activity. With the composition of the loan portfolio largely fixed in the short to medium term, the Company's credit risk profile is now determined by the credit quality of the existing portfolio alone. Changes in credit quality will arise either from changes in the underlying economic environment, our assumptions about the future trends in the economy, changes in the specific characteristics of individual loans and the credit risk strategies developed to add value to the book while mitigating credit risk.

It is the Company's policy to monitor the profile of its lending exposure on a regular basis. Changes in the risk profile are reported as part of the Company's stress tests. The stress test forecasts losses, impairment and capital requirements at a portfolio and product level over a 10 year horizon for a downside economic scenario.

The Board receives a monthly update on changes in the key drivers of the lending credit risk profile, with more detailed information on the factors underlying these key drivers being reported monthly to the Retail Credit Risk Committee, and which became monthly reporting to the executive Risk Committee from November 2010.

Risk management and control (continued)

Pages 30 to 36 form an integral part of the audited Financial Statements

The Company also holds a structured finance portfolio that primarily consists of investments in asset backed securities ('ABS'). The credit risk is determined by the quality of the underlying securitised assets and this drives the market demand for these investments. Credit limits have been set for the structured finance portfolios. No new structured finance investments were made in 2010.

Credit related policies and limits are developed and maintained within Credit Risk and are reviewed and approved annually by the Board or when significant changes to policies are recommended. The Retail Credit Risk Committee, which became the executive Risk Committee in November 2010, ensures that any exposure to credit risk remains within overall risk exposure levels as agreed by the Board. Authorised credit risk limits for wholesale money market counterparties reflect the size, depth and quality of each counterparty's capital base and, where published, credit ratings assigned by the major credit rating agencies.

(ii) Market risk

Market risk is the potential adverse change in Company income or Company net worth arising from movements in interest rates, exchange rates or other market prices. Effective identification and management of market risk is essential for maintaining stable net interest income. NRAM does not trade or make markets in any areas and market risk arises only as a consequence of carrying out and supporting core business activities.

Market risk within the Company can be subdivided into the following risks:

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

The Company has legacy mortgage products with varying interest rate features and maturities which create potential interest rate risk exposures. Primary risks arise as a result of timing differences on the repricing of assets and liabilities, unexpected changes in yield curves and changes in the correlation of interest rates between different financial instruments.

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

Interest rate risk

Interest rate sensitivity arises from the relationship between interest rates and net interest income resulting from the periodic repricing of assets and liabilities. The Company carries legacy fixed rate residential mortgages on its Balance Sheet on which the interest rate paid by the customer is fixed for an agreed period of time at the start of the contract. The Company closely monitors mortgage redemption and repayment patterns and reduces the mismatch of the expected maturity profiles of its interest-earning assets and interest-bearing liabilities through the use of interest rate derivatives, which are principally interest rate swaps which are over-the-counter arrangements with highly rated banking counterparties. The Company also takes advantage of the natural offset of its asset and liability positions to minimise the costs and risks of arranging transactions external to the Company.

Risk management and control (continued)

Pages 30 to 36 form an integral part of the audited Financial Statements

Foreign exchange risk

NRAM has legacy funding and investments in currencies other than sterling. Accordingly, foreign exchange risk arises from activities related to the Company managing borrowing costs and investment returns. As with interest rate risk, Group Treasury is responsible for managing this exposure within the limits prescribed in the Market Risk Policy as approved by ALCO and the Board.

The Company will remain exposed to foreign exchange risk until all assets and liabilities denominated in foreign currencies have matured or been sold.

Foreign currency exposure is measured daily by Group Treasury taking into consideration all non-sterling assets and liabilities. This exposure position is broken down by individual foreign currency and the net exposure circulated daily to senior managers with an overall summary position provided to ALCO on a monthly basis.

(iii) Liquidity risk

Liquidity risk represents the risk of being unable to pay liabilities as they fall due and arises from the mismatch in cash flows generated from current and expected assets, liabilities and derivatives.

Liquidity risk management within the Company considers both the overall Balance Sheet structure and projected daily liquidity requirements, measuring the combined effect of asset and liability maturity mismatches across the Company, undrawn commitments and other contingent obligations. The day-to-day management of liquidity is the responsibility of Group Treasury.

Liquidity risk management is set out in the Liquidity Policy as approved by the Board. This considers the quality of liquid assets as well as projected funding requirements. The Company obtains any sterling funds required from a sterling denominated facility provided by HM Treasury. This facility enables sufficient sterling liquidity to be available even in extreme circumstances. The Company remains dependent on the markets, as it principally generates liquidity in foreign currencies by converting funds from sterling with foreign exchange swap transactions in the financial markets. Thus, whilst liquidity risk in sterling is very low, that in foreign currencies remains.

The impact of liquidity risk is monitored by liquidity stress tests, the results of which are considered by ALCO and reported to the Board.

(iv) Operational risk

NRAM defines Operational Risk as follows:

'The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events'

Operational risks are further classified into the following broad categories:

- Financial crime – including the risks of external and internal fraud, theft and non compliance with anti money laundering regulations
- Business continuity – covering the risks associated with the inability of the organisation to maintain and recover operations in the event of an incident or major crisis
- Business processes – including the risks associated with outsourcing arrangements, process / procedural design, documentation and delivery, MI production and delivery, transaction processing, and operational risks arising from change
- Technology – covering the risks associated with IT systems (including both hardware and software) in terms of development, delivery, maintenance and application
- People – encompassing the risks associated with employing the right people, deployment and succession planning, colleague engagement and commitment, performance, reward and recognition processes, diversity, dignity, fairness and respect, and compliance with HR regulations
- Legal – covering the risks associated with contractual arrangements and litigation claims against NRAM

Risk management and control (continued)

Pages 30 to 36 form an integral part of the audited Financial Statements

The Company's business areas manage Operational Risk through execution of the Operational Risk Framework using the methodology, approach, tools, techniques and processes provided by the Operational Risk Function in accordance with the NRAM Operational Risk Policy

The NRAM Operational Risk Framework consists of three main components

- Risk and Control Self Assessment
- Risk Event Reporting
- Monitoring and Reporting Operational Risk

These components and the underlying processes supporting them are designed to ensure the key phases of the risk 'life cycle' (identification, assessment, mitigation, and monitoring and reporting) are fully embedded within the Operational Risk Management activities for NRAM

Risk and control self assessment

Provides the business with a mechanism to identify, assess and, where appropriate, mitigate operational risk exposures outside NRAM's Operational Risk appetite. This process utilises a probability and impact matrix and helps the business ascertain its inherent versus residual risk profile (gross versus net) as well as assess the adequacy of its internal control framework

Risk event reporting

Risk events can indicate movement in the Operational Risk profile of the business as well as identifying deficiencies and failures within the control framework

A process is in place for the recognition, capture, assessment and reporting of risk events. This process is used to help identify where process and control requirements are needed to reduce the recurrence of risk events. The Risk Event Reporting process is designed to ensure all Operational Risk Events are suitably escalated to the Executive and Senior Management of NRAM and catalogued for regulatory monitoring and reporting purposes. The process also ensures that management are aware of individual Operational Risk Events and the aggregate level of events including actual losses and exposures (i.e. potential losses) and the appropriate remedial activity is undertaken to prevent recurrence or reduce the level of impact if recurrence is inevitable.

Operational Risk Events for reporting purposes are classified as those which have an actual or potential financial impact in excess of £10,000 or have a significant non-financial impact e.g. reputational damage, impact on normal business operations, compliance or regulatory breach including fraud events or business continuity incidents.

Monitoring and reporting operational risk

Prior to November 2010, Operational Risk matters were reported to the Operational Risk Working Group, the Business Continuity Working Group, the Information Security Working Group and the Operational Risk and Compliance Committee (ORCC), all of which met on a monthly basis. The ORCC reported into the Executive Committees of both NR and NRAM. Since November, NRAM Operational Risk matters have been reported to the ORC. In turn, the ORC reports to the executive Risk Committee.

Information security, business continuity management and financial crime specialists monitor activity in their areas of expertise and contribute towards monthly reporting.

The Company's business areas manage Operational Risk through appropriate monitoring, controls and loss mitigation actions, including insurance. These actions include a balance of policies, appropriate procedures and internal controls to ensure compliance with laws and regulations. At a detailed level, risk and control assurance is facilitated by Risk Control, in conjunction with line managers, on the risks and control effectiveness within their areas of responsibility.

The Company currently calculates its capital requirement for Operational Risk using the Basel II Standardised Approach, although not strictly required to do so under the MIPRU regulatory regime. Operational risk will remain an important part of the Company's risk profile throughout the wind-down process.

Directors' remuneration report

This section of the Annual Report outlines the role and responsibilities of both the NRAM and B&B Remuneration Committees, summarises the key focus for the year and provides details of the remuneration for the Directors. This remuneration report does not form part of the Financial Statements and is not audited. It also outlines the overarching reward policy covering all colleagues. Given the current structure and commonality of the Directors in the two organisations, it is appropriate to provide one Directors' Remuneration Report for the Company.

As outlined in the Relationship Framework Document, the ongoing relationship between the Company and UKFI ensures the Company operates in the context of the agreed business plan and the overarching strategic objectives. In addition, the Company will seek to ensure that remuneration policy and practices are appropriate and both incorporate, and are reflective of, sound risk management principles.

This report covers the overarching principles of remuneration for UKAR and its subsidiary companies, NRAM and B&B, since they were transferred to UKAR ownership on 1 October 2010 and the UKAR Group was established. The report also references both NRAM and B&B during the period prior to UKAR establishment (1 January - 30 September 2010). There were no Directors or colleagues directly employed by NRAM during 2010. The remuneration and fees of the Executive Directors, Non-Executive Directors and all employees were recharged from NR to NRAM under the terms of the service agreement between the two companies, which for Directors was up to 30 September 2010 from when they were paid by B&B and recharged to NRAM under a new service agreement.

FSA code of practice on remuneration

UKAR does not need to comply with the FSA's code of practice on remuneration, as non-banks are not in scope, but UKAR and its subsidiary companies will continue to ensure the principles of the Code underpin its remuneration policies and practices.

Advisers

PricewaterhouseCoopers LLP were independent advisers to the Remuneration Committee of B&B for the year. They provided external advice on market data, structure and design of incentives across all levels of the organisation and a review of compliance against the FSA Code of Practice on Remuneration. In addition, Hewitt New Bridge Street advised the companies on incentive scheme design. As NRAM had no employees, its Remuneration Committee did not seek any external advice.

Remuneration policies

UKAR and its subsidiary companies operate aligned reward and incentivisation policies that aim to support the achievement of our overall business strategy by establishing objective, consistent and fair schemes to support the consistent application and management of remuneration policies in order to provide a competitive, yet cost-effective, salary and benefits package to all employees.

Remuneration Committees

During the year the CEO, HR Director, Risk Director and Head of Reward were invited to attend B&B Remuneration Committee meetings for those items other than their own arrangements and to provide advice. UKFI representatives also attended meetings to represent the interests of the Shareholder.

Service agreements

The Company's policy is to employ Executive Directors on one-year rolling contracts. It is not the Company's policy to make non-contractual payments to Executive Directors on termination of their service agreement and no such payments were made in 2010. Executive Directors are entitled to pay in lieu of notice, should their contract be terminated, and statutory redundancy only. Since 1 October 2010 Richard Banks has been the only Executive Director of the Company.

Pre-UKAR establishment: 1 January 2010 – 30 September 2010

Remuneration Committees

The NRAM Remuneration Committee met twice during this time to consider its Terms of Reference.

The B&B Remuneration Committee met three times and, amongst other items, considered Company-wide annual bonus payments for 2009 and 2010 salary review and bonus scheme proposals. The scope of the Committee was to focus on remuneration policy across all levels of the organisation.

Directors' remuneration report (continued)

The Remuneration Committees of both companies were composed entirely of Non-Executive Directors as outlined below

Table 1 – Remuneration Committee membership up to 30 September 2010 (pre-UKAR)

B&B	NRAM
Louise Patten (Chairman)	Robert Davies (Chairman)
Michael Buckley	Sue Langley
Richard Pym	Richard Pym

Table 2 – Executive Directors' service contracts (pre-UKAR)

	Date of service contract	Company	Company's notice period	Director's notice period
Richard Banks	27/04/2009	B&B	12 months	6 months

Gary Hoffman was Co-CEO of NRAM and NR, and Andrew Tate was Chief Operating Officer (COO) of NRAM. Both were Executive Directors of NRAM for the period 1 January - 30 September 2010. They both resigned from the Board of NRAM on 30 September 2010.

Table 3 – Non-Executive Directors' terms of appointment (pre-UKAR)

	Date of appointment	Company	Company's notice period	Director's notice period
Richard Pym	01/07/2009 01/01/2010	B&B NRAM	1 day 3 months	1 month 3 months
Michael Buckley	26/07/2007	B&B	Nil	Nil
Louise Patten	17/12/2003	B&B	Nil	Nil
John Tattersall	01/04/2010	B&B	3 months	3 months
Robert Davies	01/01/2010	NRAM	3 months	3 months
Sue Langley	01/01/2010	NRAM	3 months	3 months
Kent Atkinson	01/01/2010	NRAM	3 months	3 months
Keith Morgan	01/01/2010	NRAM	3 months	3 months
Philip Remnant	01/01/2010	NRAM	3 months	3 months

Non-Executive Chairman and Non-Executive Directors' fees (pre-UKAR)

Richard Pym's total fees for Chairing both NRAM and B&B from 1 January 2010 remain unchanged at £250,000 p a. Between 1 January and 30 September 2010, 25% (equivalent to £62,800 p a) of this was paid by NRAM, 75% (equivalent to £187,200 p a) by B&B.

Fee levels for NRAM Non-Executive Directors were determined by NR before the legal separation of NRAM and NR. Fees comprised a basic fee of £50,000, with additional sums of £20,000 paid to the Chair of the Risk Committee, £15,000 to the Chairs of the Audit and Remuneration Committees and £5,000 for membership of a Board Committee. Non-Executive Directors did not participate in any incentive arrangements, did not have service contracts and did not receive any other benefits.

Fee levels for B&B Non-Executive Directors were determined by a committee, which had a membership of the Managing Director, HR Director and Finance Director. At the beginning of the year fees comprised a basic fee of £48,000, with additional sums of £22,000 paid to the Chair of the Audit, Risk and Compliance Committees and £10,000 paid to the Chair of the Remuneration Committee. On 1 July 2010, following a review of committee structures and the splitting of Audit and Risk into two committees, these additional sums changed to £15,000 for the Audit Committee Chair, and £10,000 for both the Risk and Remuneration Committee Chairs. Non-Executive Directors do not participate in any incentive arrangements, do not have service contracts and do not receive any other benefits.

Directors' remuneration report (continued)

The emoluments of the Non-Executive Chairman and Non-Executive Directors for the year are detailed in table 7

Components of Executive Director remuneration (pre-UKAR)

Remuneration frameworks were structured to place appropriate importance on fixed pay and short term bonus – there were no share schemes and no long-term incentive opportunities have existed since nationalisation

- **Basic salary**

NRAM did not have any employees but did have two Executive Directors pre establishment of UKAR – Gary Hoffman, Co-CEO for NR and NRAM and Andrew Tate, COO of NRAM. They were both employed by NR and their services were provided and charged under the service level agreement between these two companies. Gary Hoffman was a Director of NR and his total remuneration is disclosed in the Annual Report & Accounts of NR. Andrew Tate was seconded to NRAM and was not a Director of NR therefore his total remuneration is not disclosed in the Annual Report & Accounts of NR. His salary and emoluments attributable to NRAM totalling £250,152, whilst a Director of NRAM, were charged to NRAM so are not disclosed in table 7 of this report.

Richard Banks, Managing Director, was the only Executive Director of B&B and his basic salary was the only element of pay that pension was calculated from. He received a remuneration package determined by the Board and the Remuneration Committee. His salary increased from £250,000 p a at the beginning of the year to £256,000 p a from 1 April 2010.

- **Annual bonus arrangements**

Although NRAM did not have any employees, an accrual for bonus payments is included in the Company's Financial Statements. This is to cover any bonus payments for all those colleagues who transferred from NR post UKAR establishment, as it was agreed that all colleagues would participate in the NR annual bonus scheme for all of 2010.

B&B senior employees participated in an annual bonus scheme which was aligned to targets derived directly from the Business Plan and individual payments linked to achievement of personal objectives. A maximum of 30% annual bonus was awarded, with 60% of any bonus earned payable in March 2011, and the remaining 40% deferred and payable in three equal instalments over three years. Where bonus payments have been deferred, they will be paid provided that there are no material adverse issues regarding personal and/or business performance which, in the opinion of the Remuneration Committee, were not evident at the time of making the award. Richard Banks falls into the scope of this bonus arrangement.

- **Pensions and other benefits**

Richard Banks received an annual supplement of 30% of basic salary in lieu of any company pension benefit. In line with typical market practice, other executive benefits are provided in the form of a company car allowance, housing allowance, private medical insurance, life assurance, permanent disability insurance and accident insurance.

The emoluments for the year of the Executive Director who was in place at the year end are detailed in table 7.

Post-UKAR establishment: 1 October 2010 – 31 December 2010

The information below details any changes that were made as part of the establishment of UKAR when the Remuneration Committees for UKAR, NRAM and B&B were aligned with common membership.

Appointment of Chief Executive Officer

Richard Banks, previously Managing Director of B&B, was appointed as Designate CEO of UKAR in April 2010 and this appointment was confirmed on 1 October 2010. His salary of £340,000 p a was determined by the 'Designate' Members of the Board and Remuneration Committee of UKAR taking into account the increased size and scope of the new role encompassing both NRAM and B&B. External advice was sought as to the appropriate salary range for this role.

The Remuneration Committee

The primary objective of the UKAR Remuneration Committee is to have oversight of the remuneration policy of the UKAR Group Companies. It is responsible for recommending to the Boards of NRAM and B&B all aspects of the remuneration arrangements for Executive Directors, Senior Executives, Approved Persons and Code Employees (as defined by the FSA Code of Practice on Remuneration) across the Companies regardless of whether such appointments are on a permanent or an interim basis. The UKAR Remuneration Committee monitors the targets for any performance-related pay schemes operated by the Companies. The Committee is also responsible for reviewing proposals as to the remuneration policies of the Companies for all staff and monitors and advises on any major changes in employee benefit structures throughout the Companies.

Directors' remuneration report (continued)

The full Terms of Reference for the Committee are available on the NRAM corporate website

The Remuneration Committee met twice between 1 October and 31 December 2010 and, amongst other items, considered changes to relevant regulations and best practice approaches within remuneration and 2011 incentive arrangements

The Remuneration Committees of UKAR, NRAM and B&B are composed entirely of Non-Executive Directors as follows

Table 4 – Remuneration Committee membership (post-UKAR)

Robert Davies (Chairman) *	1 October 2010 to 31 December 2010
Sue Langley (Chairman) *	From 1 October 2010
Keith Morgan	From 1 October 2010
Louise Patten	From 1 October 2010

*Robert Davies resigned on 31 December 2010 and Sue Langley took over as Chairman of the Remuneration Committee from that date

Components of Executive Director remuneration

Executives and senior management are eligible for an annual bonus of up to 60% of basic salary. For 2010 this will be pro-rated as appropriate, 40% will be payable in March 2011, and the remaining 60% deferred and payable in three equal instalments over three years

Service agreements

Service agreements following UKAR's establishment are shown below

Table 5 – Executive Directors' service contracts (post-UKAR)

	Date of service contract	Company's notice period	Director's notice period
Richard Banks	1 October 2010	12 months	6 months

There was no change to Richard Banks' notice period post UKAR establishment

Table 6 – Non-Executive Directors' terms of appointment (post-UKAR)

	Date of appointment**	Initial term end date	Company's notice period	Director's notice period
Richard Pym	1 October 2010	31 December 2011	3 months	3 months
Kent Atkinson	1 October 2010	31 December 2011	3 months	3 months
Michael Buckley	1 October 2010	31 December 2011	3 months	3 months
Sue Langley	1 October 2010	31 December 2011	3 months	3 months
Keith Morgan	1 October 2010	31 December 2011	3 months	3 months
Louise Patten	1 October 2010	31 December 2011	3 months	3 months
John Tattersall	1 October 2010	31 December 2011	3 months	3 months
Robert Davies*	1 October 2010	31 December 2011	3 months	3 months

* Robert Davies resigned on 31 December 2010

** Represents the date of appointment to the Board of UKAR. The Directorships of NRAM and B&B continued unchanged but all notice periods have been aligned to the UKAR notice periods

Directors' remuneration report (continued)

Non-Executive Chairman and Non-Executive Directors' fees

With effect from 1 October 2010 the basic fee for Non-Executive Directors was set at £50,000 p a to cover directorships of all three companies, UKAR, NRAM and B&B. In addition, the members of the Audit, Risk, Remuneration and Nomination Committees receive a fee of £5,000 p a per membership, which increases to £15,000 for the Chairs of the Audit, Risk, and Remuneration Committees.

Richard Pym's total annual fees for chairing all three companies was unchanged at £250,000 p a.

There were no further changes to fee levels for Non-Executive Directors post UKAR establishment.

Non-Executive Directorships

Executive Directors who hold Non-Executive Directorships in other companies are permitted to retain their earnings from these posts. Richard Banks is the only Executive Director for the Company and he has held two external directorships during the year, in each case for the whole of 2010. One was with Liverpool Compact Education Business Partnership for which he received no fees (2009: £nil) and the second was with ICICI Bank UK plc for which he received fees of £50,000 (2009: £4,166).

Full Year 2010

This Report sets out the framework of remuneration policies and the tables show how this framework is applied to each individual Director in the year under review. Benefits received by Directors comprise of the provision of a car allowance, health benefits and housing allowance. An amount in lieu of pension entitlement is also paid, this is shown in table 7.

Pensions

There were no NRAM employees during the year and therefore no disclosure relating to pensions. For Gary Hoffman and Andrew Tate, pension salary supplements were paid by NR and 50% recharged through to NRAM under the terms of a service agreement.

The final salary-based Bradford & Bingley Staff Pension Scheme closed to future accrual with effect from 31 December 2009. No Director who served during the year had any accrued pension entitlements under any UKAR Company pension scheme.

In 2010, pension payments due to former Bradford & Bingley Building Society Directors, paid directly by B&B and not connected to the Bradford & Bingley plc Staff Pension Scheme, amounted to £23,714 (2009: £23,073). For NRAM, pension payments due to former Directors, paid directly by NRAM and not connected to the Northern Rock Staff Pension Scheme, amounted to £277,306 (2009: £210,565).

Directors' remuneration report (continued)

The table below sets out the total emoluments paid to those Directors who were Directors of UKAR Group companies at 31 December 2010 in respect of their services in 2010 to companies within the UKAR Group. This table also sets out the total emoluments paid to those individuals who were Directors of NR for the year ended 31 December 2009 before the legal separation of NRAM from NR and the total emoluments paid to those individuals who were Directors of B&B for the year ended 31 December 2009.

Table 7 – Directors' emoluments for the period 1 January 2010 to 31 December 2010

	Basic salary/fees*	Non-cash benefits	Allowances	Payment in lieu of pension	Bonus**	Total emoluments 2010	B&B Total emoluments 2009	NR*** Total emoluments 2009
Executive Directors								
Richard Banks ¹	£275,500	£1,061	£22,800	£82,650	£170,000	£552,011	£261,799	–
Chris Wilford ⁹	–	–	–	–	–	–	£946,297	–
Roger Hattam ⁹	–	–	–	–	–	–	£651,442	–
Gary Hoffman ⁸	–	–	–	–	–	–	–	£1,487,166
Anne Godbehere ²	–	–	–	–	–	–	–	£85,641
Andrew Tate ³	–	–	–	–	–	–	–	–
Total	£275,500	£1,061	£22,800	£82,650	£170,000	£552,011	£1,859,538	£1,572,807
Non-Executive Directors								
Richard Pym ⁴	£250,000	–	–	–	–	£250,000	£454,913	–
Kent Atkinson	£70,000	–	–	–	–	£70,000	–	£80,000
Michael Buckley	£67,000	–	–	–	–	£67,000	£70,000	–
Robert Davies	£68,750	–	–	–	–	£68,750	–	£70,000
Sue Langley ⁵	£60,000	–	–	–	–	£60,000	–	–
Keith Morgan ⁶	–	–	–	–	–	–	–	–
Philip Remnant ¹⁰	£45,000	–	–	–	–	£45,000	–	£70,000
Louise Patten	£58,500	–	–	–	–	£58,500	£58,000	–
John Tattersall	£44,000	–	–	–	–	£44,000	–	–
Ron Sandler ⁷	–	–	–	–	–	–	–	£350,000
Laurie Adams ⁷	–	–	–	–	–	–	–	£85,000
Richard Coates ⁷	–	–	–	–	–	–	–	£70,000
John Devaney ⁷	–	–	–	–	–	–	–	£80,000
Tom Scholar ^{6,7}	–	–	–	–	–	–	–	–
Total	£663,250	–	–	–	–	£663,250	£582,913	£805,000
Grand Total	£938,750	£1,061	£22,800	£82,650	£170,000	£1,215,261	£2,442,451	£2,377,807

* The only element of pay that pension is calculated on.

** Payment is subject to the same rules around deferral and clawback as outlined earlier in this report.

*** NR was renamed NRAM on 1 January 2010.

¹ As MD of B&B, Richard Banks was entitled to receive an annual bonus award which was capped upon his appointment at a maximum of £30,000 for 2009. The Remuneration Committee awarded Richard the maximum amount of £30,000 in early 2010. Scheme rules meant any bonus was deferred over three years, therefore Richard was entitled to receive £10,000 in 2010, 2011 and 2012 but he deferred his entitlement to receive the first payment in 2010 as the business had not made a profit. In 2011 the Remuneration Committee agreed to award Richard this deferred payment of £10,000 for 2009 together with the second tranche of £10,000 for 2010. In addition £73,100 will be paid in respect of 2010 performance with £96,900 deferred to future periods.

² Anne Godbehere remuneration relates to the period of service from 1 January to 31 January 2009.

³ Andrew Tate was COO and a Director of NRAM for the period from 1 January to 30 September 2010 during which time he was employed by NR and seconded to NRAM. His remuneration was paid by NR and charged to NRAM under the terms of a service agreement. He was not an Executive Director of either NR or NRAM during 2009, and therefore no comparative information is included. The remuneration paid to him in respect of his services to NRAM was £250,152 representing 50% of the total of his remuneration for the period of service to 30 September 2010.

⁴ Richard Pym was Executive Chairman of B&B for the period up to 1 July 2009 for which he was paid £361,313 and became Non-Executive Chairman from that date for which he received fees of £93,600.

Directors' remuneration report (continued)

- ⁵ Sue Langley's fees are not paid directly to her. The fees shown in table 7 were paid to Lloyd's of London during 2010 for her services.
- ⁶ Keith Morgan, as the representative of UKFI, waived all fees for the year, as did Tom Scholar who was the representative for HM Treasury.
- ⁷ Ron Sandler, Laurie Adams, Richard Coates, John Devaney and Tom Scholar all stood down as Non-Executive Directors with effect from 1 January 2010. 2009 information is included as individuals were Non-Executive Directors of NR in 2009.
- ⁸ Gary Hoffman's emoluments in 2010 were paid by NR and he received no direct remuneration from NRAM or other UKAR companies during his period as Co-CEO of NRAM and NR. His remuneration was approved by the NR Remuneration Committee and NRAM was charged 50% of his employment costs and expenses under a service agreement. This is not included in the total emoluments in table 7 above.
- ⁹ As stated in B&B's 2009 Annual Report & Accounts, two Executive Directors, Chris Willford and Roger Hattam, stood down and their notice expired on 4 June 2010.
- ¹⁰ Philip Remnant stood down with effect from 1 October 2010.

Table 7 disclosures do not reflect what has been charged in the accounts in 2010 as the emoluments shown relate to the UKAR Non-Executive Chairman, Executive Directors and Non-Executive Directors in total, which have been charged to NRAM and B&B in accordance with the service agreements between these companies. The emoluments of both Andrew Tate and Gary Hoffman are not included for 2010 in table 7 as they were paid through NR being recharged to NRAM under the service agreement in place at that time.

Details of the emoluments of the highest paid Director and of total Directors' remuneration for the Company may be found within the notes to the Financial Statements. These differ from the values disclosed in table 7 above, as the values in this table relate to services to all UKAR Group companies.

Corporate social responsibility report

NRAM aims to conduct its business in a socially responsible manner in respect of customers, local communities and the environment

Workplace and employees

NRAM's employment practices reflect international and national standards covering areas such as minimum working age, working hours, health and safety and discrimination

The Company promotes diversity and equality across all aspects of working life and believes it is important to share best practice and success

Opportunities are provided for all employees to develop their skills and knowledge

The Company recognises that the health and well-being of employees is vital to the business

The recognised union for employees is Unite

Customers

NRAM has around 400,000 mortgage customers (2009 440,000) and 200,000 unsecured loan customers to serve and manage. The Company endeavours to treat each customer as an individual, with openness, honesty and integrity. The Company adheres to the FSA's formal framework for Treating Customers Fairly.

NRAM works closely with those customers experiencing payment difficulties to exhaust all reasonable efforts before commencing repossession proceedings, which is viewed as a last resort.

Community

Since demutualisation in 1997, the Company has supported The Northern Rock Foundation, which supports community and charitable causes, mainly in the North East of England and Cumbria. In line with the commitment made when first taken into public ownership, The Foundation received a donation of £15m from NRAM in 2010.

During 2010, NRAM continued its investment into the community especially in the North East area, where the majority of our employees live and work.

In 2010, NRAM focused charitable support on the Samaritans and a total of £71,000 was raised by employees in support of this charity. A further £498,000 was raised for other national and local charities and organisations. This fundraising was undertaken in collaboration with the employees of NR as prior to the establishment of UKAR all NRAM staff were employed by NR.

The environment

During 2010, NRAM sought to continue to improve its environmental performance through a number of initiatives.

NRAM promotes its commitment to environmentally friendly travel by offering employees discounted annual travel tickets for the North East area.

The main waste streams produced by NRAM consist of general office waste, confidential paper waste and IT equipment.

There are procedures in place to recycle waxed and plastic cups, cans, bottles, toner cartridges, waste electrical equipment, mobile phone batteries, paper and cardboard. All paper waste throughout the Company is recycled securely.

Corporate social responsibility in 2011

From March 2011 The Northern Rock Foundation will no longer be supported by the Company who will instead support homeless charities and local community involvement. The corporate social responsibility strategies for NRAM and B&B will be aligned.

Statement of Directors' responsibilities

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

Company law requires the Directors to prepare Financial Statements for each financial year. Under that law the Directors have prepared the Group and Parent Company Financial Statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU').

Under company law the Directors must not approve the Financial Statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Company and Group for that period. In preparing these Financial Statements, the Directors are required to

- Select suitable accounting policies and then apply them consistently,
- Make judgements and accounting estimates that are reasonable and prudent,
- State whether applicable IFRS as adopted by the EU have been followed, subject to any material departures disclosed and explained in the Financial Statements,
- Prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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

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

Other matters

Principal activities

The principal activities of the UKAR Group are explained in the CEO's review on pages 6 to 7

Review of business, future developments, principal risks and uncertainties

A review of the business, future developments, principal risks and uncertainties, is set out in the CEO's review on pages 6 to 7

Property, plant and equipment

Land and buildings, which are included in the Balance Sheet at cost less accumulated depreciation amounted to £29.6m at 31 December 2010. In the Directors' opinion, based on valuations carried out by the Company's external qualified Chartered Surveyors, the total market value of those assets at that date was not significantly different to the Balance Sheet amount. During the year, part of the office complex in Gosforth was reclassified as an investment property, being predominantly let-out to NR. At the time of reclassification this part of the building was revalued and is now carried in the Balance Sheet at fair value. As at 31 December 2010 its value was £26.6m.

Dividends

The Directors do not propose the payment of any dividend in respect of the year ended 31 December 2010 (2009: £nil).

Shares

On 22 February 2008, under the terms of The Northern Rock plc Transfer Order 2008 (SI 2008 No. 432), all shares in the Company were transferred to the Treasury Solicitor as nominee of the HM Treasury. Each Foundation share was converted into and redesignated as one Ordinary share in the Company. On 1 October 2010 all of these shares were transferred to UKAR, the newly formed holding company into which the ownership of B&B was also transferred. UKAR is wholly owned by HM Treasury with the shares of the Company being held by the Treasury Solicitor.

There has been no change in the issued share capital since the Company was taken into public ownership and the number of ordinary shares of 25 pence each in issue throughout 2010 and as at 31 December 2010 was 495,559,500. The number of preference shares of 25 pence each in issue throughout 2010 and as at 31 December 2010 was 400,000.

The Company has two classes of shares: ordinary and preference shares of 25 pence each. Further details concerning the rights and obligations attaching to the shares, including voting rights, can be found in the Company's Articles of Association.

Directors' interests

Following the Transfer on 22 February 2008, no Director has any interest in shares in the Company.

No Director had any material interest during the year in any contract of significance to the Company's business.

Major Shareholders

As at the date of this Report, all shares are held by UKAR, which is wholly owned by HM Treasury.

Compensation Scheme Order

In September 2008, in accordance with the Northern Rock plc Compensation Scheme Order 2008, HM Treasury appointed an independent valuer, Mr Andrew Caldwell of BDO LLP, to assess what compensation is due, if any, to former shareholders and other interested parties following the Transfer. Further details about the Valuer can be found at his website, www.northernrockvaluer.org.uk.

Other matters (continued)

Charitable and political donations

In line with the commitment made when NRAM was first taken into public ownership, NRAM has continued to support The Northern Rock Foundation, and paid a donation of £15m in 2010, which was provided for in 2009

No contributions were made for political purposes in 2010. The UKAR Group does not make any payments that might be deemed to be political in nature

Creditor payment policy

This measure is no longer relevant to the Company as, on the whole, it no longer engages external suppliers for goods and services, the majority of which are now supplied by either NR or B&B, for which separate service agreements are in place (general terms are that cash settlement takes place within 25 days of invoice). The average period for creditor payment in 2009 was 39 days

Events after the reporting period

Details of events after the reporting period are shown in note 49 to the Financial Statements

Directors' indemnities

UKAR, the holding company, has provided each Director with a Deed of Indemnity indemnifying them to the fullest extent permitted by law against all losses suffered or incurred in respect of acts and omissions arising as a result of holding office. The indemnities also extend to the reimbursement of each Director with the costs of defending all claims, actions and proceedings including regulatory investigation arising out of or connected with the exercise of, or failure to exercise, any of the Director's powers, duties or responsibilities as an officer, director, trustee, agent or employee of the UKAR Group and any of its subsidiaries. Reimbursement is subject to the Director's obligation to repay the Company in accordance with the provisions of the Companies Act 2006. The payment obligations of the Company under each Deed of Indemnity are backed by a specific guarantee in favour of the Director entered into between the Company and HM Treasury.

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

Annual General Meeting ('AGM')

It is proposed that the AGM of the Company will be held on 28 April 2011.

Auditor

A resolution to appoint the Company's auditors, following a competitive tendering process, will be put to the Shareholder at the forthcoming AGM.

Disclosure of information to the Auditor

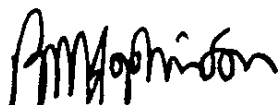
As at the date of this report, each person who is a Director confirms that

- So far as each Director is aware there is no relevant audit information of which the Company's auditor is unaware, and
- Each Director has taken such steps as he or she ought to have taken as a Director in order to make him or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 (2) of the Companies Act 2006.

Paul Hopkinson

Company Secretary, on behalf of the Board
30 March 2011



The Accounts

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115	49	Events after the reporting period

Independent Auditors' report to the Shareholder of Northern Rock (Asset Management) plc

We have audited the Group and Parent Company Financial Statements (the 'Financial Statements') of Northern Rock (Asset Management) plc for the year ended 31 December 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of Directors and Auditors

As explained more fully in the Directors' Responsibilities Statement on page 45, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the Financial Statements

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

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2010 and of the Group's profit and Group's and Parent Company's cash flows for the year then ended,
- the Group Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the Parent Company Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

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

Independent Auditors' report to the Shareholder of Northern Rock (Asset Management) plc (continued)

Matters on which we are required to report by exception

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

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



Lindsay Gardiner (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP

Chartered Accountants and Statutory Auditors

Newcastle upon Tyne

30 March 2011

Independent Auditors' report to the Shareholder of Northern Rock (Asset Management) plc

We have audited the Group and Parent Company Financial Statements (the 'Financial Statements') of Northern Rock (Asset Management) plc for the year ended 31 December 2010 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Balance Sheets, the Consolidated and Company Statements of Changes in Equity, the Consolidated and Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union and, as regards the Parent Company Financial Statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of Directors and Auditors

As explained more fully in the Directors' Responsibilities Statement on page 45, the Directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the Financial Statements

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

Opinion on Financial Statements

In our opinion:

- the Financial Statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2010 and of the Group's profit and Group's and Parent Company's cash flows for the year then ended,
- the Group Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the Parent Company Financial Statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the Financial Statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

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

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Consolidated Income Statement

For the year ended 31 December

	Note	2010 £m	(Restated) ¹ 2009 £m
Interest receivable and similar income	4	1,741.8	2,249.2
Interest expense and similar charges	4	(481.9)	(990.1)
Net interest income		1,259.9	1,259.1
Fee and commission income		19.1	26.8
Fee and commission expense		(15.9)	(84.6)
Net fee and commission income / (expense)		3.2	(57.8)
Net realised gains less losses on investment securities	17	0.2	(6.8)
Unrealised fair value movements on financial instruments	6	417.7	95.3
Hedge ineffectiveness	6	(65.0)	(101.7)
Provision for customer redress	31	(160.0)	(78.5)
Other operating income		7.1	12.5
Non interest income		203.2	(137.0)
Net operating income		1,463.1	1,122.1
Analysed as			
Exceptional State aid clawback	4	-	200.0
Recurring net operating income		1,463.1	922.1
		1,463.1	1,122.1
Administrative expenses			
- Ongoing	5	(165.2)	(265.6)
- Other net expenses	5	(138.4)	-
- Exceptional operating expenses	5	-	(39.9)
- The Northern Rock Foundation donation	5	-	(30.0)
Impairment on loans and advances to customers	13	(812.8)	(1,044.8)
Net impairment on investment securities	17	(15.0)	0.7
Defined benefit pension scheme curtailment	30	9.1	-
Gain on repurchase of capital instruments	7	59.7	-
Profit / (loss) before taxation		400.5	(257.5)
Taxation	8	9.1	(19.1)
Profit / (loss) for the financial year		409.6	(276.6)
Attributable to			
Appropriations	36	-	32.5
Profit / (loss) attributable to equity shareholder		409.6	(309.1)
Total		409.6	(276.6)

The notes on pages 62 to 115 form an integral part of these Financial Statements

¹ See note 3

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2010

	Note	Gross of tax £m	Tax £m	Net of tax £m
Profit for the financial year		400.5	9.1	409.6
Available-for-sale instruments	38			
- Net gains recognised in available-for-sale reserve during the year		134.6	-	134.6
- Amounts transferred from available-for-sale reserve and recognised in profit during the year		7.9	-	7.9
Cash flow hedges	38			
- Net gains recognised in cash flow hedge reserve during the year		43.5	-	43.5
- Amounts transferred from cash flow hedge reserve and recognised in profit during the year		15.8	-	15.8
Actuarial gains and losses on retirement benefit obligations	30	(6.2)	-	(6.2)
Total other comprehensive income		195.6	-	195.6
Total comprehensive income for the financial year		596.1	9.1	605.2
Attributable to				
Appropriations	36	-	-	-
Comprehensive income attributable to equity shareholder		596.1	9.1	605.2
Total		596.1	9.1	605.2

For the year ended 31 December 2009

	Note	Gross of tax £m	Tax £m	Net of tax £m
Loss for the financial year		(257.5)	(19.1)	(276.6)
Available-for-sale instruments	38			
- Net gains recognised in available-for-sale reserve during the year		232.9	0.2	233.1
- Amounts transferred from available-for-sale reserve and recognised in loss during the year		(16.9)	-	(16.9)
Cash flow hedges	38			
- Net gains recognised in cash flow hedge reserve during the year		164.8	-	164.8
- Amounts transferred from cash flow hedge reserve and recognised in loss during the year		(20.9)	-	(20.9)
Actuarial gains and losses on retirement benefit obligations	30	(45.9)	11.1	(34.8)
Total other comprehensive income		314.0	11.3	325.3
Total comprehensive income for the financial year		56.5	(7.8)	48.7
Attributable to				
Appropriations	36	32.5	-	32.5
Comprehensive income attributable to equity shareholder		24.0	(7.8)	16.2
Total		56.5	(7.8)	48.7

The cumulative other comprehensive income in respect of assets classified as held for resale is £16.2m at 31 December 2009

The notes on pages 62 to 115 form an integral part of these Financial Statements

Consolidated Balance Sheet

At 31 December

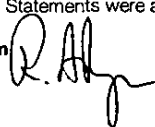
	Note	Total 2010 £m	Continuing operations 2009 £m	Held for resale 2009 £m	Total 2009 £m
Assets					
Cash and balances at central banks	10	6,980.8	7,500.5	9.9	7,510.4
Loans and advances to banks	11	1,944.0	2,836.8	865.6	3,702.4
Loans and advances to customers	12	47,758.5	53,924.9	10,343.3	64,268.2
Fair value adjustments on portfolio hedging	12	539.6	971.3	160.3	1,131.6
Investment securities and unsecured investment loans	17	2,396.4	2,663.8	424.0	3,087.8
Derivative financial instruments	42	6,542.5	7,473.8	–	7,473.8
Prepayments and accrued income		15.4	13.5	13.7	27.2
Other assets		16.1	24.5	4.4	28.9
Current tax assets		6.6	6.8	–	6.8
Retirement benefit asset	30	8.3	–	–	–
Investment property	20	26.6	–	–	–
Property, plant and equipment	21	41.9	121.9	32.7	154.6
Intangible assets	22	–	30.7	23.1	53.8
Total assets		66,276.7	75,568.5	11,877.0	87,445.5

Items held for resale are those transferred to Northern Rock plc on 1 January 2010

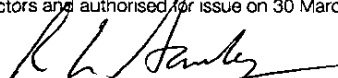
The notes on pages 62 to 115 form an integral part of these Financial Statements

The Financial Statements were approved by the Board of Directors and authorised for issue on 30 March 2011 and signed on its behalf by

Richard Pym
Chairman



Richard Banks
Chief Executive Officer



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

Consolidated Balance Sheet (continued)

At 31 December

	Note	Total 2010 £m	Continuing operations 2009 £m	Held for resale 2009 £m	Total 2009 £m
Liabilities					
Loans from HM Treasury	24	21,713.4	14,315.5	–	14,315.5
Deposits by banks	25	4,900.8	5,787.0	235.3	6,022.3
Customer accounts	26	–	–	20,607.6	20,607.6
Derivative financial instruments	42	826.4	1,673.8	–	1,673.8
Debt securities in issue					
- Securitised notes	14	24,015.1	28,801.9	–	28,801.9
- Covered bonds	15	9,783.8	9,866.1	–	9,866.1
- Other	16	2,084.4	3,305.7	–	3,305.7
Other liabilities	28	117.7	68.7	19.2	87.9
Accruals and deferred income	29	231.9	252.7	188.4	441.1
Deferred tax liabilities	23	3.3	7.1	–	7.1
Retirement benefit obligations	30	–	4.9	–	4.9
Provisions	31	215.2	87.8	–	87.8
Subordinated liabilities	32	930.6	935.0	–	935.0
Tier one notes	34	135.7	233.7	–	233.7
Total liabilities		64,958.3	65,339.9	21,050.5	86,390.4
Equity					
Issued capital and reserves attributable to equity holder of the parent					
- Share capital	37	124.0	124.0	–	124.0
- Share premium reserve	38	403.2	403.2	–	403.2
- Capital redemption reserve	38	7.3	7.3	–	7.3
- Available-for-sale reserve	38	(227.6)	(370.1)	(16.2)	(386.3)
- Cash flow hedge reserve	38	(66.5)	(125.8)	–	(125.8)
- Retained earnings		868.9	(425.5)	17.1	(408.4)
Share capital and reserves		1,109.3	(386.9)	0.9	(386.0)
Non shareholders' funds					
Reserve capital instruments	35	156.2	299.3	–	299.3
Subordinated notes	33	52.9	1,141.8	–	1,141.8
Total non shareholders' funds		209.1	1,441.1	–	1,441.1
Total equity		1,318.4	1,054.2	0.9	1,055.1
Total equity and liabilities		66,276.7	66,394.1	21,051.4	87,445.5

The notes on pages 62 to 115 form an integral part of these Financial Statements

Company Balance Sheet

At 31 December

	Note	Total 2010 £m	Continuing operations 2009 £m	Held for resale 2009 £m	Total 2009 £m
Assets					
Cash and balances at central banks	10	6,980 8	7 500 5	9 9	7,510 4
Loans and advances to banks	11	1,795 4	2,888 0	864 6	3,552 6
Loans and advances to customers	12	47,799 7	54,005 6	10,343 3	64,348 9
Fair value adjustments on portfolio hedging	12	539 6	971 3	160 3	1,131 6
Investment securities and unsecured investment loans	17	2,341 8	2,610 4	424 0	3,034 4
Derivative financial instruments	42	3,022 1	3,459 7	–	3 459 7
Prepayments and accrued income		16 4	14 2	13 7	27 9
Other assets		16 1	58 1	4 1	62 2
Investments in Group undertakings	19	35 0	35 0	50 0	85 0
Current tax assets		7 4	8 0	–	8 0
Retirement benefit asset	30	8 3	–	–	–
Investment property	20	24 5	–	–	–
Property, plant and equipment	21	43 9	130 7	32 7	163 4
Intangible assets	22	–	–	23 1	23 1
Total assets		62,631 0	71,481 5	11,925 7	83,407 2

Items held for resale are those transferred to Northern Rock plc on 1 January 2010

The notes on pages 62 to 115 form an integral part of these Financial Statements

The Financial Statements were approved by the Board of Directors and authorised for issue on 30 March 2011 and signed on its behalf by

Richard Pym
Chairman

Richard Banks
Chief Executive Officer

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

Company Balance Sheet (continued)

At 31 December

	Note	Total 2010 £m	Continuing operations 2009 £m	Held for resale 2009 £m	Total 2009 £m
Liabilities					
Loans from HM Treasury	24	21,713.4	14,315.5	–	14,315.5
Deposits by banks	25	3,213.5	3,502.8	1,249.4	4,752.2
Customer accounts	26	–	–	19,671.6	19,671.6
Other deposits	27	21,940.3	26,819.4	–	26,819.4
Derivative financial instruments	42	826.4	1,668.8	–	1,668.8
Debt securities in issue					
- Covered bonds	15	9,783.8	9,866.1	–	9,866.1
- Other	16	2,084.4	3,305.7	–	3,305.7
Other liabilities	28	397.0	286.7	17.4	304.1
Accruals and deferred income	29	223.8	244.0	177.9	421.9
Deferred tax liabilities	23	–	3.8	–	3.8
Retirement benefit obligations	30	–	4.9	–	4.9
Provisions	31	215.2	87.8	–	87.8
Subordinated liabilities	32	930.6	935.0	–	935.0
Tier one notes	34	135.7	233.7	–	233.7
Total liabilities		61,464.1	61,274.2	21,116.3	82,390.5
Equity					
Issued capital and reserves attributable to equity holder of the parent					
- Share capital	37	124.0	124.0	–	124.0
- Share premium reserve	38	403.2	403.2	–	403.2
- Capital redemption reserve	38	7.3	7.3	–	7.3
- Available-for-sale reserve	38	(227.7)	(369.4)	(16.2)	(385.6)
- Cash flow hedge reserve	38	(66.5)	(125.8)	–	(125.8)
- Retained earnings		717.5	(447.5)	–	(447.5)
Share capital and reserves		957.8	(408.2)	(16.2)	(424.4)
Non shareholders' funds					
Reserve capital instruments	35	156.2	299.3	–	299.3
Subordinated notes	33	52.9	1,141.8	–	1,141.8
Total non shareholders' funds		209.1	1,441.1	–	1,441.1
Total equity		1,166.9	1,032.9	(16.2)	1,016.7
Total equity and liabilities		62,631.0	62,307.1	21,100.1	83,407.2

The notes on pages 62 to 115 form an integral part of these Financial Statements

Consolidated Statement of Changes in Equity

For the year ended 31 December 2010

	Note	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total share capital & reserves £m	Non shareholders' funds £m	Total equity £m
At 31 December 2009		124 0	403 2	7 3	(512.1)	(408 4)	(386 0)	1,441 1	1,055 1
Transferred to Northern Rock plc	48	–	–	–	16.2	(17 1)	(0 9)	–	(0 9)
At 1 January 2010		124 0	403 2	7 3	(495 9)	(425.5)	(386 9)	1,441 1	1,054 2
Other comprehensive income									
- Net movement in available-for-sale reserve	38	–	–	–	142 5	–	142.5	–	142 5
- Net movement in cash flow hedge reserve	38	–	–	–	59 3	–	59.3	–	59 3
- Actuarial gains and losses	30	–	–	–	–	(6 2)	(6.2)	–	(6 2)
- Tax effects of the above		–	–	–	–	–	–	–	–
Total other comprehensive income		–	–	–	201 8	(6.2)	195 6	–	195 6
Profit for the financial year		–	–	–	–	409 6	409 6	–	409 6
Gain on repurchase of capital instruments	7	–	–	–	–	891.0	891 0	(1,232.0)	(341 0)
At 31 December 2010		124 0	403 2	7 3	(294 1)	868.9	1,109 3	209 1	1,318.4

For the year ended 31 December 2009

	Note	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total share capital & reserves £m	Non shareholders' funds £m	Total equity £m
At 1 January 2009		124 0	403 2	7 3	(872 2)	(64 5)	(402 2)	1,035 8	633 6
Other comprehensive income									
- Net movement in available-for-sale reserve	38	–	–	–	216 0	–	216 0	–	216 0
- Net movement in cash flow hedge reserve	38	–	–	–	143 9	–	143 9	–	143 9
- Actuarial gains and losses	30	–	–	–	–	(45 9)	(45 9)	–	(45 9)
- Tax effects of the above		–	–	–	0 2	11 1	11 3	–	11 3
Total other comprehensive income		–	–	–	360 1	(34 8)	325 3	–	325 3
Loss for the financial year		–	–	–	–	(309 1)	(309 1)	32 5	(276 6)
Appropriations	36	–	–	–	–	–	–	(32 5)	(32 5)
Reclassification of subordinated debt instrument	33	–	–	–	–	–	–	405 3	405 3
At 31 December 2009		124 0	403 2	7 3	(512 1)	(408 4)	(386 0)	1,441 1	1 055 1

The notes on pages 62 to 115 form an integral part of these Financial Statements

Company Statement of Changes in Equity

For the year ended 31 December 2010

	Note	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total share capital & reserves £m	Non shareholders' funds £m	Total equity £m
At 31 December 2009		124.0	403.2	7.3	(511.4)	(447.5)	(424.4)	1,441.1	1,016.7
Transferred to Northern Rock plc	48	-	-	-	16.2	-	16.2	-	16.2
At 1 January 2010		124.0	403.2	7.3	(495.2)	(447.5)	(408.2)	1,441.1	1,032.9
Other comprehensive income									
- Net movement in available-for-sale reserve	38	-	-	-	141.7	-	141.7	-	141.7
- Net movement in cash flow hedge reserve	38	-	-	-	59.3	-	59.3	-	59.3
- Actuarial gains and losses	30	-	-	-	-	(6.2)	(6.2)	-	(6.2)
- Tax effects of the above		-	-	-	-	-	-	-	-
Total other comprehensive income		-	-	-	201.0	(6.2)	194.8	-	194.8
Profit for the financial year	9	-	-	-	-	280.2	280.2	-	280.2
Gain on repurchase of capital instruments	7	-	-	-	-	891.0	891.0	(1,232.0)	(341.0)
At 31 December 2010		124.0	403.2	7.3	(294.2)	717.5	957.8	209.1	1,166.9

For the year ended 31 December 2009

	Note	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Other reserves £m	Retained earnings £m	Total share capital & reserves £m	Non shareholders' funds £m	Total equity £m
At 1 January 2009		124.0	403.2	7.3	(869.5)	(75.0)	(410.0)	1,035.8	625.8
Other comprehensive income									
- Net movement in available-for-sale reserve	38	-	-	-	213.3	-	213.3	-	213.3
- Net movement in cash flow hedge reserve	38	-	-	-	143.9	-	143.9	-	143.9
- Actuarial gains and losses	30	-	-	-	-	(45.9)	(45.9)	-	(45.9)
- Tax effects of the above		-	-	-	0.9	11.1	12.0	-	12.0
Total other comprehensive income		-	-	-	358.1	(34.8)	323.3	-	323.3
Loss for the financial year	9	-	-	-	-	(337.7)	(337.7)	32.5	(305.2)
Appropriations	36	-	-	-	-	-	-	(32.5)	(32.5)
Reclassification of subordinated debt instrument	33	-	-	-	-	-	-	405.3	405.3
At 31 December 2009		124.0	403.2	7.3	(511.4)	(447.5)	(424.4)	1,441.1	1,016.7

The notes on pages 62 to 115 form an integral part of these Financial Statements

Consolidated Cash Flow Statement

For the year ended 31 December

	Note	2010 £m	2009 £m
Cash flows from operating activities			
Profit / (loss) after taxation for the financial year		409 6	(276 6)
Adjustments to reconcile profit / (loss) to cash flow used in operating activities			
Taxation	8	(9 1)	19 1
Depreciation and amortisation	5	54.8	24 3
Impairment of goodwill	5	30 7	–
Gain on repurchase of capital instruments	7	(59 7)	–
Exceptional impairment credits on property, plant and equipment	21	–	(5 3)
Impairment on loans and advances to customers	13	812 8	1 044 8
Net impairment on investment securities	17	15 0	(0 7)
Provision for customer redress	31	160 0	78 5
Income taxes refunded		5 2	39 4
Fair value adjustments on financial instruments		645.5	335 9
Other non-cash movements		404 0	320 9
Cash flows from operating activities before changes in operating assets and liabilities		2,468 8	1 580 3
Net (increase) / decrease in operating assets			
- Deposits held for regulatory or monetary control purposes		63 8	(12 4)
- Loans and advances to banks and customers		15,723 6	6 853 9
- Derivative financial instruments receivable		931 3	5,840 6
- Other assets		12 8	4 0
- Prepayments and accrued income		11 8	87 8
Net increase / (decrease) in operating liabilities			
- Debt securities in issue		(6,208 0)	(15,754 7)
- Loans from HM Treasury		7,397 9	(1,267 9)
- Deposits from other banks		(1,121 5)	1,397 2
- Amounts due to customers		(20,556 9)	(48 5)
- Derivative financial instruments payable		(847 4)	(547 0)
- Provisions	31	(31 8)	(16 6)
- Other liabilities		29 8	10 3
- Accruals and deferred income		(209 2)	(508 3)
Net cash used in operating activities		(2,335 0)	(2,381 3)
Cash flows from investing activities			
Net disposal of property, plant and equipment and intangible assets		54 4	35 9
Purchase of investment securities		(83 5)	(42 6)
Proceeds from sale and redemption of investment securities		527 2	764 1
Net cash from investing activities		498 1	757 4
Cash flows used in financing activities			
Appropriations (including tax of £nil, 2009 £nil)	36	–	(32 5)
Repurchase of capital instruments	7	(392 3)	–
Net cash used in financing activities		(392 3)	(32 5)
Net decrease in cash and cash equivalents		(2,229 2)	(1,656 4)
Cash and cash equivalents at beginning of year		11,154 0	12,810 4
Cash and cash equivalents at end of year		8,924 8	11,154 0
Represented by cash and assets with original maturity of three months or less within			
- Cash and balances at central banks		6,980 8	7 446 6
- Loans and advances to banks		1,944 0	3,702 4
- Investment securities and unsecured investment loans		–	5 0
Total		8,924 8	11,154 0
Mandatory balances maintained with the Bank of England		–	63 8

The Group maintained mandatory balances with the Bank of England as shown above. These balances were not included in cash and cash equivalents for the purposes of the Cash Flow Statement as they were not accessible by the Group. The notes on pages 62 to 115 form an integral part of these Financial Statements.

Company Cash Flow Statement

For the year ended 31 December

	Note	2010 £m	2009 £m
Cash flows from operating activities			
Profit / (loss) after taxation for the financial year		280.2	(337.7)
Adjustments to reconcile profit / (loss) to cash flow used in operating activities			
Taxation		(9.1)	14.6
Depreciation and amortisation		63.8	26.6
Gain on repurchase of capital instruments	7	(59.7)	–
Exceptional impairment credits on property, plant and equipment	21	–	(5.3)
Impairment on loans and advances to customers		812.7	1,044.8
Net impairment on investment securities	17	15.0	(0.7)
Provision for customer redress	31	160.0	78.5
Income taxes refunded		6.7	39.5
Fair value adjustments on financial instruments		645.5	339.4
Other non-cash movements		420.1	316.1
Cash flows from operating activities before changes in operating assets and liabilities		2,335.2	1,515.8
Net (increase) / decrease in operating assets			
- Deposits held for regulatory or monetary control purposes		63.8	(12.4)
- Loans and advances to banks and customers		15,763.2	6,945.2
- Derivative financial instruments receivable		437.6	2,582.1
- Other assets		46.1	99.4
- Prepayments and accrued income		11.5	91.0
Net increase / (decrease) in operating liabilities			
- Debt securities in issue		(1,421.2)	(6,573.2)
- Loans from HM Treasury		7,397.9	(1,267.9)
- Deposits from other banks		(1,538.7)	(65.0)
- Amounts due to customers		(19,620.9)	84.5
- Other deposits		(4,879.1)	(4,707.3)
- Derivative financial instruments payable		(842.4)	(540.9)
- Provisions	31	(31.8)	(16.6)
- Other liabilities		92.9	83.7
- Accruals and deferred income		(198.1)	(475.0)
Net cash used in operating activities		(2,384.0)	(2,256.6)
Cash flows from investing activities			
Net disposal of investments in Group undertakings		50.0	–
Net disposal of property, plant and equipment and intangible assets		54.3	13.5
Purchase of investment securities		(33.5)	(0.2)
Proceeds from sale and redemption of investment securities		482.5	612.9
Net cash from investing activities		553.3	626.2
Cash flows used in financing activities			
Appropriations (including tax of £nil, 2009 £nil)	36	–	(32.5)
Repurchase of capital instruments	7	(392.3)	–
Net cash used in financing activities		(392.3)	(32.5)
Net decrease in cash and cash equivalents		(2,223.0)	(1,662.9)
Cash and cash equivalents at beginning of year		10,999.2	12,662.1
Cash and cash equivalents at end of year		8,776.2	10,999.2
Represented by cash and assets with original maturity of three months or less within			
- Cash and balances at central banks		6,980.8	7,446.6
- Loans and advances to banks		1,795.4	3,552.6
- Investment securities and unsecured investment loans		–	–
Total		8,776.2	10,999.2
Mandatory balances maintained with the Bank of England		–	63.8

The Company maintained mandatory balances with the Bank of England as shown above. These balances were not included in cash and cash equivalents for the purposes of the Cash Flow Statement as they were not accessible by the Company. The notes on pages 62 to 115 form an integral part of these Financial Statements.

NRAM

Notes to the Financial Statements

1. Principal accounting policies

Northern Rock (Asset Management) plc ('the Company') is a public limited company which was incorporated in the United Kingdom under the Companies Act 1985. The Company is domiciled in the United Kingdom and registered in England and Wales.

These Financial Statements were authorised for issue by the Directors on 30 March 2011 and will be put to the shareholder for approval at the Company's Annual General Meeting to be held on 28 April 2011.

(a) Statement of compliance

Both the Company Financial Statements and the Group (comprising the Company and its subsidiaries) Financial Statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU. In publishing the Company Financial Statements here together with the Group Financial Statements, the Company has taken advantage of the exemption in s408 of the Companies Act 2006 not to present its individual Income Statement and related notes.

For these 2010 Financial Statements, including the 2009 comparative financial information where applicable, the Group and Company have adopted for the first time the following statements:

- The January 2008 amendment to IFRS 3 'Business Combinations'. This amendment does not change the treatment of business combinations which occurred in prior years and has had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.
- The May 2008 amendment to IAS 27 'Consolidated and Separate Financial Statements'. This amendment has had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.
- The July 2008 amendment to IAS 39 'Financial Instruments: Recognition and Measurement' relating to eligible hedged items. This amendment has had no impact on the Group's or Company's Income Statements, Balance Sheets or Cash Flow Statements.

For these 2010 Financial Statements the Group and Company have not adopted the following statement:

- IFRS 9 'Financial Instruments', issued in October 2010 as part of the IASB's project to replace IAS 39. This is expected to be mandatory for 2013 Financial Statements, with 2012 comparative information, but has not yet been adopted for use in the EU.

All other new standards, amendments to standards and interpretations are not relevant to and have no impact upon the Financial Statements of the Group and Company.

(b) Basis of preparation

The Financial Statements have been prepared on a going concern basis and using the historical cost convention except:

- (i) the following assets and liabilities are carried at their fair value:
 - derivative financial instruments
 - financial instruments categorised under IAS 39 as 'at fair value through profit or loss'
 - financial instruments categorised under IAS 39 as 'available-for-sale'
 - investment property
- (ii) where fair value hedge accounting has been applied, the carrying value of hedged items has been adjusted to take account of the fair value of the risk which has been hedged.

Following the completion of a legal and capital restructuring on 1 January 2010, the Company no longer operates as a deposit taking institution under the supervision of the Financial Services Authority ('FSA'). It is now regulated by the FSA as a mortgage administration company and the Directors believe it has appropriate and adequate levels of capital to support these activities. On 1 October 2010, all shares in the Company were acquired via a share for share exchange by UK Asset Resolution Limited who became the Company's ultimate parent undertaking from that date.

The validity of the going concern basis of accounting is dependent upon the funding position of the Company. At the date of approval of these Financial Statements, the Group and Company are reliant upon the financing facilities and also upon the guarantee arrangements provided to the Company by HM Treasury. Withdrawal of the financing facilities, which are repayable on demand, or the guarantee arrangements would have a significant impact on the Group's and Company's operations and their ability to continue as a going concern, in which case adjustments may have to be made to reduce the carrying value of assets to recoverable amounts and to provide for further liabilities that might arise. At the signing date, HM Treasury has confirmed its intentions to continue to provide funding until at least 31 December 2012. It has also committed to convert up to £1.6bn of its loan to meet regulatory capital requirements if so required.

The Directors consider that the accounting policies set out in this note are the most appropriate to the Group's and the Company's circumstances, have been consistently applied to both the Group and the Company in dealing with items which are considered material, and are supported by reasonable and prudent estimates and judgements. The accounting policies have been applied to all periods presented in these Financial Statements and are consistent with the accounting policies used by the Group in preparing its Interim Financial Information for the six months ended 30 June 2010.

The Financial Statements have been prepared in accordance with EU endorsed International Financial Reporting Standards ('IFRS'), International Financial Reporting Interpretations Committee ('IFRIC') interpretations and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. A summary of accounting policies is set out below. The preparation of the Financial Statements in conformity with these accounting policies and generally accepted accounting principles requires the use of estimates and assumptions that affect the reported values of assets and liabilities at the date of the Financial Statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates (see note 2).

Notes to the Financial Statements (continued)

1. Principal accounting policies**(c) Basis of consolidation**

The Group's Financial Statements incorporate on a fully consolidated line-by-line basis the Financial Statements of the Company and those entities (including special purpose structures) which are controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. Where subsidiaries have been acquired during a period, their results are consolidated into the Group's Financial Statements from the date control is transferred to the Group. Where subsidiaries have been disposed of, their results are consolidated to the date of disposal. On the acquisition of a business, fair values are attributed to the assets, liabilities and contingent liabilities acquired. Any difference between the consideration given and the fair value of the net assets acquired is capitalised as goodwill, which is subject to impairment testing in accordance with IAS 36.

The Group has securitised various residential mortgage loans, generally by sale or transfer to Special Purpose Vehicles ("SPVs") which in turn issue securities to investors. The SPVs are consolidated line-by-line into the Group Financial Statements if they are, in substance, controlled by the Company. The Group presently receives substantially all of the post-tax profits of all the SPVs and hence retains substantially all of the risks and rewards of the securitised loans, and consequently all of the SPVs are fully consolidated.

(d) Interest income and expense

For all interest-bearing financial instruments except derivatives and any assets or liabilities held at fair value through profit and loss, interest income and expense are recognised in the Income Statement on an Effective Interest Rate ("EIR") basis.

The EIR method calculates the amortised cost of a financial asset or financial liability and spreads the resulting interest income or interest expense on a level yield basis over the expected life of the instrument. The EIR is the rate which at the inception of the instrument exactly discounts expected future cash flows over the expected life of the instrument to the initial carrying amount. When calculating the EIR, future cash flows are estimated, considering all contractual terms of the instrument (for example prepayment options) but potential future credit losses are not considered. The calculation includes all directly attributable incremental fees and costs, premia on acquisition of mortgage portfolios and all other premia and discounts as well as interest.

When a financial asset or a group of similar financial assets is written down as a result of an impairment loss, interest income continues to be recognised by applying the applicable EIR to the reduced balance.

(e) Fee and commission income

Where Value Added Tax (VAT) is charged, income is stated net of VAT.

Fee and commission income arises on various activities and where they are not included within the EIR calculation, they are generally recognised on an accruals basis when the service has been provided, or as cash is received, and are accounted for within 'fee and commission income' in the Income Statement.

(f) Bonuses payable

Accrual is made for all bonuses which have been earned by the Balance Sheet date, even though these may not subsequently be payable due to clawback or the employee leaving the Group.

(g) Financial instruments

In accordance with IAS 39 'Financial Instruments: Recognition and Measurement' each financial asset is classified at initial recognition into one of four categories:

- (i) Financial assets at fair value through profit or loss
- (ii) Held-to-maturity investments,
- (iii) Loans and receivables, or
- (iv) Available-for-sale,

and each financial liability into one of two categories:

- (v) Financial liabilities at fair value through profit or loss, or
- (vi) Other liabilities

The Fair Value Option within IAS 39 permits designation of a financial asset or financial liability as being at fair value through profit or loss under wider circumstances than had previously been allowed.

Where the Directors believe it appropriate to do so, financial assets may be reclassified out of the 'fair value through profit or loss' and 'available-for-sale' categories to 'loans and receivables' or 'held to maturity' in accordance with the revisions to IAS 39 issued by the IASB in October 2008 and effective from July 2008. Reclassification is permitted only under certain restricted circumstances, including that there is no active market for the asset. The asset is reclassified using its fair value at the point of transfer, and from that point on is accounted for on an EIR basis. The difference between the carrying value at the point of reclassification and the expected value at the redemption date is recognised in profit or loss on an EIR basis over the expected life of the asset and the asset's carrying value accretes up to the redemption amount over that period. The balance in the available-for-sale reserve which related to the asset is amortised to profit or loss over the expected life of the asset, in the Income Statement the amortisation of the difference between value at reclassification and at redemption and the amortisation out of the available-for-sale reserve exactly offset each other.

Measurement of financial instruments is either at amortised cost (categories (ii), (iii) and (vi) above) or at fair value (categories (i), (iv) and (v) above), depending on the category of financial instrument.

Amortised cost is the amount measured at initial recognition, adjusted for subsequent principal and other payments, less cumulative amortisation calculated using the EIR method, the amortisation is taken to interest income or expense depending on whether the instrument is an asset or a liability. For assets, the amortised cost balance is reduced where appropriate by an allowance for amounts which are considered to be impaired or uncollectible.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Where an active market exists, fair values are based on quoted market prices. For instruments which do not have active markets, fair value is calculated using present value models, which take individual cash flows together with assumptions based on market conditions and credit spreads, and are consistent with accepted economic methodologies for pricing financial instruments. Interest income and interest expense on instruments carried at fair value are included in the Income Statement in 'interest receivable and similar income' or 'interest expense and similar charges'. Movements in fair value are recognised in the 'unrealised fair value movements on financial instruments' line in the Income Statement, except in the case of instruments categorised as 'available-for-sale', in which case the fair value movements are taken to the 'available-for-sale' reserve. On sale or derecognition of an available-for-sale instrument the accumulated fair value movements are transferred from the 'available-for-sale' reserve to the 'net realised gains less losses on investment securities' line of the Income Statement.

Certain certificates of deposit, fixed and floating rate notes and mortgage-backed securities are classified as available-for-sale.

(h) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the Balance Sheet only where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(i) Derivative financial instruments and hedge accounting

All of the Group's derivative contracts are used for commercial management of exposures to interest rate risks, foreign currency risks and risks arising from forecast transactions.

For most of the Group's derivative contracts hedge accounting is applied. However, in some cases natural offsets apply and, as explained in note 1g, the Company has used the provisions of the Fair Value Option amendment to IAS 39 to prevent technical accounting mismatches in respect of certain swap arrangements.

All derivatives are carried at fair value in the Balance Sheet, as assets when the fair value is positive and as liabilities when the fair value is negative. The fair value of a derivative includes any interest accrued on that derivative. Changes in the fair value of derivatives are charged to the Income Statement, however by applying the hedge accounting rules set out in IAS 39 the changes in fair value of derivatives which are used to hedge particular risks can either be mitigated in the Income Statement (fair value hedging) or deferred to reserves (cash flow hedging). The Group has adopted cash flow hedge accounting and fair value hedge accounting.

(i) Cash flow hedges

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

(ii) Fair value hedges

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans. Changes in fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the Income Statement over the period to maturity. The Group uses hedge accounting on one-to-one relationship and portfolio hedging bases, as described below.

Embedded derivatives

Certain financial instruments have embedded within them derivative features. Where the economic characteristics and risks of the embedded derivative are not closely related to those of the host instrument and where changes in value in the host instrument are not reflected in the Income Statement, the embedded derivative is separated from the host and carried in the Balance Sheet at fair value, with gains and losses on the embedded derivative being recognised in the Income Statement. In accordance with IFRIC 9 'Reassessment of Embedded Derivatives' the decision as to whether to separate and value an embedded derivative is reassessed when and only when the terms of the host contract are significantly modified.

One-to-one fair value hedges

Where one or more specific derivative financial instruments hedge the changes in fair value of a specific asset or liability, provided that the hedge arrangement meets the requirements of IAS 39 to be classed as 'highly effective', the associated hedged item is carried on the Balance Sheet at fair value in respect of the hedged risk. Fair value gains and losses are recognised in the Income Statement, mitigating the fair value movements on the associated derivative financial instruments. Hence profit volatility is mitigated. The Income Statement immediately recognises any hedge accounting 'ineffectiveness', that is any difference between the fair value movement on the hedging instrument and that on the hedged item.

Portfolio fair value hedges

Where a group of derivative financial instruments hedges the interest rate exposure of a group of assets or liabilities, and the hedge meets the requirements of IAS 39 to be classed as 'highly effective', the hedge relationship is accounted for in the same way as a one-to-one fair value hedge except that the Balance Sheet carrying value of the hedged items is not adjusted, instead the difference between the carrying value and the fair value in respect of the hedged risk is carried on the Balance Sheet in 'fair value adjustments on portfolio hedging'.

Termination of hedges

Where a hedge relationship is terminated or deemed not to be highly effective (other than as a result of the hedged item being derecognised from the Balance Sheet due to sale or other reason), the adjustment relating to the terminated hedge relationship is amortised to the Income Statement over the period to the date of maturity of the hedged item. The derivative continues to be carried at fair value.

Hedge effectiveness

At the inception of each hedging arrangement, the relationship between the hedging instruments and the hedged items is documented, as well as the risk management objective and strategy. Also documented is an assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in the hedging arrangement are highly effective in offsetting changes in fair values or cash flows of the hedged items.

Under IAS 39 a hedge is deemed to be highly effective if effectiveness is forecast to fall, and is actually found to fall, within the 80% to 125% range. Any hedge relationship falling outside these limits is deemed to be ineffective and hedge accounting is discontinued.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(j) Sale and repurchase agreements

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

(k) Impairment losses

Financial assets which are not held at fair value through profit or loss are reviewed for indications of possible impairment throughout the year and at each published Balance Sheet date.

An impairment loss is recognised if, and only if, there is objective evidence that a loss event (or events) has occurred after initial recognition and before the Balance Sheet date and has a reliably measurable impact on the estimated future cash flows of the financial asset or groups of financial assets. Losses that are expected to be incurred as a result of events occurring after the Balance Sheet date are not recognised.

Financial assets held at amortised cost

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.

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

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

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

Available-for-sale financial assets

Impairment is recognised when the debt security exhibits objective evidence of impairment or is uncollectible. Such evidence may include:

- significant financial difficulty,
- payment defaults,
- renegotiation of terms due to borrower difficulty,
- sustained fall in credit rating or creditworthiness,
- significant restructuring,
- disappearance of an active market,
- significant and sustained fall in market price, or
- observable data indicating measurable decrease in the estimated future cash flows from a group of financial assets, although the decrease cannot yet be identified within individual assets in the group.

Movements in the fair value which are a reflection of impairment of the long term value of the debt security are charged to 'net impairment on investment securities' in the Income Statement. Investment impairment losses recognised against debt securities are reversed through 'net impairment on investment securities' in the Income Statement if the improvement relates to an event occurring after the initial impairment was recognised.

If there is a sustained increase in the fair value of a debt security where an impairment loss has previously been recognised, but no improvement can be attributed to a subsequent credit event, then the increase in value may be treated as a revaluation and recognised through the Consolidated Statement of Comprehensive Income in the available-for-sale reserve.

(l) Recognition and derecognition of financial instruments

Sales of mortgage portfolios are accounted for on the completion date. All other purchases and sales of financial assets are accounted for on the date of commitment to buy or sell (the 'trade date'). A financial asset is derecognised (i.e. removed from the Balance Sheet) only when substantially all of the risks and rewards associated with that asset have been transferred to another party and control is lost. In respect of the Company's secured funding structures, the Company sells to another entity the right to receive the cash flows arising on the loans which have been securitised. However, the Company receives substantially all of the post-tax profit of that entity, and hence retains substantially all of the risks and rewards of the securitised loans. Consequently both the debt securities in issue and the loans and advances to customers remain on the Group Balance Sheet within the appropriate Balance Sheet headings.

The Group derecognises financial liabilities only when the contractual obligation is discharged, cancelled or has expired.

Notes to the Financial Statements (continued)

1. Principal accounting policies (continued)

(m) Debt and equity securities in issue

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

On initial recognition, debt issued is measured at its fair value net of directly attributable issue and transaction costs. Subsequent measurement is at amortised cost using the EIR method to amortise attributable issue and transaction costs, premia and discounts over the life of the instrument. These costs are charged along with interest on the debt to 'interest expense and similar charges'. Unamortised amounts are added to or deducted from the carrying value of the instrument.

Equity instruments are initially recognised at net proceeds, after deducting transaction costs and any related income tax. Appropriations to holders of equity securities are deducted from equity net of any related income tax, as they become irrevocably due to the holders of the securities.

(n) Foreign currencies

The presentational and functional currency of the Group and Company is pounds sterling.

Transactions which are not denominated in pounds sterling are translated into sterling at the spot rate of exchange on the date of the transaction. Monetary assets and liabilities which are not denominated in pounds sterling are translated into pounds sterling at the closing rate of exchange at the Balance Sheet date.

Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in the Income Statement. Non-monetary items measured at amortised cost and denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are translated at the exchange rate at the date of valuation. Where these are held at fair value through profit and loss, exchange differences are reported as part of the fair value gain or loss.

(o) Intangible assets**(i) Goodwill**

Goodwill arising on the acquisition of subsidiary companies, which is represented by the excess of fair value of the purchase consideration over the fair value of the assets acquired, is capitalised and shown as an asset in the Balance Sheet. It is reviewed for impairment annually at the lowest level for which cash flows can be identified. Any impairment is recognised immediately in the Income Statement and is not subsequently reversed.

Goodwill arising on acquisitions before the date of transition to IFRS was retained at the previous UK GAAP amount, having been tested for impairment at 31 December 2003. This goodwill has been impaired in the current year (see note 22).

(ii) Computer software

Computer software licences are capitalised as intangible assets where it is probable that expected future benefits will flow to the Group. Thereafter they are carried at cost less accumulated amortisation. Amortisation is provided on a straight line basis over their useful economic lives, which may be up to five years. Those which have a life expectancy at the outset of less than two years are not capitalised but instead their costs are charged to the Income Statement as they arise.

Costs that are directly associated with developing identifiable computer software systems are capitalised if the criteria in IAS 38 'Intangible Assets' are satisfied, the main criteria are that the successful completion of the development project is reasonably certain and that the software is expected to generate future economic benefits. Each item of capitalised developed computer software is carried at cost less accumulated amortisation. Amortisation is provided on a straight line basis over its estimated useful life. Costs that do not qualify for capitalisation or are associated with maintaining software are charged to the Income Statement as they arise.

All items of intangible assets are reviewed annually for impairment. If any item is considered to be impaired, it is written down to the impaired value. In addition, the estimated useful lives are also reassessed annually, and if they are judged to have changed then the rate of amortisation charged in periods after the date of the change reflects the revised estimates.

(p) Cash and cash equivalents

For the purposes of the Cash Flow Statement, cash and cash equivalents comprise balances which are highly liquid and have an original maturity of three months or less.

(q) Taxation**(i) Current tax**

The charge for taxation is based on the result for the year and takes into account taxation deferred or accelerated arising from temporary differences between the carrying amounts of certain items for taxation and for accounting purposes. Tax relating to items which are taken directly to reserves is also taken directly to reserves.

(ii) Deferred tax

Deferred tax is calculated using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted by the Balance Sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled. The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits, rolled over gains on disposal of property, plant and equipment, unremitted earnings from overseas subsidiaries, tax losses carried forward and change in accounting basis on adoption of IFRS.

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

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

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

Notes to the Financial Statements (continued)

1. Principal accounting policies**(r) Pensions and employee benefits**

On 1 January 2010 all employees previously employed by the Company transferred to Northern Rock plc. As a consequence of this, members of the pension scheme operated by the Company became members of the Northern Rock (2010) Pension Scheme and the existing scheme, which had both defined benefit and defined contribution sections, was closed.

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

The Group's Income Statement includes the current service cost of providing pension benefits, the expected return on the scheme's assets net of administration costs, and the interest cost on the scheme's liabilities. Following closure of the scheme, the current service cost for 2010 and subsequent years is nil. Cumulative actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately through the Statement of Comprehensive Income.

Past service costs were recognised immediately in the Income Statement, unless the changes to the scheme were conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs were amortised on a straight line basis over the average vesting period.

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

(s) Property, plant and equipment

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

Depreciation is provided so as to write off the cost less the estimated residual value of each significant component of each item of property, plant and equipment over that component's estimated useful life, as follows:

- Freehold land is not depreciated
- Freehold buildings 1% - 2% pa on a straight line basis
- Leasehold properties over the shorter of the lease period and 50 years on a straight line basis
- Motor vehicles 25% pa on a straight line basis
- Computer equipment 20% - 33% pa on a straight line basis
- Plant 3% pa on a straight line basis
- Furniture 10% pa on a straight line basis
- Fixtures and fittings 20% pa on a straight line basis

All items of property, plant and equipment are reviewed annually for impairment. If any item is considered to be impaired, it is written down to the higher of value in use and estimated net proceeds of sale. In addition, the estimated useful lives and estimated residual values are also reassessed annually and if they are judged to have changed then the rate of depreciation charged in periods after the date of the change reflects the revised estimates.

Where a property ceases to be occupied by the Company and it is not intended to re-occupy or sell the property in the ordinary course of business, it is reclassified as an investment property and valued at fair value. Any shortfall between the carrying amount of the property and its fair value at the date of reclassification is charged to the Income Statement unless there is a revaluation surplus in respect of that property against which to allocate any shortfall. Any surplus between the carrying amount of the property and its fair value at the date of reclassification is credited direct to equity except to the extent that the increase reverses a previous impairment loss for that property, in which case the increase is recognised in the Income Statement.

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

A previously recognised impairment charge may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

Notes to the Financial Statements (continued)

1. Principal accounting policies**(t) Investment property**

Investment properties represent properties held as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the Balance Sheet at fair value with changes recognised in the Income Statement in the period of change. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

(u) Leases

Rentals under operating leases are charged to 'administrative expenses' on a straight line basis to the date of change in the rental amount. Typically operating leases have rent review dates in their terms, several years apart, and between those dates the annual rent remains constant. Any initial rent-free period and any lease premia paid are amortised over the full lease period on a straight line basis.

If a lease agreement in which the Group is a lessee transfers the risks and rewards of the asset, the lease is recorded as a finance lease and the related asset is capitalised. At inception the asset is recorded at the lower of the present value of the minimum lease payments or fair value and is depreciated over the estimated useful life. The lease obligations are recorded as borrowings. If the lease does not transfer the risks and rewards of the asset, the lease is recorded as an operating lease.

Where an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor in compensation is charged to the Income Statement in the period in which termination is made.

When the Group enters into a sale and leaseback arrangement, the leaseback is accounted for as a finance lease or an operating lease, according to its terms. If it is a finance lease, and the sale and leaseback gives rise to a profit, the profit is not recognised immediately but is deferred and amortised over the lease term. If it is an operating lease, any profit or loss is accounted for in the period of disposal.

Where the Group leases assets out under an operating lease agreement, the asset is included in the Balance Sheet based on the nature of the asset. Lease income is recognised over the term of the lease on a straight line basis.

(v) Provisions and contingent liabilities

Provisions are recognised when, and only when, the following criteria are all met:

- there is a present obligation (legal or constructive) as a result of a past event,
- it is probable that an outflow of resources will be required to settle the obligation, and
- a reliable estimate can be made of the amount of the obligation.

Provisions are discounted to net present value using rates which reflect the risks specific to the provision, if the effect of discounting is material.

Provisions are reviewed at each Balance Sheet date and are released if they no longer meet the above criteria.

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

(w) Disposal groups held for sale

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

(x) Investments in Group undertakings

In the Financial Statements of the Company, investments in Group undertakings are carried at cost less any impairment. Investments are reviewed at each published Balance Sheet date for any indications of impairment. If there is indication of impairment of any investment, the carrying value of the investment is reviewed, and any impairment identified is charged immediately to the Income Statement.

Notes to the Financial Statements (continued)

2. Critical judgements and accounting estimates

In preparing the Financial Statements management are required to make a series of judgements and estimates. Judgements involve an interpretation of requirements to decide how to allocate, value or recognise an item. Estimates arise from using assumptions which result in a range of possible outcomes. The most important judgements and estimates used in preparing these Financial Statements are described below.

Judgements

Financial instrument designation

Upon initial designation, judgement is required in ascertaining within which category, as prescribed in IAS 39, a financial instrument should be designated. The IAS 39 categories are detailed in the accounting policies set out in note 1 and the designation is based on the criteria specified in IAS 39.

Qualifying hedge relationships

In designating a financial instrument as part of a qualifying hedge relationship the Group and Company have determined that the hedge is expected to be highly effective over the life of the hedging instrument. In accounting for a derivative as a cash flow hedge the Group and Company have determined that the hedged cash flow exposure relates to highly probable future cash flows.

Impairment of investment securities

For investment securities carried at fair value, judgement is applied in determining whether any fall in value represents impairment. Factors considered in determining whether an asset is impaired or impairment has reversed, are detailed in note 1.

Securitisations

In applying the Group's policies on securitised financial assets the Group and Company have considered both the degree of transfer of risks and rewards on assets transferred to another entity and the degree of control exercised by the Group over the other entity.

- Where the Group, in substance, controls the entity to which financial assets have been transferred, the entity is included in these consolidated Financial Statements and the transferred assets continue to be recognised on the Group's Balance Sheet.
- Where the Company or another Group entity has transferred financial assets to another entity, but has not transferred substantially all of the risks and rewards relating to the transferred assets, the assets continue to be recognised on the transferring entity's Balance Sheet.

Fair value calculations

Fair value is defined as the value at which assets, liabilities or positions could be closed out or sold in an arm's length transaction with a willing and knowledgeable counterparty. For the majority of instruments carried at fair value, this is determined by reference to quoted market prices. Where these are not available, fair value is based upon cash flow models, which use, wherever possible, independently sourced market parameters such as interest rate yield curves, currency rates and option volatilities. Other factors are also considered, such as counterparty credit quality and liquidity. Management must use judgement to arrive at estimates where not all necessary data can be externally sourced or where factors specific to the Group's and Company's holdings need to be considered. The accuracy of the fair value calculations may therefore be affected by unexpected market movements or variations in actual outcomes when compared to estimates and assumptions used for modelling purposes. For example, if management were to use a tightening in the credit spread of 10 basis points, the fair values of liabilities (including derivatives) would increase from the reported fair values by £39.0m (2009: £52.5m).

Deferred tax assets

Significant management judgement is required to determine the extent to which tax losses can be offset against future taxable profits and therefore recognised in the form of deferred tax assets. This judgement is based upon examination and assessment of the business plan, and the expectation that there may be sufficient profitability in future years to utilise tax losses in the Company and certain subsidiaries. A deferred tax asset is recognised accordingly, but only to the extent to which future taxable profits are foreseen. In excess of this value any taxable losses are not recognised as deferred tax assets. Management continue to monitor closely the opportunities for the recoverability of unrecognised deferred tax assets and will reassess the appropriateness of recognition at subsequent Balance Sheet dates. Details of recognised and unrecognised deferred tax assets are contained in note 23.

Estimates

Effective interest rate

IAS 39 requires interest earned from mortgage lending to be measured under the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset. Management must therefore use judgement to estimate the expected life of each instrument and hence the expected cash flows relating to it. On a periodic basis throughout the financial reporting period, models are reviewed to re-assess expected life by portfolio of products based upon actual redemptions by product and anticipated market conditions. At 31 December 2010, if the expected average life of a loan were increased or reduced by one month, the Balance Sheet amount of loans and advances to customers would be increased or reduced by £15.3m (2009: £26.5m) and £15.3m (2009: £23.3m) respectively.

Impairment losses on loans and advances

The Group and Company reviews its loan impairment on a monthly basis and assesses individual impairment losses by reference to an individual review of the underlying asset and utilises actual loss experience to provide both probabilities of defaults and property forced sale discounts across a portfolio of products. Collective impairment losses on loans and advances are calculated using a statistical model. The key assumptions used in this model are the probability of any balance entering into default as a result of an event that had occurred prior to the Balance Sheet date, the probability of this default resulting in possession or write off, and the subsequent loss incurred. These key assumptions are based on observed data trends and are updated on a regular basis within agreed methodology to ensure the impairment allowance is entirely representative of the current portfolio. The accuracy of the impairment calculation would therefore be affected by unanticipated changes to the economic situation and assumptions which differ from actual outcomes. To the extent that loss given default was to vary by +/- 10%, the impairment allowance would be an estimated £148.6m higher (2009: £105.3m) or £162.8m lower (2009: £123.1m) respectively.

Post-retirement benefit obligations

The net surplus or deficit in respect of post-retirement benefit obligations is carried on the Group's and Company's Balance Sheets. The value of these obligations is calculated by the Group's actuaries using the assumptions set out in note 30. Note 30 also discloses the impact on the benefit obligations of changes in certain key assumptions.

Provisions

Provisions are carried in respect of certain known or forecast future expenditure, as described in note 31.

Notes to the Financial Statements (continued)

3. Income Statement reclassifications

The Income Statement has been subject to a number of reclassifications during 2010 to be consistent with the treatment of items by UK Asset Resolution Limited ("UKAR") which have also been reflected in the 2009 comparatives. As these reclassifications have not resulted from a change in accounting methodology, there has been no impact upon the level of loss previously reported in 2009. Consequently, the reclassifications are merely a change in the presentation of the Income Statement. The reclassifications applied to 2009 are as follows:

	Reported in 2009 £m	A £m	Reclassification B £m	C £m	D £m	Total adjustments £m	Restated 2009 values £m
Interest receivable and similar income	2,032.9	–	–	216.3	–	216.3	2,249.2
Interest expense and similar charges	(875.5)	–	–	(114.6)	–	(114.6)	(990.1)
Fee and commission income	26.8	–	–	–	–	–	26.8
Fee and commission expense	(94.2)	9.6	–	–	–	9.6	(84.6)
Losses on available-for-sale securities	(12.3)	–	–	–	12.3	12.3	–
Net realised losses on investment securities	–	–	–	–	(6.8)	(6.8)	(6.8)
Unrealised fair value movements on financial instruments	–	–	95.3	–	–	95.3	95.3
Hedge ineffectiveness	–	–	–	(101.7)	–	(101.7)	(101.7)
Net trading income	95.3	–	(95.3)	–	–	(95.3)	–
Provision for customer redress	(78.5)	–	–	–	–	–	(78.5)
Other operating income	12.5	–	–	–	–	–	12.5
Administrative expenses – ongoing	(256.0)	(9.6)	–	–	–	(9.6)	(265.6)
Exceptional operating expenses	(39.9)	–	–	–	–	–	(39.9)
The Northern Rock Foundation donation	(30.0)	–	–	–	–	–	(30.0)
Impairment on loans and advances to customers	(1,044.8)	–	–	–	–	–	(1,044.8)
Impairment credits on investment securities reclassified as loans and receivables and unsecured investment loans	6.2	–	–	–	(6.2)	(6.2)	–
Net impairment on investment securities	–	–	–	–	0.7	0.7	0.7
Loss before taxation	(257.5)	–	–	–	–	–	(257.5)
Taxation	(19.1)	–	–	–	–	–	(19.1)
Loss for the financial year	(276.6)	–	–	–	–	–	(276.6)

Reclassifications

- A In 2009 a number of third party administrator costs were included within fee and commission expense. These costs are being reclassified to administrative expenses.
- B In 2009 fair value movements of derivative financial instruments in economic but not accounting hedge relationships were classified as net trading income. This is being reclassified as unrealised fair value movements on financial instruments.
- C In 2009 fair value movements of derivative financial instruments in accounting hedge relationships, along with corresponding movements in the fair value of the underlying items being hedged, were included within net interest income. These amounts are being reclassified as hedge ineffectiveness.
- D In 2009 losses on AFS securities included both realised and impairment losses on these instruments. This is being reclassified to separate captions for realised and impairment losses. For consistency, impairment amounts in respect of investment securities reclassified as loans and receivables and unsecured investment loans have also been reclassified as impairment in respect of investment securities.

None of the reclassifications affect the Balance Sheet, therefore the comparative information presented in Group and Company Balance Sheets remains unchanged, and there is no requirement to report an additional year's data.

Notes to the Financial Statements (continued)

4. Net interest income

	2010 £m	2009 £m
Interest receivable and similar income		
On secured advances	1,537.5	1,914.7
On other lending	131.0	170.1
On investment securities and deposits	73.3	164.4
Total interest receivable and similar income	1,741.8	2,249.2
Interest expense and similar charges		
On retail customer accounts	–	323.4
On other deposits including loans from HM Treasury	191.1	100.4
Other	290.8	566.3
Total interest expense and similar charges	481.9	990.1
Net interest income	1,259.9	1,259.1
Average interest-earning assets ('IEA')	63,425.1	83,395.6
Financed by		
- Interest-bearing funding	61,313.6	81,541.2
- Interest-free funding*	2,111.5	1,854.4
Average rates	%	%
- Gross yield on IEA	2.75	2.70
- Cost of interest-bearing funding	(0.79)	(1.22)
Interest spread	1.96	1.48
Contribution of interest-free funding	0.03	0.03
Net interest margin	1.99	1.51
Annual average Bank Base Rate	0.50	0.65
Annual average 1-month LIBOR	0.56	0.83

* Interest-free funding is share capital and reserves

Total interest receivable and similar income includes interest accrued on individually impaired assets of £81.9m (2009: £81.5m)

As a result of State aid approval in October 2009, net interest income includes a net interest clawback of £223.9m in 2009. Offsetting this are additional fees payable of £23.9m resulting in a total income clawback of £200.0m

5. Administrative expenses

During 2010 the majority of the administrative costs incurred by the Group arose from the Service Level Agreement (SLA) arrangements that were in existence during the year. Full details of these SLAs are given in note 40.

Administrative expenses and employee numbers for 2010 are as follows

	2010 £m
Ongoing administrative expenses	
Costs recharged by Northern Rock plc under SLA	115.5
Costs recharged by Bradford & Bingley plc under SLA	10.3
Other costs incurred directly by the Group	39.4
Total	165.2

On 1 January 2010 all employees previously employed by the Company transferred to Northern Rock plc under the terms of the Northern Rock Transfer Order 2009, SI 2009/3226. On 1 November 2010 approximately 1,250 of these employees transferred to Bradford & Bingley plc. Throughout 2010 services were provided to the Company by employees of Northern Rock plc and Bradford & Bingley plc, consequently the Company had no employees during the whole of the year. The costs of these employees are included in the SLA recharges above. The recharge for staff costs from Bradford & Bingley plc for the period 1 November 2010 to 31 December 2010 amounted to £6.0m.

Other costs incurred directly by the Group includes £3.0m in respect of depreciation and amortisation and £1.9m in respect of the defined benefit pension scheme.

Notes to the Financial Statements (continued)

5. Administrative expenses

At 31 December 2010 933 full time, 321 part time and 70 temporary employees of Bradford & Bingley plc provide services to the Company for which a recharge is being made. There are no additional employees in the Group.

	2010 £m
Other net administrative expenses	
Impairment of goodwill (see note 22)	30.7
Accelerated depreciation (see note 21)	51.8
Transformation costs	47.2
Restructure costs	8.7
Total	138.4

Transformation and restructure costs relate to the separation of the Company from Northern Rock plc and its integration into UKAR.

Other net administrative expenses in 2010 includes certain items that were classed as exceptional items in 2009. See page 15 in the Financial Review for further information.

Administrative expenses and employee numbers for 2009 are as follows:

	2009 £m
Ongoing administrative expenses	
Wages and salaries	117.6
Social security costs	11.6
Other pension costs	12.9
Total staff costs	142.1
Depreciation and amortisation	24.3
Other administrative expenses	99.2
Total	265.6

Other administrative expenses include:

Hire of equipment	3.7
Property rentals	4.3
Remuneration of auditors (see below)	1.7

Exceptional operating expenses

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

	2009 £m
Redundancy and other staff costs	0.1
Professional fees incurred by the Company	1.2
Professional fees recharged by the Tripartite Authorities	2.7
Company valuation	1.6
Other operating expenses	0.2
	5.8
Impairment credits on property, plant and equipment	(5.3)
Provision for onerous contracts	0.1
Strategic project development	39.3
Total	39.9

Notes to the Financial Statements (continued)

5. Administrative expenses (continued)

Company valuation costs of £1.6m relate to work done by BDO Stoy Hayward to value the Company's shares before the Company was taken into public ownership

The impairment credits of £5.3m have arisen primarily due to reversals of impairments made in 2007 in respect of properties in the course of construction (see note 21)

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

The Northern Rock Foundation donation

The charge in 2009 comprises £15.0m paid in the year along with a further £15.0m accrued reflecting the commitment for 2010 that was made following the Company entering into public ownership. Given the Company's focus on repaying the loan from HM Treasury such substantial donations to a single charity will no longer be made

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

	2009
Full time	3,555
Part time	991

Directors' emoluments

The aggregate Directors' emoluments and the emoluments of the highest paid Director amounted to £1.3m and £0.6m respectively, (2009: £2.4m and £1.5m respectively). These emoluments include recharges for Gary Hoffman and Andrew Tate for their period of service up to 30 September 2010

Services provided by the Group's auditors and network firms

During the year the Group obtained the following services from the Group's auditors, as detailed below

	2010 £m	2009 £m
Ongoing administrative expenses		
Fees payable to Company auditors for the audit of parent Company and consolidated accounts	0.6	1.0
Fees payable to Company auditors and its associates for other services		
- The audit of Company's subsidiaries pursuant to legislation	0.2	0.4
- Other services pursuant to legislation (including review of half year Interim Statement)	0.1	0.1
- Reporting accountants' services (see note i)	-	0.1
- Taxation services	-	0.1
Total	0.9	1.7
Exceptional operating expenses		
Fees payable to Company auditors and its associates for other services		
- Other assurance services (see note ii)	-	0.2
Total	-	0.2

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

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

Amounts shown in the above analysis are inclusive of VAT. The totals shown for 2010 represent amounts billed in respect of work carried out for the Group. Due to the structure of the SLA the amount actually charged through the Group's Income Statement will be different

Notes to the Financial Statements (continued)

6. Unrealised fair value movements on financial instruments and hedge ineffectiveness

	2010 £m	2009 £m
Net losses on changes in fair value of assets designated as held at fair value through profit or loss	–	(10.7)
Fair value movements of future cash flows, excluding accruals, on derivatives not in hedge accounting relationships	561.7	(2,391.6)
Translation (losses) / gains on underlying instruments	(144.0)	2,497.6
Total unrealised fair value movements on financial instruments	417.7	95.3
Fair value hedge ineffectiveness		
- on hedging instruments	313.1	(693.2)
- on the hedged items attributable to the hedged risk	(356.3)	632.3
	(43.2)	(60.9)
Cash flow hedge ineffectiveness	(21.8)	(40.8)
Total hedge ineffectiveness	(65.0)	(101.7)
Total unrealised fair value movements on financial instruments and hedge ineffectiveness	352.7	(6.4)

7. Gain on repurchase of capital instruments

	Subordinated notes £m	Reserve capital instruments £m	Tier one notes £m	Total 2010 £m
Carrying amount of capital instruments repurchased	1,088.9	143.1	111.0	1,343.0
Amount paid to repurchase capital instruments	(302.4)	(35.9)	(51.1)	(389.4)
Fees	(2.4)	(0.3)	(0.2)	(2.9)
Gain on repurchase of capital instruments	784.1	106.9	59.7	950.7

The gain on repurchase of subordinated notes and reserve capital instruments amounting to £891.0m is reported in reserves as these instruments are accounted for as equity. The gain on repurchase of tier one notes amounting to £59.7m is reported in the Income Statement. Although tier one notes are eligible for inclusion in regulatory capital these instruments are accounted for as liabilities. There were no repurchases in 2009.

8. Taxation

	2010 £m	2009 £m
The tax credit / (charge) for the year comprises		
Current tax		
- on profit / (loss) for the year	–	(0.1)
- adjustments in respect of prior years	5.3	28.6
Total current tax	5.3	28.5
Deferred tax (see note 23)		
- origination and reversal of temporary differences	–	(13.0)
- adjustments in respect of prior years	3.8	–
- write off of deferred tax asset previously recognised	–	(34.6)
Total deferred tax	3.8	(47.6)
Total taxation credit / (charge) per the Income Statement	9.1	(19.1)

Notes to the Financial Statements (continued)

8. Taxation *(continued)*

The following tax amounts have also been (charged) / credited directly to equity

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Current tax				
- Relating to actuarial gains	-	(1.0)	-	(1.0)
Deferred tax				
- Relating to actuarial losses	-	12.1	-	12.1
- Relating to available-for-sale investments	-	0.2	-	0.9
Net credit to equity	-	11.3	-	12.0

The tax on the Group's profit / (loss) before tax differs from the theoretical amount that would arise using the standard weighted average rate of UK corporation tax of 28% (2009: 28%) as follows

	2010 £m	2009 £m
Profit / (loss) before taxation	400.5	(257.5)
Tax calculated at rate of 28% (2009: 28%)	(112.1)	72.1
Deferred tax assets transferred to Northern Rock plc	(5.8)	-
Utilisation of deferred tax assets	108.9	-
Deferred tax asset arising not recognised	-	(95.7)
Deferred tax asset write off	-	(34.6)
Income not subject to tax	33.6	16.0
Expenses not deductible for tax purposes	(24.6)	(5.5)
Adjustments in respect of prior years	9.1	28.6
Total taxation credit / (charge) per the Income Statement	9.1	(19.1)

The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate would reduce from 28% to 27% on 1 April 2011 and would further reduce by 1% each year for the next 3 years, ultimately reducing to 24% on 1 April 2014. The Budget on 23 March 2011 amended this to a reduction of 2% to 26% on 1 April 2011, further reducing by 1% each year ultimately to 23% on 1 April 2014. Further details of the expected impact of the changes are provided in note 23.

9. Profit attributable to equity shareholder

Of the profit attributable to the equity shareholder, £280.2m (2009: loss of £337.7m) has been dealt with in the accounts of the Company. As permitted by section 408 of the Companies Act 2006, the Company's Income Statement and Statement of Comprehensive Income have not been presented separately.

10. Cash and balances at central banks

At 31 December	Group and Company	
	2010 £m	2009 £m
Cash in hand	-	9.9
Balances with Bank of England for liquidity purposes	3,349.2	3,590.2
Collateral balances with Bank of England	3,631.6	3,846.5
Included in cash and cash equivalents	6,980.8	7,446.6
Mandatory reserve deposits with central banks	-	63.8
Total	6,980.8	7,510.4

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

At 31 December 2009 £9.9m was held for resale.

Notes to the Financial Statements (continued)

11. Loans and advances to banks

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Fixed rate	1,147.2	1,692.7	1,134.0	1,679.3
Variable rate	796.8	2,009.7	661.4	1,873.3
Total	1,944.0	3,702.4	1,795.4	3,552.6

At 31 December 2009 £865.6m was held for resale in the Group and £864.6m in the Company

12. Loans and advances to customers

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Advances secured on residential property not subject to securitisation	15,893.7	27,336.0	15,893.7	27,336.0
Advances secured on residential property subject to securitisation	23,886.5	27,254.4	23,886.5	27,254.4
	39,780.2	54,590.4	39,780.2	54,590.4
Advances secured on residential buy-to-let property not subject to securitisation	4,552.1	5,477.3	4,552.1	5,477.3
Total advances secured on residential property	44,332.3	60,067.7	44,332.3	60,067.7
Commercial secured advances not subject to securitisation	312.4	287.9	312.4	287.9
Unsecured loans not subject to securitisation	3,113.8	3,912.6	3,113.8	3,912.6
Amounts due from subsidiary undertakings	–	–	41.2	80.7
Total	47,758.5	64,268.2	47,799.7	64,348.9
Fixed rate	14,763.3	29,987.4	14,763.3	29,987.4
Variable rate	32,995.2	34,280.8	33,036.4	34,361.5
Total	47,758.5	64,268.2	47,799.7	64,348.9

At 31 December 2009 £10,343.3m was held for resale in both Group and Company

Fair value adjustments on portfolio hedging amounting to £539.6m (2009: £1,131.6m) relate to fair value adjustments to loans and advances to customers in relation to interest rate risk as a result of their inclusion in a fair value portfolio hedge relationship. At 31 December 2009 £160.3m of this balance was held for resale in both Group and Company.

Concentration risk

All balances within loans and advances to customers are UK exposures.

Notes to the Financial Statements (continued)

13. Loan impairment

(a) Loan impairment allowance for loans and advances to customers

Group 2010	On advances secured on residential property £m	On advances secured on residential buy- to-let property £m	On commercial secured advances £m	On unsecured loans £m	Total £m
At 1 January 2010	495.8	100.3	12.5	564.3	1,172.9
Transferred to Northern Rock plc	(0.4)	-	-	(0.2)	(0.6)
Impairment on loans and advances to customers	609.0	3.6	18.9	181.3	812.8
Amounts written off during the year	(192.9)	(11.8)	(1.4)	(213.1)	(419.2)
Discount unwind	8.8	0.6	-	10.0	19.4
At 31 December 2010	920.3	92.7	30.0	542.3	1,585.3

Company 2010	On advances secured on residential property £m	On advances secured on residential buy- to-let property £m	On commercial secured advances £m	On unsecured loans £m	Total £m
At 1 January 2010	495.8	100.3	12.5	564.4	1,173.0
At 31 December 2010	920.3	92.7	30.0	542.4	1,585.4

Group 2009	On advances secured on residential property £m	On advances secured on residential buy- to-let property £m	On commercial secured advances £m	On unsecured loans £m	Total £m
At 1 January 2009	335.4	42.9	7.8	483.6	869.7
Impairment on loans and advances to customers	458.9	83.4	4.4	498.1	1,044.8
Amounts written off during the year	(303.3)	(26.3)	-	(423.3)	(752.9)
Discount unwind	4.8	0.3	0.3	5.9	11.3
At 31 December 2009	495.8	100.3	12.5	564.3	1,172.9

Company 2009	On advances secured on residential property £m	On advances secured on residential buy- to-let property £m	On commercial secured advances £m	On unsecured loans £m	Total £m
At 1 January 2009	335.4	42.9	7.8	483.7	869.8
At 31 December 2009	495.8	100.3	12.5	564.4	1,173.0

(b) Credit quality of loans and advances to customers

Residential data presented represents amounts in respect of advances secured on residential property and advances secured on residential buy-to-let property, including commercial buy-to-let loans. Commercial data presented represents amounts in respect of other commercial secured advances.

In respect of loans and advances to customers, the Group and Company hold collateral in the form of mortgages over residential and commercial properties. The fair value of this collateral was as follows:

	Group and Company			
	2010 Residential £m	2010 Commercial £m	2009 Residential £m	2009 Commercial £m
At 31 December				
Neither past due nor impaired	57,917.7	434.0	86,609.1	384.8
Past due but not impaired	5,579.0	6.8	4,612.9	0.3
Impaired	1,349.4	6.3	1,527.5	8.5
Total	64,846.1	447.1	92,749.5	393.6

Notes to the Financial Statements (continued)

13. Loan impairment (continued)

If the collateral amount on each individual loan were capped at the amount of the balance outstanding, and any surplus of collateral values over balances outstanding ignored, the fair value of collateral held would be as follows

	Group and Company			
	2010 Residential £m	2010 Commercial £m	2009 Residential £m	2009 Commercial £m
At 31 December				
Neither past due nor impaired	38,083.7	313.2	52,526.4	277.1
Past due but not impaired	4,345.8	4.5	3,810.7	0.2
Impaired	1,223.8	6.3	1,515.1	8.5
Total	43,653.3	324.0	57,852.2	285.8
The impaired balances above include the following carrying amount of assets in possession	159.2	–	159.1	–

The fair value of the collateral is estimated by taking the most recent valuation of the property and adjusting for house price inflation or deflation up to the Balance Sheet date

The indexed average loan to value (LTV) of residential and commercial loans and advances to customers was as follows

	Group and Company			
	2010 Residential %	2010 Commercial %	2009 Residential %	2009 Commercial %
At 31 December				
Neither past due nor impaired	67.9	73.5	63.3	73.4
Past due but not impaired	81.2	67.6	87.2	66.7
Impaired	111.0	295.2	117.4	207.1
Total book	69.9	76.6	65.4	76.3

Further information regarding the credit quality of loans and advances to customers

	At 31 December 2010				At 31 December 2009			
	Advances secured on residential property £m	Other secured advances £m	Unsecured personal loans £m	Total £m	Advances secured on residential property £m	Other secured advances £m	Unsecured personal loans £m	Total £m
Neither past due nor impaired	39,319.9	319.2	2,986.3	42,625.4	54,847.2	282.6	3,885.9	59,015.7
Past due but not impaired								
- Up to 3 months	2,408.4	0.4	123.2	2,532.0	2,043.4	0.2	183.6	2,227.2
- 3 to 6 months	1,276.7	0.2	7.9	1,284.8	1,159.3	–	7.0	1,166.3
- Over 6 months	843.1	4.0	15.3	862.4	820.0	–	11.0	831.0
Impaired	1,497.2	18.6	523.4	2,039.2	1,793.9	17.6	389.4	2,200.9
	45,345.3	342.4	3,656.1	49,343.8	60,663.8	300.4	4,476.9	65,441.1
Impairment allowances	(1,013.0)	(30.0)	(542.3)	(1,585.3)	(596.1)	(12.5)	(564.3)	(1,172.9)
Loans and advances to customers net of impairment allowances	44,332.3	312.4	3,113.8	47,758.5	60,067.7	287.9	3,912.6	64,268.2
Impairment allowances								
- Individual	110.8	13.7	–	124.5	70.4	9.1	–	79.5
- Collective	923.2	16.3	546.3	1,485.8	535.1	3.4	574.3	1,112.8
- Discount	(21.0)	–	(4.0)	(25.0)	(9.4)	–	(10.0)	(19.4)
Total impairment allowances	1,013.0	30.0	542.3	1,585.3	596.1	12.5	564.3	1,172.9

Arrears and possessions are monitored at portfolio level for the Group as a whole, and also split by type of product

Notes to the Financial Statements (continued)

13. Loan impairment (continued)

		Group and Company			
		At 31 December 2010		At 31 December 2009	
Residential and unsecured arrears and possessions – total		Residential	Unsecured	Residential	Unsecured
Arrears over 3 months					
Number of cases	Number	23,435	26,274	22,564	21,454
Proportion of total	%	6.07	7.48	4.28	4.58
Asset value	£m	3,284.4	397.9	3,135.0	364.4
Proportion of book	%	7.41	12.78	5.22	9.31
Total value of payments overdue	£m	146.1	42.5	128.6	36.5
Possessions					
Number of cases	Number	1,984		2,061	
Proportion of total	%	0.51		0.39	
Asset value	£m	254.1		254.6	
Proportion of book	%	0.57		0.42	
Total value of payments overdue	£m	16.6		17.3	
Total arrears over 3 months and possessions					
Number of cases	Number	25,419		24,625	
Proportion of total	%	6.58		4.67	
Asset value	£m	3,538.5		3,389.6	
Proportion of book	%	7.98		5.64	
Total value of payments overdue	£m	162.7		145.9	
Proportion of book	%	0.37		0.24	
Residential loan impairment balance					
As % of residential balances	%	2.23		0.98	
As % of residential arrears and possessions	%	28.63		17.59	

		Group and Company			
		At 31 December 2010		At 31 December 2009	
Analysis of residential and unsecured accounts over 3 months in arrears by product		Residential	Unsecured	Residential	Unsecured
Buy-to-let					
Number of cases	Number	1,450		1,162	
Proportion of total	%	4.56		2.96	
Asset value	£m	244.7		192.0	
Proportion of book	%	5.38		3.51	
Together					
Number of cases	Number	11,262	15,239	11,260	11,030
Proportion of total	%	7.40	9.61	6.93	6.09
Asset value	£m	1,281.6	272.2	1,266.8	220.5
Proportion of book	%	7.99	12.85	7.28	9.37
Other					
Number of cases	Number	10,723	11,035	10,142	10,424
Proportion of total	%	5.30	5.73	3.12	3.63
Asset value	£m	1,758.1	125.7	1,676.2	143.9
Proportion of book	%	7.40	12.64	4.51	9.23

Notes to the Financial Statements (continued)

14. Securitisation

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

At 31 December 2010	Gross assets securitised £m	Notes in issue £m
Granite Finance Funding Limited	3,749.6	3,746.0
Granite Finance Funding 2 Limited	17,540.4	19,826.7
	21,290.0	23,572.7
Retained interest in Granite Finance Trustees Limited	3,963.5	
Less cash deposits held with Northern Rock (Asset Management) plc	(1,238.6)	
Total	24,014.9	23,572.7

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

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

At 31 December 2010	Gross assets securitised £m	Notes in issue £m
Total as above	24,014.9	23,572.7
Less cash deposits with third parties included within loans and advances to banks	(128.4)	
Less accrued interest on loan notes included within accruals and deferred income		(9.1)
Add loan notes issued by Whinstone Limited (see below)		451.5
Total advances subject to securitisation (see note 12)	23,886.5	
Total securitised notes as per consolidated Balance Sheet		24,015.1

At 31 December 2009	Gross assets securitised £m	Notes in issue £m
Granite Finance Funding Limited	4,461.8	4,536.8
Granite Finance Funding 2 Limited	20,988.9	23,816.7
	25,450.7	28,353.5
Retained interest in Granite Finance Trustees Limited	3,709.2	
Less cash deposits held with Northern Rock (Asset Management) plc	(1,777.1)	
Total	27,382.8	28,353.5

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

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

At 31 December 2009	Gross assets securitised £m	Notes in issue £m
Total as above	27,382.8	28,353.5
Less cash deposits with third parties included within loans and advances to banks	(128.4)	
Less accrued interest on loan notes included within accruals and deferred income		(9.6)
Add loan notes issued by Whinstone Limited (see below)		458.0
Total advances subject to securitisation (see note 12)	27,254.4	
Total securitised notes as per consolidated Balance Sheet		28,801.9

Notes to the Financial Statements (continued)

14. Securitisation (continued)

The movement in securitised notes in issue was as follows	2010 £m	2009 £m
At 1 January	28,801.9	37,986.9
Repayments	(4,848.6)	(6,935.3)
Exchange rate movements and fair value adjustments	61.8	(2,249.7)
At 31 December	24,015.1	28,801.9

At 31 December 2010 the SPVs had cash deposits with Northern Rock (Asset Management) plc amounting to £2,931.4m including collateral deposits of £1,687.3m (31 December 2009 £4,061.3m, including collateral deposits of £2,284.2m). This balance (excluding the collateral deposits) is restricted in use to the repayment of the debt securities issued by the SPVs and other legal obligations.

Many of the securitised notes are issued in foreign currency and are translated into sterling at exchange rates prevailing at 31 December. All issuance in foreign currency is subject to cross currency swaps that provide the amounts of foreign currency required to repay the notes in exchange for an amount of sterling fixed at the outset of the securitisation, thereby protecting against foreign exchange risk. At 31 December 2010 there is a gross derivative asset in respect of derivatives economically hedging the foreign currency notes of £3,520.4m (31 December 2009 £4,014.1m). The value of the loans assigned to the bankruptcy remote special purpose vehicles exceed the value of sterling required under the foreign exchange swaps, and therefore the debt securities in issue are more than covered by loan assets allocated for this purpose.

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

On 15 November 2005, Northern Rock (Asset Management) plc entered into a financial guarantee contract with Whinstone Capital Management Limited, a special purpose vehicle, in respect of £423.0m of the first loss reserve funds held by the Granite securitisation entities repayable to Northern Rock (Asset Management) plc only after repayment of all other liabilities. Whinstone Capital Management Limited simultaneously issued credit linked notes to the value of £423.0m in respect of which there were no repayments during 2010 (2009 £nil). The remaining credit linked notes of £221.2m are included within debt securities in issue at year end exchange rates where issued in currencies other than sterling. As a consequence of the Granite Master Trust entering pass through in 2008 the expected maturity of the notes issued by Whinstone Capital Management Limited has been significantly extended. It is highly likely that the notes will not be called on their step up and call dates.

On 20 June 2006, Northern Rock (Asset Management) plc entered into a financial guarantee contract with Whinstone Capital Management 2 Limited, a special purpose vehicle, in respect of £168.5m of the first loss reserve funds held by the Granite securitisation entities repayable to Northern Rock (Asset Management) plc only after repayment of all other liabilities. Whinstone Capital Management 2 Limited simultaneously issued credit linked notes to the value of £168.5m which are included within debt securities in issue at year end exchange rates where issued in currencies other than sterling. As a consequence of the Granite Master Trust entering pass through in 2008 the expected maturity of the notes issued by Whinstone Capital Management 2 Limited has been significantly extended. It is highly likely that the notes will not be called on their step up and call dates.

Notes to the Financial Statements (continued)

15. Covered bonds

included within loans and advances to customers not subject to securitisation are £11,497.6m (2009 £11,953.2m) of mortgage advances assigned to a bankruptcy remote special purpose vehicle. These loans provide security to issues of covered bonds made by the Company, which are included within debt securities in issue amounting to £9,783.8m (2009 £9,866.1m). The Company retains substantially all the risks and rewards associated with these loans and therefore these transactions do not qualify for derecognition under IAS 39. Most of the covered bonds are issued in foreign currency and are translated into sterling at exchange rates prevailing at 31 December. All issuance in foreign currency is subject to cross currency swaps that provide the amounts of foreign currency required to repay the notes in exchange for an amount of sterling fixed at the issue of the bond, thereby protecting against foreign exchange risk. At 31 December 2010 there is a gross derivative asset in respect of derivatives economically hedging the foreign currency notes of £2,694.7m (2009 £2,689.2m). The value of the loans assigned to the bankruptcy remote special purpose vehicle exceed the value of sterling required under the foreign exchange swaps and therefore the debt securities in issue are more than covered by loan assets allocated for this purpose.

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
The movement in covered bonds was as follows				
At 1 January	9,866.1	12,550.3	9,866.1	12,550.3
Repayments	-	(1,780.6)	-	(1,780.6)
Exchange rate movements and fair value adjustments	(82.3)	(903.6)	(82.3)	(903.6)
At 31 December	9,783.8	9,866.1	9,783.8	9,866.1

16. Other debt securities in issue

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Bonds and medium term notes	2,084.4	3,305.7	2,084.4	3,305.7
Fixed rate	281.7	332.5	281.7	332.5
Variable rate	1,802.7	2,973.2	1,802.7	2,973.2
Total	2,084.4	3,305.7	2,084.4	3,305.7

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
The movement in other debt securities in issue was as follows				
At 1 January	3,305.7	7,199.1	3,305.7	7,199.1
Issuances	-	848.4	-	848.4
Repayments	(1,285.8)	(4,355.2)	(1,285.8)	(4,355.2)
Exchange rate movements and fair value adjustments	64.5	(386.6)	64.5	(386.6)
At 31 December	2,084.4	3,305.7	2,084.4	3,305.7

17. Investment securities and unsecured investment loans

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Available-for-sale securities	124.3	168.5	69.7	115.1
Investment securities held as loans and receivables	1,922.7	2,561.0	1,922.7	2,561.0
Unsecured investment loans	349.4	358.3	349.4	358.3
Total	2,396.4	3,087.8	2,341.8	3,034.4

Notes to the Financial Statements (continued)

17. Investment securities and unsecured investment loans (continued)

Net realised gains less losses and impairment on investment securities for the year comprises

	Group	
	2010	2009
	£m	£m
Net realised gains less losses on disposal of available-for-sale securities	0.2	(6.8)
Impairment losses on available-for-sale securities	(7.8)	(5.5)
Impairment (losses) / reversals on investment securities reclassified as loans and receivables and unsecured investment loans	(7.2)	6.2
Total net impairment on investment securities	(15.0)	0.7
Total	(14.8)	(6.1)

Gains of £0.2m (2009: losses of £6.8m) previously recognised in reserves have been transferred to the Income Statement on the disposal of available-for-sale securities

(a) Available-for-sale securities

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 31 December				
At fair value				
Listed	36.6	85.6	23.4	78.9
Unlisted	87.7	82.9	46.3	36.2
Total	124.3	168.5	69.7	115.1
Fixed rate	70.8	125.5	23.4	78.8
Variable rate	53.5	43.0	46.3	36.3
Total	124.3	168.5	69.7	115.1

The movement in available-for-sale securities was as follows

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 1 January	168.5	422.5	115.1	261.9
Transferred to Northern Rock plc	(53.0)	–	(53.0)	–
Additions	88.5	311.0	33.5	204.6
Disposals (sales and redemptions)	(73.0)	(549.8)	(18.3)	(339.6)
Exchange rate movements	(0.5)	(11.4)	(0.5)	(11.4)
Net losses on changes in fair value	(6.2)	(3.8)	(7.1)	(0.4)
At 31 December	124.3	168.5	69.7	115.1

At 31 December 2009 £53.0m in respect of available-for-sale securities was held for resale in both the Group and Company

(b) Assets held at fair value through profit or loss

	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 31 December				
At fair value	–	–	–	–
	Group		Company	
	2010	2009	2010	2009
	£m	£m	£m	£m
The movement in assets held at fair value through profit or loss was as follows				
At 1 January	–	11.5	–	11.5
Exchange rate movements	–	(0.8)	–	(0.8)
Net losses on changes in fair value	–	(10.7)	–	(10.7)
At 31 December	–	–	–	–

Certain securities which contain an embedded derivative are classified as held at fair value through profit or loss. Fair value is based on quoted prices in an active market. The Group has not reclassified any financial assets between those held at amortised cost and those held at fair value during the year (2009: £nil).

Notes to the Financial Statements (continued)

17. Investment securities and unsecured investment loans (continued)**(c) Investment Securities held as loans and receivables**

	Group		Company	
At 31 December	2010 £m	2009 £m	2010 £m	2009 £m
Carrying value	1,922.7	2,561.0	1,922.7	2,561.0
Fair value	1,813.0	2,307.1	1,813.0	2,307.1
Listed	1,891.7	2,521.8	1,891.7	2,521.8
Unlisted	31.0	39.2	31.0	39.2
Total	1,922.7	2,561.0	1,922.7	2,561.0
Fixed rate	66.5	65.9	66.5	65.9
Variable rate	1,856.2	2,495.1	1,856.2	2,495.1
Total	1,922.7	2,561.0	1,922.7	2,561.0

In 2008, a pool of asset backed securities and floating rate notes were reclassified from available-for-sale to loans and receivables under the terms of IAS 39 paragraph 50E. If the financial assets had not been reclassified, fair value gains recognised in the available-for-sale reserve in 2010 would have been £277.0m (2009: gains of £271.2m).

At 31 December 2009 £371.0m in respect of investment securities held as loans and receivables was held for resale in both the Group and Company.

(d) Unsecured investment loans

	Group		Company	
At 31 December	2010 £m	2009 £m	2010 £m	2009 £m
Fixed rate	–	–	–	–
Variable rate	349.4	358.3	349.4	358.3
Total	349.4	358.3	349.4	358.3

	Group		Company	
At 31 December	2010 £m	2009 £m	2010 £m	2009 £m
Impairment allowance on unsecured investment loans	250.6	333.5	250.6	333.5

18. Wholesale assets

The assets in the following table are of a wholesale nature as opposed to individual customer assets. The credit and concentration risk characteristics of these portfolios should therefore be considered together.

	Group		Company	
At 31 December	2010 £m	2009 £m	2010 £m	2009 £m
Cash and balances at central banks (note 10)	6,980.8	7,510.4	6,980.8	7,510.4
Loans and advances to banks (note 11)	1,944.0	3,702.4	1,795.4	3,552.6
Investment securities and unsecured investment loans (note 17)	2,396.4	3,087.8	2,341.8	3,034.4
Total	11,321.2	14,300.6	11,118.0	14,097.4

Notes to the Financial Statements (continued)

18. Wholesale assets Table 1

(a) Credit risk

The credit quality of wholesale assets by reference to credit ratings is set out in the table below

Group At 31 December 2010	Total £m	AAA %	AA+ to AA- %	A+ to A- %	BBB to B- %	CCC and below %
Cash and balances at central banks	6,980.8	100	–	–	–	–
Loans and advances to banks	1,944.0	12	34	54	–	–
Investment securities and unsecured investment loans						
- Available-for-sale securities	124.3	26	12	21	3	38
- Investment securities held as loans and receivables	1,922.7	18	21	27	31	3
- Unsecured investment loans	349.4	–	–	–	100	–
Total investment securities and unsecured investment loans	2,396.4	16	17	23	40	4
Total	11,321.2	67	9	14	9	1
Group At 31 December 2009	Total £m	AAA %	AA+ to AA- %	A+ to A- %	BBB to B- %	CCC and below %
Cash and balances at central banks	7,510.4	100	–	–	–	–
Loans and advances to banks	3,702.4	10	36	54	–	–
Investment securities and unsecured investment loans						
- Available-for-sale securities	168.5	48	3	25	2	22
- Investment securities held as loans and receivables	2,561.0	30	23	24	22	1
- Unsecured investment loans	358.3	–	–	–	100	–
Total investment securities and unsecured investment loans	3,087.8	27	20	21	30	2
Total	14,300.6	61	13	19	6	1

(b) Concentration risk

Wholesale assets are analysed by geographical region at their carrying amounts in the table below. Exposures are allocated to regions based on the country of domicile of the counterparty

Group At 31 December 2010	UK £m	Europe £m	US £m	Other countries £m	Total £m
Cash and balances at central banks	6,980.8	–	–	–	6,980.8
Loans and advances to banks	704.6	965.3	72.8	201.3	1,944.0
Investment securities and unsecured investment loans					
- Available-for-sale securities	45.9	28.8	–	49.6	124.3
- Investment securities held as loans and receivables	898.8	377.5	126.9	519.5	1,922.7
- Unsecured investment loans	–	–	–	349.4	349.4
Total investment securities and unsecured investment loans	944.7	406.3	126.9	918.5	2,396.4
Total	8,630.1	1,371.6	199.7	1,119.8	11,321.2
Group At 31 December 2009	UK £m	Europe £m	US £m	Other countries £m	Total £m
Cash and balances at central banks	7,492.8	17.6	–	–	7,510.4
Loans and advances to banks	1,800.9	1,388.6	113.3	399.6	3,702.4
Investment securities and unsecured investment loans					
- Available-for-sale securities	53.3	78.8	–	36.4	168.5
- Investment securities held as loans and receivables	1,163.3	643.1	166.8	587.8	2,561.0
- Unsecured investment loans	–	–	–	358.3	358.3
Total investment securities and unsecured investment loans	1,216.6	721.9	166.8	982.5	3,087.8
Total	10,510.3	2,128.1	280.1	1,382.1	14,300.6

Notes to the Financial Statements (continued)

19. Investments in Group undertakings

	Company £m
Cost	
At 1 January 2010	85 0
Disposal to Northern Rock plc	(50 0)
At 31 December 2010	35 0

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

	2010 £m	2009 £m
At 31 December		
Credit institutions	–	50 0
Other	35 0	35 0
Total	35 0	85 0

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

At 31 December 2009 £50 0m was held for resale. This represented the Company's wholly owned subsidiary, Northern Rock (Guernsey) Limited

The principal subsidiaries of Northern Rock (Asset Management) plc at 31 December 2010 are listed below, all of which operate in their country of incorporation or registration

The following subsidiary is directly held and wholly owned by the Company

	Class of shares held	Nature of business	Country of incorporation
Northern Rock Mortgage Indemnity Company Limited	Ordinary	Provision of mortgage indemnity insurance	Guernsey

The following companies are SPVs established in connection with the Group's securitisation programme (see note 14). Although the Company has no direct or indirect ownership interest in these companies, they are regarded as legal subsidiaries under UK companies legislation. This is because they are principally engaged in providing a source of long term funding to the Group, which in substance has the rights to all benefits from the activities of the SPVs. They are therefore effectively controlled by the Group

	Nature of business	Country of incorporation
Granite Mortgages 03-2 plc	Issue of securitised notes	England & Wales
Granite Mortgages 03-3 plc	Issue of securitised notes	England & Wales
Granite Mortgages 04-1 plc	Issue of securitised notes	England & Wales
Granite Mortgages 04-2 plc	Issue of securitised notes	England & Wales
Granite Mortgages 04-3 plc	Issue of securitised notes	England & Wales
Granite Master Issuer plc	Issue of securitised notes	England & Wales
Granite Finance Trustees Limited	Holding of interests in securitisations	Jersey
Granite Finance Funding Limited	Holding company	Jersey
Granite Finance Funding 2 Limited	Holding company	England & Wales
Whinstone Capital Management Limited	Issue of credit linked notes	Jersey
Whinstone Capital Management 2 Limited	Issue of credit linked notes	Jersey

The Directors consider that to give full particulars of all subsidiary undertakings would lead to a statement of excessive length. A full list of subsidiary undertakings at 31 December 2010 will be annexed to the Company's next Annual Return to be filed at Companies House

Notes to the Financial Statements (continued)

20. Investment property

At 31 December 2009 the Group's Gosforth Head Office site was wholly occupied by the Group and was classed as owner occupied property within property plant and equipment. Following the completion of a legal and capital restructuring, a proportion of this site has been leased to Northern Rock plc since 1 January 2010. On 1 October 2010 the Company was acquired by UKAR which has resulted in a clearer strategy for the Group's plans in respect of the Head Office site. The Group has no current intention to occupy that element of the property currently leased to Northern Rock plc. Accordingly that element has been reclassified as an investment property since that date.

The Group has valued its investment property at fair value at 31 December 2010. Fair value is determined by independent professional valuers who apply recognised valuation techniques.

During the period since the date of reclassification, rental income and direct property repair and maintenance costs in respect of the property of £1.7m and £0.3m respectively have been recognised in the Income Statement.

Movements in the fair value of investment property during the year are analysed as follows:

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 1 January	–	–	–	–
Transfer from property, plant and equipment	26.6	–	24.5	–
At 31 December	26.6	–	24.5	–

There has been no change in the fair value of the investment property since the date of reclassification.

21. Property, plant and equipment

Group 2010	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Total £m
Cost			
At 1 January 2010	113.8	166.1	279.9
Transferred to Northern Rock plc (see note 48)	(23.5)	(104.0)	(127.5)
Additions	0.2	1.7	1.9
Disposals	(0.3)	(0.6)	(0.9)
Transferred to investment property (see note 20)	(55.9)	(38.0)	(93.9)
At 31 December 2010	34.3	25.2	59.5
Depreciation			
At 1 January 2010	11.9	113.4	125.3
Transferred to Northern Rock plc (see note 48)	(5.9)	(88.9)	(94.8)
Charged in year	0.9	2.1	3.0
Accelerated depreciation	29.6	22.2	51.8
Adjustment arising on disposals	–	(0.4)	(0.4)
Transferred to investment property (see note 20)	(31.8)	(35.5)	(67.3)
At 31 December 2010	4.7	12.9	17.6
Net book amount			
At 1 January 2010	101.9	52.7	154.6
At 31 December 2010	29.6	12.3	41.9

Notes to the Financial Statements (continued)

21. Property, plant and equipment (continued)

Company 2009	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Accelerated depreciation £m	Total £m
Cost				
At 1 January 2009	117.1	171.2	59.3	347.6
Additions	0.6	5.0	0.2	5.8
Disposals	(3.9)	(10.1)	(59.5)	(73.5)
At 31 December 2009	113.8	166.1	-	279.9
Depreciation				
At 1 January 2009	14.3	109.4	25.5	149.2
Charged in year	0.8	10.6	-	11.4
Impairment reversals	-	-	(5.3)	(5.3)
Adjustment arising on disposals	(3.2)	(6.6)	(20.2)	(30.0)
At 31 December 2009	11.9	113.4	-	125.3
Net book amount				
At 1 January 2009	102.8	61.8	33.8	198.4
At 31 December 2009	101.9	52.7	-	154.6

Company 2010	Land and buildings £m	Plant, equipment, fixtures, fittings and vehicles £m	Total £m
Cost			
At 1 January 2010	121.3	165.8	287.1
Transferred to Northern Rock plc (see note 48)	(21.8)	(105.0)	(126.8)
Additions	0.2	1.8	2.0
Disposals	(0.3)	(0.6)	(0.9)
Transferred to investment property (see note 20)	(61.1)	(39.5)	(100.6)
At 31 December 2010	38.3	22.5	60.8
Depreciation			
At 1 January 2010	11.4	112.3	123.7
Transferred to Northern Rock plc (see note 48)	(5.9)	(88.2)	(94.1)
Charged in year	1.1	2.1	3.2
Accelerated depreciation	36.8	23.8	60.6
Adjustment arising on disposals	-	(0.4)	(0.4)
Transferred to investment property (see note 20)	(39.0)	(37.1)	(76.1)
At 31 December 2010	4.4	12.5	16.9
Net book amount			
At 1 January 2010	109.9	53.5	163.4
At 31 December 2010	33.9	10.0	43.9

Notes to the Financial Statements (continued)

21. Property, plant and equipment (continued)

2010 2009	Cost and depreciation £m	Net carrying amount £m	Assets in the course of construction £m	Net book value £m
Cost				
At 1 January 2009	126.2	147.2	59.3	332.7
Additions	49.3	28.7	0.2	78.2
Disposals	(54.2)	(10.1)	(59.5)	(123.8)
At 31 December 2009	121.3	165.8	–	287.1
Depreciation				
At 1 January 2009	16.4	103.7	25.5	145.6
Charged in year	2.6	15.2	–	17.8
Impairment reversals	–	–	(5.3)	(5.3)
Adjustment arising on disposals	(7.6)	(6.6)	(20.2)	(34.4)
At 31 December 2009	11.4	112.3	–	123.7
Net book amount				
At 1 January 2009	109.8	43.5	33.8	187.1
At 31 December 2009	109.9	53.5	–	163.4

An accelerated depreciation charge of £51.8m in the Group and £60.6m in the Company has been made in 2010 (2009: £nil). This represents the difference between the carrying amount of the element of property, plant and equipment reclassified as investment property (see note 20) and its fair value at the date of reclassification.

Impairment credits of £nil have arisen in 2010 (2009: £5.3m) in both the Group and Company. The credit in 2009 was primarily due to reversals of impairments made in 2007 in respect of properties in the course of construction.

At 31 December 2009 £32.7m was held for resale in both the Group and Company.

22. Intangible assets

Group 2010	Goodwill £m	Software £m	Total £m
Cost			
At 1 January 2010	30.7	161.1	191.8
Transferred to Northern Rock plc (see note 48)	–	(161.1)	(161.1)
At 31 December 2010	30.7	–	30.7
Impairment and amortisation			
At 1 January 2010	–	138.0	138.0
Transferred to Northern Rock plc (see note 48)	–	(138.0)	(138.0)
Impairment charged in year	30.7	–	30.7
At 31 December 2010	30.7	–	30.7
Net book amount			
At 1 January 2010	30.7	23.1	53.8
At 31 December 2010	–	–	–

Notes to the Financial Statements (continued)

22. Intangible assets – intangible

Group 2009	Goodwill £m	Software £m	Total £m
Cost			
At 1 January 2009	30.7	159.8	190.5
Additions	–	1.5	1.5
Disposals	–	(0.2)	(0.2)
At 31 December 2009	30.7	161.1	191.8
Impairment and amortisation			
At 1 January 2009	–	125.6	125.6
Amortisation charged in year	–	12.5	12.5
Adjustment arising on disposals	–	(0.1)	(0.1)
At 31 December 2009	–	138.0	138.0
Net book amount			
At 1 January 2009	30.7	34.2	64.9
At 31 December 2009	30.7	23.1	53.8

Company 2010	Software £m	Total £m
Cost		
At 1 January 2010	161.1	161.1
Transferred to Northern Rock plc (see note 48)	(161.1)	(161.1)
At 31 December 2010	–	–
Impairment and amortisation		
At 1 January 2010	138.0	138.0
Transferred to Northern Rock plc (see note 48)	(138.0)	(138.0)
At 31 December 2010	–	–
Net book amount		
At 1 January 2010	23.1	23.1
At 31 December 2010	–	–

Company 2009	Software £m	Total £m
Cost		
At 1 January 2009	159.8	159.8
Additions	1.5	1.5
Disposals	(0.2)	(0.2)
At 31 December 2009	161.1	161.1
Impairment and amortisation		
At 1 January 2009	125.6	125.6
Amortisation charged in year	12.5	12.5
Adjustment arising on disposals	(0.1)	(0.1)
At 31 December 2009	138.0	138.0
Net book amount		
At 1 January 2009	34.2	34.2
At 31 December 2009	23.1	23.1

Goodwill resulted from the acquisition of a mortgage company and related to the Company's ability to sell further products to the customers acquired. Following the completion of a legal and capital restructuring the Company no longer writes new mortgage business therefore the goodwill is deemed to be impaired resulting in an impairment charge of £30.7m in 2010 (2009: £nil).

At 31 December 2009 £23.1m was held for resale in both the Group and Company.

Notes to the Financial Statements (continued)

23. Deferred tax assets and liabilities

	Group		Company	
At 31 December	2010 £m	2009 £m	2010 £m	2009 £m
Deferred tax assets	-	-	-	-
Deferred tax liabilities	(3 3)	(7 1)	-	(3 8)
Total	(3 3)	(7 1)	-	(3 8)

The full movement in deferred tax liabilities was as follows

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 1 January	(7 1)	28 3	(3 8)	(3 8)
Income Statement credit / (charge)	3 8	(47 6)	3 8	(13 0)
Deferred tax impact credited direct to equity				
- Revaluation reserve – available-for-sale investments	-	0 1	-	0 9
- Actuarial losses recognised in other comprehensive income	-	12 1	-	12 1
At 31 December	(3 3)	(7 1)	-	(3 8)

Deferred tax assets and liabilities are attributable to the following items

	Group		Company	
At 31 December	2010 £m	2009 £m	2010 £m	2009 £m
Deferred tax assets				
Pensions and other retirement benefits	-	0 8	-	0 8
Other temporary differences	-	0 1	-	0 1
Tax losses	12 0	10 9	12 0	10 9
Total	12 0	11 8	12 0	11 8
Deferred tax liabilities				
Pensions and other retirement benefits	(2 2)	-	(2 2)	-
Excess of capital allowances over depreciation	(0 1)	(0 1)	-	-
Available-for-sale securities	(1 7)	(1 7)	(1 9)	(1 9)
Unremitted earnings from overseas subsidiary	(3 4)	(3 4)	-	-
Rolled over gains	-	(3 8)	-	(3 8)
Change in accounting basis on adoption of IFRS	(7 9)	(9 9)	(7 9)	(9 9)
Total	(15 3)	(18 9)	(12 0)	(15 6)
Net deferred tax liability	(3 3)	(7 1)	-	(3 8)

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

Deferred tax appropriately reflects a change to the standard rate of UK corporation tax from 28% to 27% with effect from 1 April 2011. This change was substantively enacted on 20 July 2010. The announced further rate reductions by an additional 1% on 1 April 2011 and a further 3% by 1 April 2014, as described in note 8, would have the maximum potential impact of reducing the Group's deferred tax liability by £0.5m.

The amount of deferred tax asset expected to be recovered after more than twelve months for the Group is £nil (2009: £nil).

The amount of deferred tax liability expected to be settled after more than twelve months is £3.3m (2009: £7.1m) for the Group and £nil (2009: £3.8m) for the Company.

Notes to the Financial Statements (continued)

23. Deferred tax assets and liabilities (continued)

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

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Deductible temporary differences (gross)	258.0	427.9	258.0	427.9
Unused tax losses (gross)	306.4	1,700.3	306.4	1,700.3
Total	564.4	2,128.2	564.4	2,128.2

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

Deferred tax liabilities have not been established for tax that would be payable if earnings of the Group's overseas subsidiaries were remitted to the UK. Such amounts are either reinvested for the foreseeable future or are expected to be remitted free of tax. Unremitted earnings at 31 December 2010 totalled £39.6m (2009: £39.6m).

The deferred tax (credit)/charge in the Income Statement comprises the following temporary differences:

	2010 £m	2009 £m
Pensions and other employee benefits	-	2.6
Derivative financial instruments	-	34.6
Excess of capital allowances over depreciation	-	(1.1)
Tax losses	-	11.4
Unremitted earnings from overseas subsidiary	-	0.1
Rolled over gains	(3.8)	-
Total	(3.8)	47.6

24. Loans from HM Treasury

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Amount due to HM Treasury	21,713.4	14,315.5	21,713.4	14,315.5

The amount due to HM Treasury is repayable on demand. Following the restructuring of the Company on 1 January 2010, the interest payable changed from a margin above LIBOR to a margin above the Bank Base Rate.

25. Deposits by banks

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Amounts due to subsidiaries	-	-	-	1,014.1
Other deposits	4,900.8	6,022.3	3,213.5	3,738.1
Total	4,900.8	6,022.3	3,213.5	4,752.2
Fixed rate	-	235.3	-	235.3
Variable rate	4,900.8	5,787.0	3,213.5	4,516.9
Total	4,900.8	6,022.3	3,213.5	4,752.2

At 31 December 2009 £235.3m was held for resale within the Group and £1,249.4m within the Company.

Notes to the Financial Statements (continued)

26. Customer accounts

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Retail funds and deposits	-	19,478.2	-	18,542.2
Other customer accounts	-	1,129.4	-	1,129.4
Total	-	20,607.6	-	19,671.6
Fixed rate	-	12,383.8	-	11,698.2
Variable rate	-	8,223.8	-	7,973.4
Total	-	20,607.6	-	19,671.6

At 31 December 2009 £20,607.6m was held for resale within the Group and £19,671.6m within the Company

27. Other deposits

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Amounts due to securitisation special purpose vehicles	-	-	21,940.3	26,819.4
Fixed rate	-	-	-	-
Variable rate	-	-	21,940.3	26,819.4
Total	-	-	21,940.3	26,819.4

Amounts due to securitisation special purpose vehicles represent the beneficial interests held in mortgage portfolios by securitisation special purpose vehicles (see note 14). Because the mortgage loans do not qualify for derecognition from the Company's Balance Sheet, the securitisation special purpose vehicles' beneficial interests in the mortgage portfolios are represented by a deemed loan to the Company. This is equivalent in value to the beneficial interest in the mortgage portfolios plus associated inter Group balances directly relating to the beneficial interests in the mortgage portfolios.

28. Other liabilities

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Amounts owed to subsidiary companies	-	-	273.1	218.2
Other creditors	117.7	87.9	123.9	85.9
Total	117.7	87.9	397.0	304.1

At 31 December 2009 £19.2m was held for resale within the Group and £17.4m within the Company

29. Accruals and deferred income

	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 31 December				
Accrued interest	218.4	382.2	210.5	363.2
Deferred income	-	0.6	-	0.6
Other accruals	13.5	58.3	13.3	58.1
Total	231.9	441.1	223.8	421.9

At 31 December 2009 £188.4m was held for resale within the Group and £177.9m within the Company

Notes to the Financial Statements (continued)

30. Retirement benefit obligations

On 1 January 2010 all employees previously employed by the Company transferred to Northern Rock plc under the terms of the Northern Rock Transfer Order 2009, SI 2009/3226. As a consequence of this, members of the employee benefit scheme ('the Scheme') operated by the Company became members of the Northern Rock (2010) Pension Scheme and the existing Scheme, which had both defined benefit and defined contribution sections, was closed.

Defined benefit section of Scheme

The defined benefit section of the Scheme provides benefits based on final salary for certain employees. The assets of the Scheme are held in a separate trustee-administered fund. Contributions to the defined benefit section are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new entrants in July 1999. As a consequence of the closure of the Scheme to existing members all members are now deferred members and accrue no further benefits within it.

The Company's policy for recognising actuarial gains and losses is to recognise them immediately on the Balance Sheet through the Statement of Comprehensive Income.

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

Summary of assumptions

At 31 December	2010 %	2009 %
Price inflation	3.40	3.85
Rate of increase in salaries	n/a	4.35
Rate of increase for pre 6 April 2006 pensions in payment (in excess of any Guaranteed Minimum Pension (GMP) element)	3.70	3.90
Rate of increase for post 6 April 2006 pensions in payment	3.30	3.65
Rate of increase for deferred pensions	3.40	3.85
Discount rate	5.30	5.65
Expected rate of return on assets	5.05	4.92

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

At 31 December	2010		2009	
	Pensioner	Non-pensioner	Pensioner	Non-pensioner
Male	27.4 years	28.4 years	27.3 years	28.4 years
Female	29.9 years	30.8 years	29.9 years	30.7 years

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

Categories of assets held

At 31 December	2010 %	2009 %
Equities	3	2
Government and other corporate bonds	49	94
Property	3	3
Cash / other	45	1
Total	100	100

Funded status

At 31 December	2010 £m	2009 £m
Present value of defined benefit obligation	(371.9)	(391.4)
Assets at fair value	380.2	386.5
Defined benefit asset / (liability)	8.3	(4.9)

Notes to the Financial Statements (continued)

30. Retirement benefit obligations**Disclosed pension expense for year**

	2010 £m	2009 £m
(a) Components of defined benefit pension expense		
Current service cost	–	5.7
Interest cost	21.1	20.0
Expected return on assets	(19.2)	(17.2)
Curtailment gain	(9.1)	–
Total pension expense	(7.2)	8.5

The curtailment gain in 2010 has been calculated in accordance with IAS 19 and arises due to members accruing no further benefits within the Scheme following its closure

	2010 £m	2009 £m
(b) Statement of Comprehensive Income		
Actuarial loss recognised in Statement of Comprehensive Income	(6.2)	(45.9)
Cumulative actuarial (losses) / gains recognised at 1 January	(28.7)	17.2
Cumulative actuarial losses recognised at 31 December	(34.9)	(28.7)

	2010 £m	2009 £m
Movements in present value of defined benefit obligation during the year		
At 1 January	391.4	335.8
Defined benefit service cost	–	5.7
Interest cost	21.1	20.0
Defined benefit employee contributions	–	1.3
Actuarial (gain)/loss	(15.8)	39.6
Benefits paid	(11.9)	(11.0)
Curtailments	(9.1)	–
Other adjustments	(3.8)	–
At 31 December	371.9	391.4

Other adjustments are in respect of the transfer to the Northern Rock (2010) Pension Scheme of obligations for the money purchase guarantee reserve

	2010 £m	2009 £m
Movements in fair value of defined benefit assets during the year		
At 1 January	386.5	367.5
Expected return on assets	19.2	17.2
Actuarial loss	(22.0)	(6.3)
Defined benefit actual Company contributions	12.2	17.8
Defined benefit employee contributions	–	1.3
Defined benefit actual benefits paid	(11.9)	(11.0)
Other adjustments	(3.8)	–
At 31 December	380.2	386.5

Other adjustments are in respect of the transfer to the Northern Rock (2010) Pension Scheme of assets for the money purchase guarantee reserve

The actual loss on plan assets in 2010 was £2.8m (2009 return of £10.9m)

Notes to the Financial Statements (continued)

30. Retirement benefit obligations

Experience gains and losses	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Defined benefit obligation	371.9	391.4	335.8	354.6	350.7
Fair value of assets	380.2	386.5	367.5	360.3	329.0
Surplus / (deficit)	8.3	(4.9)	31.7	5.7	(21.7)
Experience gain / (loss) on liabilities	9.3	12.2	2.8	19.5	(10.5)
Experience (loss) / gain on assets	(22.0)	(6.3)	(1.9)	6.2	4.6

Estimated contributions for the year ending 31 December 2011

As a consequence of the closure of the Scheme no further monthly contributions are made by the Company or members. However, the Company has agreed with the Trustees to fund the deficit in the defined benefit section of the Scheme by making annual contributions which will result in a payment of £18.4m in January 2011.

Sensitivities

The following table illustrates the sensitivity of the defined benefit obligation to three key assumptions: the discount rate, the rate of inflation and the mortality assumption.

	Change in assumption	Impact on benefit obligation
Discount rate	Decrease by 0.5%	Increase by £43.8m
Inflation	Increase by 0.5%	Increase by £30.7m
Mortality	Decrease by 1 year	Increase by £9.0m

If the assumptions were to change by the same amount in the opposite direction to those illustrated, the benefit obligation would decrease by a similar amount to those shown in the table in each case.

Defined contribution section of Scheme

Pension costs for the defined contribution section of the Scheme were

	2010 £m	2009 £m
Total included in staff costs	–	3.6

31. Provisions

The movement in provisions was as follows:

	Group and Company					
	Provision for customer redress		Onerous contracts provision		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
At 1 January	72.4	5.0	15.4	18.5	87.8	23.5
Utilised in the year	(29.3)	(11.1)	(2.5)	(5.5)	(31.8)	(16.6)
Charged in the year	160.0	78.5	(0.8)	0.1	159.2	78.6
Adjustment on disposal of property, plant and equipment	–	–	–	2.3	–	2.3
At 31 December	203.1	72.4	12.1	15.4	215.2	87.8

The provision for customer redress is in respect of potential claims for compensation from customers regarding Payment Protection Insurance ('PPI') and other mis-sold products. At 31 December 2009 the provision comprised £71.4m for PPI and £1.0m for other general customer claims. During 2010 the level of customer complaints regarding PPI sales has increased significantly with 14,600 (2009: 8,000) received in the year, of which 8,800 were made in the second half. Based on the increase in claims, our root cause analysis and follow-up work into the selling processes adopted in the past, a further provision of £155.0m has been made to cover the cost of the claims anticipated in the future. Claims for other mis-sold products, such as endowments, continue, albeit much fewer than PPI, and a further provision of £5.0m is made for these general claims. We expect future claims to be settled over the next few years. The exact amounts and timing of the settlements will depend upon the level and value of future claims which could differ from the estimates used in the establishment of this provision, and could also be impacted by the outcome of the ongoing judicial review into the FSA's policy statement PS 10/12 on PPI.

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

Notes to the Financial Statements (continued)

32. Subordinated liabilities

At 31 December	Interest rate	Final maturity	Terms	Denomination	Group and Company	
					2010 £m	2009 £m
Subordinated bonds	5.625%	2015	Redeemable since 13/01/10	Sterling	296.1	295.1
Subordinated loan	11.734%	2016	Repayable in five equal annual instalments from 2012 to 2016	Sterling	25.6	25.8
Subordinated bonds	5.75%	2017	Not redeemable before 28/02/12	Sterling	258.6	263.9
Subordinated bonds	10¾%	2018	Not redeemable before 25/03/18	Sterling	50.4	50.5
Subordinated bonds	9¾%	2021	Not redeemable before 17/10/21	Sterling	149.2	149.1
HM Treasury PIK interest	See below	2013	See below	Sterling	150.7	150.6
Total					930.6	935.0

The HM Treasury PIK interest represents the amount of margin payable to HM Treasury which was subordinated under the terms of the facility (see note 24). Repayment of this amount is due on 1 April 2013. Interest is payable on this loan at a floating rate above the Bank Base Rate.

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

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

33. Subordinated notes

At 31 December	Interest rate	Terms	Denomination	Group and Company	
				2010 £m	2009 £m
Perpetual subordinated notes	12¾%	Not redeemable	Sterling	13.5	19.8
Undated subordinated notes	8%	Redeemable on coupon dates which fall on 15 March, 15 June, 15 September and 15 December	US\$	19.0	62.1
Perpetual fixed to floating rate subordinated notes	6.594%	Not redeemable before 28/06/17	US\$	1.2	405.3
Fixed rate step-up undated subordinated notes	6.75%	Not redeemable before 17/06/24	Sterling	10.5	195.4
Floating rate undated subordinated notes	1% above 3 month US\$ LIBOR	Not redeemable before 23/02/11	US\$	–	66.0
Undated subordinated notes	5.6%	Not redeemable before 30/04/14	US\$	8.7	393.2
Total				52.9	1,141.8

The 6.594% perpetual fixed to floating rate subordinated notes were reclassified from subordinated liabilities in 2009. This resulted from State aid approval in October 2009 which required the Company to withhold coupon payments on all subordinated instruments where possible, and the exercise of the general right of deferral of coupon payment contained within the terms and conditions of this specific instrument.

In accordance with the requirements of IAS 32, undated subordinated liabilities are classified as non shareholders' equity, as there is no contractual obligation to pay the interest coupon. Coupons on these notes are treated as appropriations and amounted to £nil (2009: £32.5m) after a tax credit of £nil (2009: £nil).

The proceeds of and coupon payments for subordinated notes denominated in US dollars have been swapped into sterling.

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

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

During the year subordinated notes with a notional value of £1,088.9m were repurchased. Further details of this transaction are given in note 7.

Notes to the Financial Statements (continued)

34. 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, if payment of the coupon would lead to breaches of regulatory capital requirements, the Company will decide whether to declare or defer the coupon. If the Company 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 the Company defers the coupon, it may not pay a dividend on any share or pay any coupon on the reserve capital instruments, nor redeem or repurchase any of its share capital or reserve capital instruments until it next makes a coupon payment for the tier one notes. While the Company is in public ownership, deferred coupons can only be satisfied in accordance with the terms of Article 5 of The Northern Rock Transfer Order 2008 which was made on 21 February 2008 pursuant to the Banking (Special Provisions) Act 2008.

The Company 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 regulatory capital.

The carrying value of tier one notes at 31 December 2010 is £135.7m (2009: £233.7m).

During the year tier one notes with a notional value of £89.5m (carrying value of £111.0m) were repurchased. Further details of this transaction are given in note 7.

35. Reserve capital instruments

Reserve capital instruments were issued for a value of £200m in September 2000 and £100m in May 2001 and are undated. They carry a coupon of 8.399% payable annually in arrears on 21 September each year. At each payment date the Company will decide whether to declare or defer the coupon. If the Company decides to declare the coupon, the holder will receive a cash payment equivalent to the coupon which will be achieved either by the payment of cash directly, or while the Company is in public ownership, as per the terms of Article 5 of The Northern Rock Transfer Order 2008 (the 'Transfer Order') which was made on 21 February 2008 pursuant to the Banking (Special Provisions) Act 2008. If the Company elects to defer the coupon, it may not declare or pay a dividend on any share until the deferred coupons are satisfied. While the Company is in public ownership, deferred coupons and any interest accruing thereon can only be satisfied in accordance with the terms of Article 5 of the Transfer Order.

The Company 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 full amount of reserve capital instruments is permitted for inclusion within regulatory capital.

In accordance with the requirements of IAS 32, reserve capital instruments are classified as non-shareholders' equity. Coupons on these notes are treated as appropriations and amounted to £nil (2009: £nil) after a tax credit of £nil (2009: £nil).

During the year reserve capital instruments with a notional value of £143.1m were repurchased. Further details of this transaction are given in note 7.

36. Appropriations

	2010 £m	2009 £m
Subordinated notes	–	32.5

One of the conditions resulting from State aid approval in October 2009 requires the Company to withhold coupon payments on all subordinated instruments where possible. Consequently no appropriations have been made in respect of the Company's reserve capital instruments or subordinated notes during 2010.

37. Called up share capital

	Group and Company					
At 31 December	2010 Number	2010 £m	2010 €m	2009 Number	2009 £m	2009 €m
Authorised share capital						
Ordinary shares of 25p each	718.5m	179.6	–	718.5m	179.6	–
Perpetual non-cumulative callable Preference shares of 25p each	100.0m	25.0	–	100.0m	25.0	–
Perpetual non-cumulative callable Preference shares of 25c each	100.0m	–	25.0	100.0m	–	25.0
Total	918.5m	204.6	25.0	918.5m	204.6	25.0

Notes to the Financial Statements (continued)

37. Called up share capital (continued)

At 31 December	Group and Company			
	2010 Number	2010 £m	2009 Number	2009 £m
Issued and fully paid share capital				
Ordinary shares of 25p each	495.6m	123.9	495.6m	123.9
Perpetual non-cumulative callable Preference shares of 25p each	0.4m	0.1	0.4m	0.1
Total	496.0m	124.0	496.0m	124.0

Since 22 February 2008, all shares in the Company have been held by the Treasury Solicitor as nominee of the Treasury as a result of The Northern Rock plc Transfer Order 2008 (SI 2008 No. 432).

Dividends on Preference shares are discretionary and, subject to Board approval, are payable annually on 4 July at a rate of 6.8509%. No dividends were paid in 2010 or 2009.

38. Reserves

Share premium reserve	Group and Company		
	Ordinary £m	Preference £m	Total £m
At 1 January 2010 and 31 December 2010	6.8	396.4	403.2

Capital redemption reserve	Group and Company	
	£m	
At 1 January 2010 and 31 December 2010	7.3	

Revaluation reserve – available-for-sale investments	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 1 January	(386.3)	(602.5)	(385.6)	(599.8)
Transferred to Northern Rock plc (see note 48)	16.2	–	16.2	–
Net gains / (losses) from changes in fair value	1.6	(3.3)	0.9	0.5
Losses transferred to net income due to impairment	7.8	5.5	7.8	5.5
Net (profits) / losses on disposal transferred to net income	(0.2)	6.8	(0.3)	0.3
Amortisation of fair value differences in respect of securities transferred to loans and receivables	133.0	236.2	133.0	236.2
Losses transferred to / (from) net income due to impairment of securities transferred to loans and receivables	0.3	(29.2)	0.3	(29.2)
Deferred taxes	–	0.2	–	0.9
At 31 December	(227.6)	(386.3)	(227.7)	(385.6)

At 31 December 2009 £16.2m of the revaluation reserve was held for resale in both Group and Company.

Hedging reserve – cash flow hedges	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
At 1 January	(125.8)	(269.7)	(125.8)	(269.7)
Amounts recognised in equity	43.5	164.8	43.5	164.8
Amounts transferred to net income	15.8	(20.9)	15.8	(20.9)
At 31 December	(66.5)	(125.8)	(66.5)	(125.8)

Notes to the Financial Statements (continued)

39. Off Balance Sheet commitments

(a) Commitments payable

At 31 December 2010	Group and Company			
	Within one year £m	In one to five years £m	Over five years £m	Total £m
Loan commitments	-	-	2,520.2	2,520.2
Operating lease commitments				
- Land and buildings	1.2	2.6	0.7	4.5
- Other operating leases	-	-	-	-
Capital commitments	-	-	-	-
Total	1.2	2.6	2,520.9	2,524.7

At 31 December 2009	Group and Company			
	Within one year £m	In one to five years £m	Over five years £m	Total £m
Loan commitments	752.8	-	3,420.3	4,173.1
Operating lease commitments				
- Land and buildings	0.4	1.1	3.8	5.3
- Other operating leases	-	3.5	-	3.5
Capital commitments	7.4	0.2	-	7.6
Total	760.6	4.8	3,424.1	4,189.5

Loan commitments represent contractual amounts to which the Group is committed for extension of credit to customers

Operating lease commitments represent minimum future lease payments under non-cancellable operating leases

Capital commitments represent commitments for the acquisition of buildings and equipment

(b) Commitments receivable

At 31 December 2010	Group and Company			
	Within one year £m	In one to five years £m	Over five years £m	Total £m
Operating lease commitments				
- Land and buildings	7.0	14.5	0.1	21.6

At 31 December 2009	Group and Company			
	Within one year £m	In one to five years £m	Over five years £m	Total £m
Operating lease commitments				
- Land and buildings	0.1	0.3	0.1	0.5

Operating lease commitments represent minimum future lease payments receivable under non-cancellable operating leases

Notes to the Financial Statements (continued)

40. Related party disclosures

(a) Service Level Agreements

The Company had Service Level Agreement (SLA) arrangements with related parties during the year as follows

(i) SLA between Northern Rock plc and Northern Rock (Asset Management) plc

Under this agreement Northern Rock plc invoices the Company monthly in arrears for the cost of services rendered to the Company plus a margin of 10%. The cost of services rendered comprises operational, non operational, transition and real estate costs. These costs are allocated between Northern Rock plc and the Company as follows

- Operational costs based on a number of agreed cost allocation drivers which create an appropriate split dependent on the respective volume of business done by each of Northern Rock plc and the Company during the relevant month
- Non operational costs on a case by case basis
- Transition costs 20% to Northern Rock plc and 80% to the Company
- Real estate costs 60% to Northern Rock plc and 40% to the Company

During the year the Company incurred a net cost of £160.8m under this SLA. Of this amount £115.5m is reflected within ongoing administrative expenses and £45.3m in other net administrative expenses

(ii) SLA between Bradford & Bingley plc and Northern Rock (Asset Management) plc

Under this agreement Bradford and Bingley plc invoices the Company for the cost of services rendered to the Company. Costs are recharged in respect of IT, ancillary, treasury, operational and support and facilities services. These costs are allocated between Bradford & Bingley plc and the Company as follows

- IT and ancillary services 100% pass through of such charges that Bradford & Bingley plc incurs under a separate SLA arrangement that it has in place with Northern Rock plc
- Treasury and operational and support services based on agreed gross budgets and a cost allocation model
- Facilities services for the Company arranged by Bradford & Bingley plc with facilities providers, the cost for these services is paid direct to the providers by the Company

During the year the Company incurred a net cost of £12.0m under this SLA. Of this amount £10.3m is reflected within ongoing administrative expenses (including £4.2m in respect of pass through of charges from Northern Rock plc) and £1.7m in other net administrative expenses. At 31 December 2010 £2.5m was owed to Bradford & Bingley plc in respect of these charges

(b) Key management personnel

The Company considers the Board of Directors and members of the Executive Committee, to be key management personnel. A number of banking transactions are entered into with key management personnel as part of normal banking business including loans and deposits. The volumes of these related party transactions outstanding balances at the year end and related income and expense for the year are set out below

	2010 £m	2009 £m
Loans		
At 1 January	1.7	2.2
Movements due to changes in key management personnel	(1.7)	0.7
Net amounts repaid	-	(1.2)
At 31 December	-	1.7
Interest income paid	-	0.1
Deposits		
At 1 January	0.5	0.3
Movements due to transfer of deposits to Northern Rock plc	(0.5)	-
Net amounts deposited	-	0.2
At 31 December	-	0.5
Interest income earned	-	-
	2010 £m	2009 £m
Remuneration of key management personnel		
Salaries, bonuses and other short term benefits	2.3	4.2
Post-employment benefits	0.3	0.7
Termination benefits	0.5	-
Total	3.1	4.9

Notes to the Financial Statements (continued)

40. Related party disclosures

(c) Subsidiary companies

Balances outstanding with subsidiary companies and movements in these loans were as follows

	Securitisation SPVs £m	Other subsidiaries £m	2010 Total £m	Securitisation SPVs £m	Other subsidiaries £m	2009 Total £m
Receivables						
At 1 January	70.3	10.4	80.7	160.7	11.3	172.0
Net movement over the year	(39.5)	–	(39.5)	(90.4)	(0.9)	(91.3)
At 31 December	30.8	10.4	41.2	70.3	10.4	80.7
	Securitisation SPVs £m	Other subsidiaries £m	2010 Total £m	Securitisation SPVs £m	Other subsidiaries £m	2009 Total £m
Payables						
At 1 January	26,990.7	1,061.0	28,051.7	31,646.7	1,179.6	32,826.3
Net movement over the year	(4,820.1)	(1,018.2)	(5,838.3)	(4,656.0)	(118.6)	(4,774.6)
At 31 December	22,170.6	42.8	22,213.4	26,990.7	1,061.0	28,051.7

(d) Fellow subsidiary

In addition to the balances and transactions with Bradford & Bingley plc under the SLA agreement (see a (ii) above) the Company held £53.1m of loan notes issued by Bradford & Bingley plc at 31 December 2010. Interest income earned by the Company on these notes during the period 1 October 2010 to 31 December 2010 amounted to £0.1m. Bradford & Bingley plc held £114.6m of loan notes issued by the Company at 31 December 2010. Interest income paid by the Company on these notes during the period 1 October 2010 to 31 December 2010 amounted to £0.3m.

(e) Other

As a consequence of the transfer of all called up share capital to the Treasury Solicitor on 22 February 2008 (see note 37) the Company regards the Government as a related party. Details of loan facilities with the Government are set out in note 24 above. Interest and guarantee fees payable on the loan net of interest receivable on liquidity deposit accounts with the Bank of England, in 2010 were £144.6m (2009 £385.9m). On 28 October 2009, the European Commission approved the Government's State aid package for Northern Rock (Asset Management) plc. This resulted in the clawback of £472.4m of net interest income and guarantee fees previously payable to the Government, of which £200.0m related to 2008.

In addition to these loans and guarantees the Group has transactions with numerous Government bodies on an arm's length basis in relation to the payment of corporation tax, value added tax and employment taxes and the payment of regulatory fees and levies. Transactions with these entities are not disclosed owing to the volume of transactions conducted.

41. Capital structure

The Group manages its capital resources to meet the regulatory requirements established by its regulator, the FSA. Capital adequacy is monitored on an ongoing basis by the Group's executive management and Board, based on the regulations established by the FSA. The required capital information is filed with the FSA on a quarterly basis.

Since 1 January 2010, following the completion of a legal and capital restructuring, the Company no longer operates as a deposit taking institution regulated under BIPRU rules (the FSA's Prudential sourcebook for Banks, Building Societies and Investment Firms). It is now regulated by the FSA as a mortgage administration company under MIPRU rules (the FSA's Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries), which have different definitions in relation to capital resources and capital requirements.

The first table below sets out the Company's regulatory capital resources under MIPRU, and the second table sets out its regulatory capital resources under BIPRU for 2009.

	At 31 December 2010 £m
Total equity attributable to equity shareholder	1,243.7
Reserve capital instruments	156.2
Tier one notes	135.7
Subordinated notes	52.9
Subordinated liabilities	905.0
Total available capital resources	2,493.5

Notes to the Financial Statements (continued)

41. Capital structure (continued)

At 31 December 2009
£m

Core Tier 1 capital	(337.5)
Perpetual non-cumulative preference shares	630.2
Innovative Tier 1 capital	299.3
Deductions from and restrictions to Tier 1 capital	(101.6)
Tier 1 capital after deductions	490.4
Upper Tier 2 capital	1,211.4
Lower Tier 2 capital	935.0
Deductions from and restrictions to Tier 2 capital	(42.5)
Tier 2 capital after deductions	2,103.9
Deductions from totals of Tier 1 and Tier 2	(5.1)
Total available capital resources	2,589.2

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

The Company met its capital requirements in full during the year to 31 December 2010.

42. Derivative financial instruments

Strategy in using derivative financial instruments

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

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

(a) Fair value hedges

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

- Hedging the interest rate and foreign currency exchange rate risk of non-prepayable, foreign currency denominated fixed rate assets or liabilities on a one-for-one basis with fixed/floating or floating/fixed cross currency interest rate swaps.
- Hedging the interest rate risk of a single currency portfolio of sterling, US Dollar or Euro non-prepayable fixed rate assets/liabilities on a one-for-one basis with vanilla fixed/floating or floating/fixed interest rate swaps.
- Hedging the interest rate risk of a portfolio of prepayable fixed rate assets with interest rate derivatives. This solution is used to establish a macro fair value hedge for derivatives hedging fixed rate mortgages. The Group believes this solution is the most appropriate as it is consistent with its policy for hedging fixed rate mortgages on an economic basis.

The total fair value of derivatives included within fair value hedges at 31 December 2010 was a net asset of £2,125.0m (2009: net asset of £1,561.0m).

(b) Cash flow hedges

The Group designates a number of derivatives as cash flow hedges. In particular, the Group adopts an approach of using fixed interest rate swaps in a cash flow hedge strategy when there is insufficient capacity or other restrictions preventing these derivatives from being utilised in the macro hedge. The accounting hedge relationship is to hedge floating rate sterling liabilities. The total fair value of derivatives included within cash flow hedges at 31 December 2010 was a net liability of £127.0m (2009: net liability of £153.0m).

(c) Net investment hedges

The Group has not designated any derivatives as net investment hedges in 2010 or 2009.

All derivative financial instruments are held for economic hedging purposes, although not all derivatives are designated as hedging instruments under the terms of IAS 39. The analysis below therefore splits derivatives between those in accounting hedge relationships and those in economic hedge relationships but not in accounting hedge relationships.

Notes to the Financial Statements (continued)

42. Derivative financial instruments (continued)

Group At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Other hedges £m	Total £m	Nominal amounts £m
Interest rate contracts	47.6	0.2	69.1	116.9	2,133.3
Exchange rate contracts	2,705.0	–	3,720.6	6,425.6	22,165.0
Total asset balances	2,752.6	0.2	3,789.7	6,542.5	24,298.3
Interest rate contracts	627.6	127.2	49.2	804.0	30,221.9
Exchange rate contracts	–	–	22.4	22.4	678.2
Total liability balances	627.6	127.2	71.6	826.4	30,900.1
Fair value of hedging instruments	2,125.0	(127.0)	3,718.1	5,716.1	(6,601.8)

Company At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Other hedges £m	Total £m	Nominal amounts £m
Interest rate contracts	217.5	3.2	102.9	323.6	17,140.8
Exchange rate contracts	2,721.3	–	4,426.7	7,148.0	25,604.4
Other	–	–	2.2	2.2	41.4
Total asset balances	2,938.8	3.2	4,531.8	7,473.8	42,786.6
Interest rate contracts	1,377.8	156.2	58.9	1,592.9	61,475.9
Exchange rate contracts	–	–	80.9	80.9	1,944.7
Other	–	–	–	–	7.0
Total liability balances	1,377.8	156.2	139.8	1,673.8	63,427.6
Fair value of hedging instruments	1,561.0	(153.0)	4,392.0	5,800.0	(20,641.0)

Company At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Other hedges £m	Total £m	Nominal amounts £m
Interest rate contracts	47.6	0.2	69.1	116.9	2,133.3
Exchange rate contracts	2,705.0	–	200.2	2,905.2	8,103.4
Total asset balances	2,752.6	0.2	269.3	3,022.1	10,236.7
Interest rate contracts	627.6	127.2	49.2	804.0	30,221.9
Exchange rate contracts	–	–	22.4	22.4	678.2
Total liability balances	627.6	127.2	71.6	826.4	30,900.1
Fair value of hedging instruments	2,125.0	(127.0)	197.7	2,195.7	(20,663.4)

Company At 31 December 2010	Fair value hedges £m	Cash flow hedges £m	Other hedges £m	Total £m	Nominal amounts £m
Interest rate contracts	211.1	3.2	102.9	317.2	16,892.3
Exchange rate contracts	2,721.3	–	419.0	3,140.3	9,074.3
Other	–	–	2.2	2.2	41.4
Total asset balances	2,932.4	3.2	524.1	3,459.7	26,008.0
Interest rate contracts	1,377.8	156.2	58.9	1,592.9	61,475.9
Exchange rate contracts	–	–	75.9	75.9	1,642.7
Other	–	–	–	–	7.0
Total liability balances	1,377.8	156.2	134.8	1,668.8	63,125.6
Fair value of hedging instruments	1,554.6	(153.0)	389.3	1,790.9	(37,117.6)

Notes to the Financial Statements (continued)

42. Derivative financial instruments (continued)**Cash flow hedges**

Periods when cash flows are expected to occur and affect the Income Statement

At 31 December	2010 £m	2009 £m
Within one year	(49.5)	(95.4)
In one to five years	(17.7)	(32.8)
Over five years	0.5	2.2
Total	(66.7)	(126.0)

Concentration risk

The carrying amount of the Group's derivative assets analysed by geographical region are set out in the table below

	UK £m	Europe £m	US £m	Other countries £m	Total £m
At 31 December 2010	2,894.3	2,968.8	584.4	95.0	6,542.5
At 31 December 2009	1,991.7	4,256.3	1,160.1	65.7	7,473.8

43. Analysis of financial assets and liabilities by measurement basis**Fair values of financial assets and liabilities**

The following table summarises the carrying amounts and fair values of financial assets and liabilities. Assets are presented at bid prices, whereas offer prices are used for liabilities. The accounting policy note sets out the key principles for estimating the fair values of financial instruments. This note provides some additional information in respect of the methodologies used.

Group At 31 December 2010	Loans and receivables £m	Available- for-sale securities £m	IAS 39 held for trading £m	Fair value hedge £m	Cash flow hedge £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial assets								
Cash and balances at central banks	6,980.8	-	-	-	-	6,980.8	6,980.8	69.8
Derivative financial instruments	-	-	3,789.7	2,752.6	0.2	6,542.5	6,542.5	65.4
Loans and advances to banks	1,944.0	-	-	-	-	1,944.0	1,944.0	19.4
Loans and advances to customers	48,298.1	-	-	-	-	48,298.1	47,886.2	478.9
Investment securities and unsecured investment loans	2,272.1	124.3	-	-	-	2,396.4	2,286.7	22.9
Other financial assets	12.8	-	-	-	-	12.8	12.8	0.1
Total financial assets	59,507.8	124.3	3,789.7	2,752.6	0.2	66,174.6	65,653.0	656.5
		Financial liabilities at amortised cost £m	IAS 39 held for trading £m	Fair value hedge £m	Cash flow hedge £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial liabilities								
Loans from HM Treasury		21,713.4	-	-	-	21,713.4	21,713.4	217.1
Deposits by banks		4,900.8	-	-	-	4,900.8	4,900.8	49.0
Derivative financial instruments		-	71.6	627.6	127.2	826.4	826.4	8.3
Debt securities in issue		35,883.3	-	-	-	35,883.3	33,596.7	336.0
Subordinated liabilities		930.6	-	-	-	930.6	633.0	6.3
Tier one notes		135.7	-	-	-	135.7	78.7	0.8
Other financial liabilities		219.4	-	-	-	219.4	219.4	2.2
Total financial liabilities		63,783.2	71.6	627.6	127.2	64,609.6	61,968.4	619.7

Notes to the Financial Statements (continued)

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

Group At 31 December 2009	Loans and receivables £m	Available- for-sale securities £m	IAS 39 held for trading £m	Fair value hedge £m	Cash flow hedge £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Financial assets								
Cash and balances at central banks	7,510.4	–	–	–	–	7,510.4	7,510.4	75.1
Derivative financial instruments	–	–	4,531.8	2,938.8	3.2	7,473.8	7,473.8	74.7
Loans and advances to banks	3,702.4	–	–	–	–	3,702.4	3,702.4	37.0
Loans and advances to customers	65,399.8	–	–	–	–	65,399.8	64,572.2	645.7
Investment securities and unsecured investment loans	2,919.3	168.5	–	–	–	3,087.8	2,833.9	28.3
Other financial assets	15.1	–	–	–	–	15.1	15.1	0.2
Total financial assets	79,547.0	168.5	4,531.8	2,938.8	3.2	87,189.3	86,107.8	861.0
Financial liabilities								
		Financial liabilities at amortised cost £m	IAS 39 held for trading £m	Fair value hedge £m	Cash flow hedge £m	Total carrying value £m	Fair value £m	If fair value increased by 1% £m
Loans from HM Treasury		14,315.5	–	–	–	14,315.5	14,315.5	143.2
Deposits by banks		6,022.3	–	–	–	6,022.3	6,019.6	60.2
Customer accounts		20,607.6	–	–	–	20,607.6	20,901.6	209.0
Derivative financial instruments		–	139.8	1,377.8	156.2	1,673.8	1,673.8	16.7
Debt securities in issue		41,973.7	–	–	–	41,973.7	37,405.1	374.1
Subordinated liabilities		935.0	–	–	–	935.0	616.7	6.2
Tier one notes		233.7	–	–	–	233.7	70.0	0.7
Other financial liabilities		385.0	–	–	–	385.0	385.0	3.8
Total financial liabilities		84,472.8	139.8	1,377.8	156.2	86,146.6	81,387.3	813.9

Valuation methods for calculations of fair values in the table above for those financial assets and liabilities not presented on the Group's Balance Sheet at their fair value are set out below

Cash and balances at central banks

Fair value approximates to carrying value because they have minimal credit losses and are either short term in nature or reprice frequently

Loans and advances to banks

Fair value was estimated by using discounted cash flows, applying either market rates where practicable or rates offered by other financial institutions for loans with similar characteristics. The fair value of floating rate placements, fixed rate placements with less than six months to maturity and overnight deposits is their carrying amount.

Loans and advances to customers

The Group provides loans of varying rates and maturities to customers. The fair value of loans with variable interest rates is considered to approximate to carrying value as the rate charged on these loans varies in line with changes in market rates. For loans with fixed interest rates, fair value was estimated by discounting cash flows, using market rates or rates normally offered by the Group. The change in interest rates since the majority of these loans were originated means that their fair value can vary significantly from their carrying value. However, as the Group's policy is to hedge fixed rate loans in respect of interest rate risk, this does not indicate that the Group has an exposure to this difference in value.

Investment securities held as loans and receivables

Fair values are based on quoted prices where available or by using discounted cash flows applying market rates.

Unsecured investment loans

The fair value of unsecured investment loans approximates the carrying value due to the impairment of these assets to the value of the future expected cash flows.

Loans from HM Treasury

The fair value is assumed to be the carrying amount as the rate charged on these loans varies in line with changes in market rates.

Deposits by banks and customer accounts

Fair values of deposit liabilities repayable on demand or with variable interest rates are considered to approximate to carrying value. The fair value of fixed interest deposits with less than six months to maturity is their carrying amount. The fair value of all other deposit liabilities was estimated using discounted cash flows, applying either market rates or rates currently offered by the Group for deposits of similar remaining maturities.

Debt securities in issue, subordinated liabilities and tier one notes

Fair values are based on quoted prices where available, or by using discounted cash flows applying market rates.

Notes to the Financial Statements (continued)

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

The table below summarises the fair value measurement basis used for assets and liabilities held on the Balance Sheet at fair value. There are three levels to the hierarchy as follows:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets and liabilities
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, whether directly (ie as prices) or indirectly (ie derived from prices)
- Level 3 Inputs for the asset or liability that are not based on observable market data (unobservable inputs)

At 31 December 2010	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	–	3,022.1	3,520.4	6,542.5
Available-for-sale securities	–	124.3	–	124.3
Financial liabilities				
Derivative financial instruments	–	826.4	–	826.4
At 31 December 2009	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments	–	3,459.7	4,014.1	7,473.8
Available-for-sale securities	–	168.5	–	168.5
Financial liabilities				
Derivative financial instruments	–	1,668.8	5.0	1,673.8

The movement in assets and liabilities measured using a valuation technique for which any significant input is not based on observable market data (Level 3) is as follows:

	Financial assets Derivative financial instruments £m	Financial liabilities Derivative financial instruments £m	Total £m
2010			
At 1 January 2010	4,014.1	(5.0)	4,009.1
Total losses in the Income Statement	(488.7)	–	(488.7)
Transfers from assets to liabilities	(5.0)	5.0	–
At 31 December 2010	3,520.4	–	3,520.4
2009			
At 1 January 2009	7,269.0	–	7,269.0
Total losses in the Income Statement	(3,218.2)	(41.7)	(3,259.9)
Transfers from assets to liabilities	(36.7)	36.7	–
At 31 December 2009	4,014.1	(5.0)	4,009.1

Total losses in the Income Statement of £488.7m are a result of fair value losses of £1,157.1m less settlement gains of £668.4m.

Notes to the Financial Statements (continued)

44. Collateral pledged and received

At 31 December	Group		Company	
	2010 £m	2009 £m	2010 £m	2009 £m
Cash collateral pledged as part of normal derivative operations	577.8	848.6	577.8	848.6
Cash collateral received as part of normal derivative operations	4,771.5	5,564.9	88.5	28.2
Securities collateral held	129.6	394.3	–	–

In addition to the collateral amounts shown above, certain loans to customers provide security in respect of securitised note and covered bond funding as detailed in notes 14 and 15. These loans, and also cash collateral pledged shown above, are carried on the Group and Company Balance Sheets. The liability to repay the collateral received is included within deposits by banks in the Group and Company Balance Sheets. In the absence of counterparty default, the Group has no right to sell or re-pledge the securities and therefore, in accordance with the provisions of IAS 39, such securities are not recognised on the Balance Sheet.

45. Financial risk management

Details of the Group's approach to risk management, including the governance structure and the way in which risks faced by the Group are identified, categorised and managed, are given in the Directors' Report on pages 30 to 36.

Corporate and wholesale credit risk

Corporate Credit Counterparty risk arises through Treasury hedging and investment activities and related Balance Sheet management requirements.

Credit risk can be broken down into two elements:

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

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

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

	2010 £m	2009 £m
On Balance Sheet		
Cash and balances at central banks	6,980.8	7,510.4
Derivative financial instruments	6,542.5	7,473.8
Loans and advances to banks	1,944.0	3,702.4
Loans and advances to customers	47,758.5	64,268.2
Investment securities and unsecured investment loans	2,396.4	3,087.8
Total on Balance Sheet	65,622.2	86,042.6
Off Balance Sheet		
Loan commitments	2,520.2	4,173.1

Notes to the Financial Statements (continued)

45. Financial risk management (continued)

The credit quality of loans, advances, investment securities and unsecured investment loans is set out in the table below

	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m	Available-for-sale securities £m	Assets reclassified from available for-sale to loans and receivables £m	Unsecured investment loans £m
At 31 December 2010							
Neither past due nor impaired	1,944 0	39,319 9	319.2	2,986 3	81.2	1,875 1	349 4
Past due but not impaired	–	4,528 2	4 6	146 4	–	6 3	–
Impaired	–	1,497 2	18 6	523 4	192 4	102 0	250 6
	1,944 0	45,345 3	342 4	3,656 1	273 6	1,983 4	600 0
Provisions	–	(1,013 0)	(30 0)	(542 3)	(149 3)	(60 7)	(250 6)
Total	1,944 0	44,332 3	312 4	3,113 8	124 3	1,922.7	349 4

	Loans and advances to banks £m	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m	Available-for-sale securities £m	Assets reclassified from available for-sale to loans and receivables £m	Unsecured investment loans £m
At 31 December 2009							
Neither past due nor impaired	3,702 4	54,847 2	282 6	3,885 9	144 7	2,521 7	358 0
Past due but not impaired	–	4,022 7	0 2	201 6	–	–	–
Impaired	–	1,793 9	17 6	389 4	191 7	93 4	333 8
	3,702 4	60,663 8	300 4	4,476 9	336 4	2,615 1	691 8
Provisions	–	(596 1)	(12 5)	(564 3)	(167 9)	(54 1)	(333 5)
Total	3,702 4	60,067 7	287 9	3,912 6	168 5	2,561 0	358 3

Past due not impaired loans

	Residential mortgage loans £m	Commercial mortgage loans £m	Unsecured personal loans £m
At 31 December 2010			
Up to three months	2,408 4	0 4	123 2
In three to six months	1,276 7	0 2	7 9
Over six months	843 1	4 0	15 3
Total	4,528 2	4 6	146 4
At 31 December 2009			
Up to three months	2,043 4	0 2	183 6
In three to six months	1,159 3	–	7 0
Over six months	820 0	–	11 0
Total	4,022 7	0 2	201 6

No loans were renegotiated that would otherwise be past due or impaired at 31 December 2010 (2009: £nil)

Notes to the Financial Statements (continued)

45. Financial risk management (continued)

Liquidity risk

The table below analyses the Group's financial assets and liabilities into relevant maturity groupings based on the remaining period from the Balance Sheet date to the contractual maturity date. Amounts shown in respect of loans and advances to customers include fair value adjustments on portfolio hedging.

At 31 December 2010	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Assets							
Cash and balances at central banks	6,980.8	-	-	-	-	-	6,980.8
Derivative financial instruments	-	335.5	125.4	680.5	2,311.7	3,089.4	6,542.5
Loans and advances to banks	810.1	1,133.9	-	-	-	-	1,944.0
Loans and advances to customers	318.2	371.8	369.2	732.5	5,903.8	40,602.6	48,298.1
Investment securities and unsecured investment loans	-	67.5	43.8	114.4	461.5	1,709.2	2,396.4
Other financial assets	3.0	9.8	-	-	-	-	12.8
Total financial assets	8,112.1	1,918.5	538.4	1,527.4	8,677.0	45,401.2	66,174.6
Liabilities							
Loans from HM Treasury	21,713.4	-	-	-	-	-	21,713.4
Deposits by banks	4,771.5	43.1	-	43.1	43.1	-	4,900.8
Derivative financial instruments	-	35.0	52.0	159.1	457.9	122.4	826.4
Debt securities in issue	-	559.6	21.9	1,841.0	4,641.5	28,819.3	35,883.3
Subordinated liabilities	-	-	-	-	296.1	634.5	930.6
Tier one notes	-	-	-	-	-	135.7	135.7
Other financial liabilities	14.0	141.8	35.1	28.5	-	-	219.4
Total financial liabilities	26,498.9	779.5	109.0	2,071.7	5,438.6	29,711.9	64,609.6
Net liquidity gap	(18,386.8)	1,139.0	429.4	(544.3)	3,238.4	15,689.3	1,565.0

Notes to the Financial Statements (continued)

45. Financial risk management (continued)

Liquidity risk (continued)

At 31 December 2009	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Assets							
Cash and balances at central banks	7,446.6	–	–	–	–	63.8	7,510.4
Derivative financial instruments	–	240.5	150.1	431.0	3,542.9	3,109.3	7,473.8
Loans and advances to banks	2,023.1	1,679.3	–	–	–	–	3,702.4
Loans and advances to customers	140.8	423.2	521.9	1,044.1	8,200.2	55,069.6	65,399.8
Investment securities and unsecured investment loans	–	126.2	83.6	90.9	724.8	2,062.3	3,087.8
Other financial assets	4.5	10.6	–	–	–	–	15.1
Total financial assets	9,615.0	2,479.8	755.6	1,566.0	12,467.9	60,305.0	87,189.3
Liabilities							
Loans from HM Treasury	14,315.5	–	–	–	–	–	14,315.5
Deposits by banks	5,564.8	235.3	88.9	–	133.3	–	6,022.3
Customer accounts	8,765.5	3,767.9	1,419.8	3,516.2	3,098.4	39.8	20,607.6
Derivative financial instruments	–	45.2	55.8	193.0	1,224.9	154.9	1,673.8
Debt securities in issue	–	53.9	246.7	964.1	5,650.4	35,058.6	41,973.7
Subordinated liabilities	–	–	–	–	–	935.0	935.0
Tier one notes	–	–	–	–	–	233.7	233.7
Other financial liabilities	9.6	208.3	66.4	66.9	33.7	0.1	385.0
Total financial liabilities	28,655.4	4,310.6	1,877.6	4,740.2	10,140.7	36,422.1	86,146.6
Net liquidity gap	(19,040.4)	(1,830.8)	(1,122.0)	(3,174.2)	2,327.2	23,882.9	1,042.7

HM Treasury has confirmed that it is its intention to continue to fund the Company so as to maintain the Company as a going concern and enable the Company to meet its debts as and when they fall due until at least 31 December 2012.

Assets and liabilities with a remaining period to contractual maturity of within one year are classed as current and those with a remaining period of more than one year are classed as non current. Non-financial assets and liabilities amount to £102.1m and £348.7m respectively (2009: £256.2m and £243.8m) of which £32.3m and £328.9m respectively are classed as current (2009: £44.6m and £169.4m) and £69.8m and £19.8m respectively are classed as non current (2009: £211.6m and £74.4m).

Notes to the Financial Statements (continued)

45. Financial risk management – continued

Non derivative cash flows

The table below analyses the Group's non derivative cash flows payable into relevant maturity groupings based on the remaining period from the Balance Sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows. These differ from Balance Sheet values due to the effects of discounting on certain Balance Sheet items and due to the inclusion of contractual future interest flows.

At 31 December 2010	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Liabilities							
Loans from HM Treasury	21,728.6	–	–	–	–	–	21,728.6
Deposits by banks	4,773.3	43.2	0.4	43.5	45.0	–	4,905.4
Debt securities in issue	–	1,709.3	1,053.9	3,866.7	17,151.8	17,944.4	41,726.1
Subordinated liabilities	–	36.7	1.4	15.7	869.2	154.4	1,077.4
Tier one notes	–	–	–	7.8	31.2	203.9	242.9
Total	26,501.9	1,789.2	1,055.7	3,933.7	18,097.2	18,302.7	69,680.4

At 31 December 2009	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Liabilities							
Loans from HM Treasury	14,325.7	–	–	–	–	–	14,325.7
Deposits by banks	5,566.5	235.7	89.5	1.0	138.3	–	6,031.0
Customer accounts	8,805.3	3,782.7	1,470.8	3,744.7	3,353.3	40.0	21,196.8
Debt securities in issue	–	1,850.9	1,257.2	3,815.7	25,320.1	16,196.1	48,440.0
Subordinated liabilities	150.7	336.5	1.2	15.2	375.7	178.6	1,057.9
Tier one notes	–	–	–	14.1	56.4	383.4	453.9
Total	28,848.2	6,205.8	2,818.7	7,590.7	29,243.8	16,798.1	91,505.3

Derivative cash flows

The following table analyses cash flows for the Group's derivative financial liabilities into relevant maturity groupings based on the remaining period from the Balance Sheet date to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

At December 2010	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Derivative financial liabilities to be settled on a net basis	–	(180.4)	(141.0)	(216.4)	(243.0)	0.3	(780.5)
Derivative financial liabilities to be settled on a gross basis							
- Outflows	–	(119.7)	(30.7)	(53.9)	(117.5)	–	(321.8)
- Inflows	–	115.2	27.9	48.0	115.4	–	306.5

At 31 December 2009	On demand £m	Within three months £m	After three months but within six months £m	After six months but within one year £m	After one year but within five years £m	After five years £m	Total £m
Derivative financial liabilities to be settled on a net basis	–	(336.2)	(296.0)	(445.8)	(445.7)	0.3	(1,523.4)
Derivative financial liabilities to be settled on a gross basis							
- Outflows	–	(104.7)	(43.8)	(77.4)	(499.3)	(115.7)	(840.9)
- Inflows	–	93.7	39.3	70.1	459.3	114.3	776.7

Notes to the Financial Statements (continued)

45. Financial risk management (continued)**Interest rate risk**

The Group uses the following measures to monitor and control interest rate risk and sensitivity

Mismatch risk

A present value sensitivity calculation is carried out for the fixed rate mortgage and unsecured loan books. The calculation measures the sensitivity of mismatch positions to a 200bp parallel shift in rates. The impact of this shift on the market value of the positions was an increase of £1.8m as at 31 December 2010.

Curve and prepayment risk

The impact on the market value of the mismatch position within the fixed rate mortgage and unsecured loan books of non-parallel movements in interest rates and a reduction in redemption and repayment rates is calculated. The results of the stresses are compared to trigger levels and reported to management.

Basis risk

After offsetting Balance Sheet assets and liabilities which reprice to the same index, any balances remaining are netted against assets or liabilities which reprice to a different index, hence creating notional basis risk positions. The impact on earnings of a shift in the relevant basis spread over a specified holding period is calculated for each basis risk position. The impact of this shift on earnings was £1.7m as at 31 December 2010.

Reset risk

The predominant indices which Balance Sheet assets and liabilities reprice to are 1 month and 3 month LIBOR. The daily net position of assets or liabilities repricing to 1 month (or 3 month) LIBOR for the following 1 month (or 3 month) period is calculated. The reset notional position is calculated as the sum of any positions over a specified amount. The impact on earnings of a shift in 1 month (or 3 month) LIBOR over a specified holding period is calculated. The impact of this shift on earnings was £2.5m as at 31 December 2010.

Foreign currency risk

At 31 December 2010, assets exceeded liabilities in US\$, after taking into account foreign currency derivatives, by \$51.5m, or £33.2m (2009 \$240.5m/£148.9m). Liabilities exceeded assets denominated in € at the same date by €359.8m, or £310.1m (2009 €1,680.5m/£1,493.2m) after taking into account foreign currency derivatives. The Group was sensitive to exchange rate gains and losses of £0.2m for each 1c movement in the £/US\$ exchange rate at 31 December 2010 (2009 £0.9m), and of £2.7m for each 1c movement in the £/€ exchange rate at the same date (2009 £13.4m).

The sterling equivalent amounts of the Group's financial assets and liabilities denominated in foreign currencies are set out in the table below. Financial assets and liabilities denominated in sterling are included to reconcile total exposures to the Balance Sheet.

At 31 December 2010	Sterling £m	Euro £m	US\$ £m	Other £m	Total £m
Assets					
Cash and balances at central banks	6,980.8	–	–	–	6,980.8
Derivative financial instruments	6,542.5	–	–	–	6,542.5
Loans and advances to banks	735.2	1,164.1	44.7	–	1,944.0
Loans and advances to customers	48,298.1	–	–	–	48,298.1
Investment securities and unsecured investment loans	1,003.1	1,259.5	133.8	–	2,396.4
Other financial assets	9.0	3.6	0.2	–	12.8
Total financial assets	63,568.7	2,427.2	178.7	–	66,174.6
Liabilities					
Loans from HM Treasury	21,713.4	–	–	–	21,713.4
Deposits by banks	2,952.3	1,941.1	7.4	–	4,900.8
Derivative financial instruments	826.4	–	–	–	826.4
Debt securities in issue	7,734.9	18,365.1	8,949.3	834.0	35,883.3
Subordinated liabilities	930.6	–	–	–	930.6
Tier one notes	135.7	–	–	–	135.7
Other financial liabilities	55.7	159.3	3.6	0.8	219.4
Total financial liabilities	34,349.0	20,465.5	8,960.3	834.8	64,609.6
Notional values of derivatives affecting currency exposure		(17,728.2)	(8,814.8)	(834.1)	
		2,737.3	145.5	0.7	
Net position		(310.1)	33.2	(0.7)	

Notes to the Financial Statements (continued)

45. Financial risk management *(continued)***Foreign currency risk (continued)**

At 31 December 2009	Sterling £m	Euro £m	US\$ £m	Other £m	Total £m
Assets					
Cash and balances at central banks	7,492.8	17.6	–	–	7,510.4
Derivative financial instruments	7,473.8	–	–	–	7,473.8
Loans and advances to banks	972.0	2,500.4	230.0	–	3,702.4
Loans and advances to customers	65,399.8	–	–	–	65,399.8
Investment securities and unsecured investment loans	1,488.0	1,443.7	156.1	–	3,087.8
Other financial assets	11.5	3.4	0.2	–	15.1
Total financial assets	82,837.9	3,965.1	386.3	–	87,189.3
Liabilities					
Loans from HM Treasury	14,315.5	–	–	–	14,315.5
Deposits by banks	3,263.8	2,691.1	67.4	–	6,022.3
Customer accounts	19,685.3	916.4	5.9	–	20,607.6
Derivative financial instruments	1,673.8	–	–	–	1,673.8
Debt securities in issue	8,621.5	21,161.8	11,338.4	852.0	41,973.7
Subordinated liabilities	935.0	–	–	–	935.0
Tier one notes	233.7	–	–	–	233.7
Other financial liabilities	215.2	164.3	4.1	1.4	385.0
Total financial liabilities	48,943.8	24,933.6	11,415.8	853.4	86,146.6
Notional values of derivatives affecting currency exposure		(19,475.3)	(11,178.4)	(851.5)	
		5,458.3	237.4	1.9	
Net position		(1,493.2)	148.9	(1.9)	

Concentration risk

Exposures are analysed by geographical region as follows

- Loans and advances to customers in note 12
- Wholesale assets in note 18
- Derivative financial instruments in note 42

46. Ultimate controlling party

All shares in the Company were transferred to the Treasury Solicitor as nominee for HM Treasury on 22 February 2008 as a result of The Northern Rock Transfer Order 2008. On 1 October 2010 all shares in the Company were acquired via a share-for-share exchange by UK Asset Resolution Limited who became the Company's ultimate parent undertaking from that date. UK Asset Resolution Limited is a private limited company incorporated in the United Kingdom under the Companies Act 2006 and registered in England and Wales and is wholly owned by the Treasury Solicitor as nominee for HM Treasury. As such, the Company considers Her Majesty's Government to remain its ultimate controlling party.

47. Contingent liability**The Financial Services Compensation Scheme**

The Financial Services Compensation Scheme ('FSCS') is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowed from HM Treasury to fund the compensation costs associated with institutions that failed in 2008 and will receive the receipts from asset sales, surplus cash flows and other recoveries from these institutions in the future.

The FSCS meets its obligations by raising management expense levies. These include amounts to cover the interest on its borrowings and compensation levies on the industry. Each deposit-taking institution contributes in proportion to its share of total protected deposits.

At 31 December 2010, the Group has an accrual of £6.3m in respect of its current obligation to meet management expense levies (2009: £16.4m).

If the FSCS does not receive sufficient funds from the failed institutions to repay HM Treasury in full, it will raise compensation levies. At this time, it is not possible to estimate the amount or timing of any shortfall resulting from the cash flows received from the failed institutions and, accordingly, no provision for compensation levies, which could be significant, has been made in these Financial Statements.

Notes to the Financial Statements (continued)

48. Assets and liabilities held for resale

On 1 January 2010 the following assets and liabilities were transferred to Northern Rock plc under the terms of The Northern Rock Transfer Order 2009, SI 2009/3226

	31 December 2009 £m	Transfer £m	1 January 2010 £m
Assets			
Cash and balances at central banks	7,510.4	(9.9)	7,500.5
Loans and advances to banks	3,702.4	(865.6)	2,836.8
Loans and advances to customers	64,268.2	(10,343.3)	53,924.9
Fair value adjustments on portfolio hedging	1,131.6	(160.3)	971.3
Investment securities and unsecured investment loans	3,087.8	(424.0)	2,663.8
Intangible assets	53.8	(23.1)	30.7
Property, plant and equipment	154.6	(32.7)	121.9
Other assets	28.9	(4.4)	24.5
Prepayments and accrued income	27.2	(13.7)	13.5
Total transferred assets		(11,877.0)	
Liabilities			
Deposits by banks	6,022.3	(235.3)	5,787.0
Customer accounts	20,607.6	(20,607.6)	–
Other liabilities	87.9	(19.2)	68.7
Accruals and deferred income	441.1	(188.4)	252.7
Other reserves	(512.1)	16.2	(495.9)
Retained earnings	(408.4)	(17.1)	(425.5)
Total transferred liabilities		(21,051.4)	
Balance owed to Northern Rock plc	–	9,174.4	9,174.4

There was no profit or loss associated with this transaction. The balance owed to Northern Rock plc has been paid in full in cash. This was funded by an increase in the loan to the Company from HM Treasury of £8,506m.

The amounts transferred above represent the amounts transferred from the Group. The difference between Group and Company amounts held for resale relates to Northern Rock (Guernsey) Limited.

The transferred assets and liabilities above have been included on the Balance Sheet of Northern Rock (Asset Management) plc as 'held for resale' at 31 December 2009 in accordance with the requirements of IFRS 5.

In addition to the transfer of the assets and liabilities set out above, all employees of Northern Rock (Asset Management) plc transferred to Northern Rock plc on 1 January 2010. The two companies entered into various agreements under which services were provided primarily by Northern Rock plc to Northern Rock (Asset Management) plc.

As part of the transfer of assets and liabilities to Northern Rock plc, Northern Rock (Asset Management) plc has agreed to indemnify Northern Rock plc against potential claims arising from past business up to a maximum of £100m.

49. Events after the reporting period

The Directors are of the opinion that there have been no significant events which have occurred since 1 January 2011 to the date of this report that are likely to have a material effect on the Group's financial position as disclosed in these Financial Statements.



NRAM

Northern Rock (Asset Management) plc, Registered Office Northern Rock House, Gosforth, Newcastle upon Tyne NE3 4PL
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