

EXPLANATORY MEMORANDUM

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt about the contents of this document or action to take, you should immediately consult your stockbroker, bank manager, solicitor, accountant or other independent financial adviser authorised under the Financial Services and Markets Act 2000 (if you are in the United Kingdom), or another appropriately authorised independent financial adviser who specialises in advising on the acquisition of shares and other securities (if you are outside the United Kingdom).

If you have sold or transferred any part or all of your holding of the €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities please hand this document to the stockbroker, bank or other agent through whom you made the sale or transfer for transmission to the purchaser or transferee.

Proposals to holders of

HALIFAX GROUP EURO FINANCE (JERSEY) L.P.

€415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities
(ISIN: GB0058322420)

guaranteed on a subordinated basis by



HALIFAX GROUP plc

(incorporated in England and Wales under the Companies Act 1985 with registered number 3474881)

for certain amendments to the terms of such preferred securities and replacement of the guarantee, inter alia, to effect the substitution of



HBOS plc

(incorporated in Scotland under the Companies Act 1985 with registered number SC 218813)

as guarantor of such amended preferred securities

Solicitation Agent

Credit Suisse First Boston

Except where the context requires otherwise, capitalised terms used herein are defined in the section headed “*Definitions*” below.

This Explanatory Memorandum is approved for issue in the United Kingdom solely for the purposes of Section 21 of the Financial Services and Markets Act 2000 by the Solicitation Agent whose address is at One Cabot Square, London E14 4QJ.

This Explanatory Memorandum does not have regard to the specific investment objectives, financial situation, or particular needs of any person to whom it is presented. If you have any doubt about the suitability of an investment for you, you should consult your financial adviser.

Past performance is not indicative of comparable future results and no projection, representation or warranty, express or implied, is made regarding future performance.

The price of securities and income derived from them can go down as well as up. Investors may not get back the full amount invested and the value of, and income from, investments may rise or fall.

The Solicitation Agent and/or its associates is or may be providing or has or may have provided, within the previous 12 months, significant advice or investment services in relation to the investments described in this Explanatory Memorandum or a related investment.

The Solicitation Agent is acting solely for the Issuer, Halifax Group and HBOS and no one else in connection with the Proposals and will not be responsible to any other person for providing the protections afforded to clients of the Solicitation Agent, or for providing advice in relation to the Proposals.

It is proposed that HBOS be substituted for Halifax Group as guarantor of the Halifax Preferred Securities and the consent of Holders is sought to such substitution and the consequential and other amendments to the terms of the Halifax Preferred Securities and related documents described herein. The Issuer and Halifax Group have prepared this Explanatory Memorandum for the purpose of providing information relating to the Proposals set out herein and nothing in this Explanatory Memorandum should be construed as advice on the merits of exercising any of the rights conferred by the Halifax Preferred Securities or on the merits of the Proposals.

The Halifax Preferred Securities, if amended, will continue to be listed on the Luxembourg Stock Exchange.

Questions and requests for assistance with the procedure for consenting to the Proposals or for additional copies of this Explanatory Memorandum may be directed to Michael Saron or Andrew Karsh at Credit Suisse First Boston (tel: +44 (0) 20 7883 5423/6748; email: michael.saron@csfb.com/andrew.karsh@csfb.com). Further communications in respect of the Proposals to Holders as a class will be made through Euroclear and Clearstream, Luxembourg and in the *Luxemburger Wort* and *The Financial Times*.

Details of the action to be taken by Holders wishing to consent to the Proposals are set out on page 17 of this Explanatory Memorandum.

The Issuer has not registered and does not intend to register the Halifax Preferred Securities, the Preferred Securities, the Notes, the Amended Notes, the Halifax Guarantee or the Guarantee under the Securities Act and, subject to certain exceptions, such securities may not be offered or sold within the United States or to, or for the account or benefit of U.S. persons, as such terms are defined in Regulation S.

The Halifax Preferred Securities, the Preferred Securities, the Notes, the Amended Notes, the Halifax Guarantee and the Guarantee have not been approved or disapproved by the U.S. Securities and Exchange Commission, any state securities commission in the United States or any

other U.S. regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the Proposals or the accuracy or adequacy of this Explanatory Memorandum. Any representation to the contrary is a criminal offence in the United States.

The Issuer and Halifax Group have caused a notice to be distributed through Euroclear and Clearstream, Luxembourg addressed to all Holders explaining that the Proposals will only be made by distribution of such notice and, where requested by such Holders, distribution of this Explanatory Memorandum for informational use only, in each case (i) outside the United States to persons other than U.S. persons (as such terms are defined in Regulation S) and (ii) in the United States to QIBs and certain institutional "accredited investors" as defined in Regulation D under the Securities Act, in a private transaction under the Securities Act. For a description of certain restrictions on resale or transfer of the Halifax Preferred Securities and the Preferred Securities, see "*Certificates and Transfer Restrictions*" below.

FOR FLORIDA RESIDENTS

THE CONSENT TO THE AMENDMENTS AND GUARANTOR SUBSTITUTION DESCRIBED HEREIN IS BEING SOUGHT PURSUANT TO A CLAIM OF EXEMPTION UNDER SECTION 517.061 OF THE FLORIDA SECURITIES ACT. THE PREFERRED SECURITIES SO AMENDED, INCLUDING SUCH GUARANTOR SUBSTITUTION, HAVE NOT BEEN REGISTERED UNDER SAID ACT IN THE STATE OF FLORIDA. ALL FLORIDA RESIDENTS WHO ARE NOT INSTITUTIONAL INVESTORS DESCRIBED IN SECTION 517.061(7) OF THE FLORIDA SECURITIES ACT HAVE THE RIGHT TO VOID THEIR ABOVE DESCRIBED CONSENT WITHOUT PENALTY WITHIN THREE (3) DAYS AFTER GIVING SUCH CONSENT.

FOR GEORGIA RESIDENTS

THE CONSENT TO THE AMENDMENTS AND GUARANTOR SUBSTITUTION DESCRIBED HEREIN IS BEING SOUGHT IN RELIANCE ON PARAGRAPH (13) OF THE CODE SECTION 10-5-9 OF THE GEORGIA SECURITIES ACT OF 1973. THE PREFERRED SECURITIES SO AMENDED, INCLUDING SUCH GUARANTOR SUBSTITUTION, MAY NOT BE SOLD OR TRANSFERRED EXCEPT IN A TRANSACTION WHICH IS EXEMPT UNDER SUCH ACT OR PURSUANT TO AN EFFECTIVE REGISTRATION UNDER SUCH ACT.

FOR NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY, OR TRANSACTION. IT IS UNLAWFUL TO MAKE OR CAUSE TO BE MADE, TO ANY PROSPECTIVE

PURCHASER, CUSTOMER, OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

The Issuer (in relation to itself only, the Halifax Preferred Securities and the Preferred Securities) and Halifax Group (in relation to itself only and the Halifax Guarantee) confirm that, in the context of the Proposals, and after having made all reasonable enquiries, this Explanatory Memorandum contains all information in relation to the Issuer, Halifax Group, the Proposals, the Halifax Preferred Securities, the Preferred Securities, the Halifax Guarantee and the Guarantee which is material and that such information is true and accurate in all material respects and is not misleading and that there are no material facts or matters, the omission of which would make any of such information misleading. Accordingly, the Issuer does not accept responsibility for any information contained herein relating to Halifax Group, the Halifax Guarantee, HBOS, the HBOS Group or the Guarantee. HBOS has confirmed to Halifax Group and the Issuer, after having made all reasonable enquiries, that the information contained herein relating to HBOS and/or the HBOS Group and the Guarantee is true and accurate in all material respects and is not misleading, that the opinions and intentions contained herein relating to HBOS and/or the HBOS Group and the Guarantee are honestly held and that there are no other material facts or matters, the omission of which would make any of such information, opinions or intentions misleading.

This Explanatory Memorandum does not constitute an offer of, or an invitation by or on behalf of Halifax Group, the Issuer, HBOS or any other person to subscribe for or purchase any securities of Halifax Group, the Issuer or HBOS. The distribution of this Explanatory Memorandum in certain jurisdictions may be restricted by law. Persons into whose possession this Explanatory Memorandum comes are required by Halifax Group, the Issuer, HBOS and the Solicitation Agent to inform themselves about and to observe any such restrictions.

In connection with the Proposals, no person is authorised to give any information or to make any representation not contained in this Explanatory Memorandum and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of Halifax Group, the Issuer, HBOS or the Solicitation Agent. The delivery of this Explanatory Memorandum at any time does not imply that the information contained in it is correct as at any time subsequent to its date.

See “*The Proposals - Certain consequences in connection with the Proposals*” on page 14 for a discussion of certain factors that should be considered by Holders.

In this Explanatory Memorandum, unless otherwise specified or the context requires, references to “A\$” are to Australian dollars, references to “sterling”, “pounds sterling” and “£” are to the lawful currency of the United Kingdom for the time being, references to “JPY”, “yen” and “¥” are to the lawful currency of Japan, references to “US\$” are to United States dollars and references to “euro” or “€” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

DOCUMENTS INCORPORATED BY REFERENCE

The audited consolidated accounts of HBOS for the year ended 31 December 2001 are incorporated by reference in this Explanatory Memorandum. Copies of such accounts are available (free of charge) at the specified office of the Paying and Transfer Agent in Luxembourg and the specified office of HBOS as described in "*General Information*" below. HBOS does not intend to publish non-consolidated annual or non-consolidated interim accounts.

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Definitions

In this Explanatory Memorandum, except where the context otherwise requires, the following words and phrases shall have meanings set opposite them:

“Amended Sterling Preferred Securities”	the Sterling Preferred Securities amended in accordance with the separate proposals relating thereto and with HBOS as subordinated guarantor thereof
“Amended Notes”	the Notes with HBOS substituted as issuer thereof
“Bank of Scotland”	The Governor and Company of the Bank of Scotland
“Clearstream, Luxembourg”	Clearstream Banking, société anonyme
“Closing Time”	5.00 p.m. (London time) on the Expiration Date
“Common Depositary”	HSBC Issuer Services Common Depositary Nominee (UK) Limited (formerly known as MSS (Common Depositary) Nominees Limited)
“Euroclear”	Euroclear Bank S.A./N.V., as operator of the Euroclear System
“Expiration Date”	14 May 2002 (subject to extension from time to time by the General Partner, on behalf of the Issuer, and Halifax Group)
“Fitch”	Fitch Inc.
“FSA”	Financial Services Authority
“FSMA”	Financial Services and Markets Act 2000
“General Partner”	Halifax Group Management (Jersey) Limited, a wholly owned subsidiary of Halifax Group, incorporated in Jersey
“Guarantee”	a subordinated deed of guarantee to be issued by HBOS in respect of the Preferred Securities replacing the Halifax Guarantee the proposed form of which is set out under the heading “ <i>Proposed Guarantee</i> ” below
“Halifax Group”	Halifax Group plc, a company incorporated in England and Wales under the Companies Act 1985 with registered number 3474881
“Halifax Guarantee”	the subordinated deed of guarantee dated 9 December 1999 in respect of the Halifax Preferred Securities executed by Halifax Group
“Halifax Preferred Securities”	the €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities of the Issuer having the benefit of the Halifax Guarantee and which are listed on the Luxembourg Stock Exchange and assigned ISIN GB0058322420
“Halifax Preferred Securities Offering Circular”	the offering circular dated 8 December 1999 in respect of the Halifax Preferred Securities

“Halifax Upper Tier 2 Securities”	the £300,000,000 7.50 per cent. Undated Subordinated Step-Up Notes, €300,000,000 Floating Rate Undated Subordinated Step-Up Notes and ¥42,500,000,000 3.50 per cent. Undated Subordinated Step-Up Notes, each issued by Halifax Group
“HBOS”	HBOS plc, a company incorporated in Scotland under the Companies Act 1985 with registered number SC 218813
“HBOS Group”	HBOS together with its subsidiaries and subsidiary undertakings (as defined in the Companies Act 1985)
“HBOS Preference Shares”	the 300,000,000 9¼ per cent. Non-cumulative Irredeemable Preference Shares of £1 each of HBOS and the 100,000,000 9¾ per cent. Non-cumulative Irredeemable Preference Shares of £1 each of HBOS and in each case any further preference shares required to be issued pursuant to the terms thereof
“Holders”	each person who is for the time being shown in the records of Euroclear and Clearstream, Luxembourg as the holder of any Halifax Preferred Securities
“IAI”	an accredited investor as defined Rule 501(a)(1), (2), (3) or (7) or Regulation D under the Securities Act
“Initial Limited Partner”	HSBC Issuer Services Common Depositary Nominee (UK) Limited (formerly known as MSS (Common Depositary) Nominees Limited)
“Issuer”	Halifax Group Euro Finance (Jersey) L.P., a limited partnership established in Jersey
“Limited Partnership Agreement”	the limited partnership agreement establishing the Issuer dated 8 December 1999
“London Stock Exchange”	London Stock Exchange plc
“Moody’s”	Moody’s Investors Services, Inc.
“New HBOS Preferred Securities”	the £600,000,000 6.461 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A issued by HBOS Capital Funding L.P. on 28 November 2001 having the benefit of a subordinated guarantee given by HBOS
“Notes”	the €415,000,000 Fixed to Floating Rate Subordinated Extendable Maturity Notes due 2048 issued by Halifax Group which are held by a custodian on behalf of the Issuer, the cash-flow from which the Issuer uses to service its payment obligations under the Halifax Preferred Securities
“Official List”	the official list maintained by the UK Listing Authority pursuant to the FSMA
“Preferred Securities”	the Halifax Preferred Securities amended in accordance with the Proposals and with HBOS as guarantor thereof
“Proposals”	the proposals as described herein for, <i>inter alia</i> , the

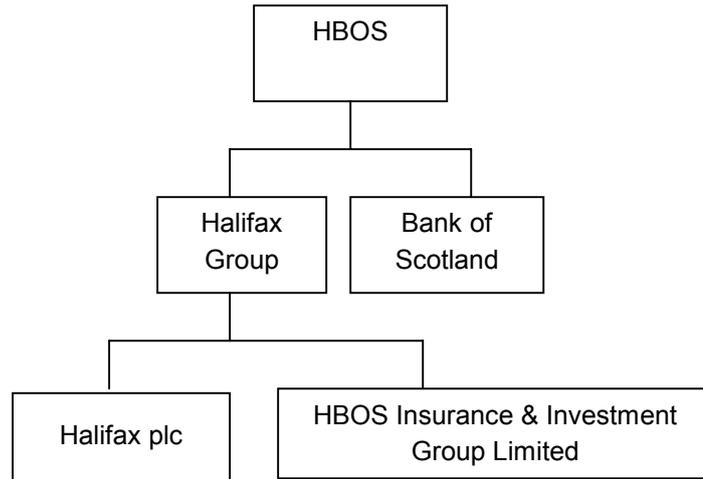
	substitution of the guarantor of the Halifax Preferred Securities through the cancellation of the Halifax Guarantee and its replacement with the Guarantee and the modification of the Halifax Preferred Securities, the Limited Partnership Agreement and the ancillary documents relating thereto
“QIBs”	Qualified Institutional Buyers within the meaning of Rule 144A
“Regulation S”	Regulation S under the Securities Act
“Rule 144A”	Rule 144A under the Securities Act
“Securities Act”	the U.S. Securities Act of 1933
“Solicitation Agent”	Credit Suisse First Boston (Europe) Limited
“Standard & Poor’s”	Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc.
“Sterling Issuer”	Halifax Group Sterling Finance (Jersey) L.P.
“Sterling Preferred Securities”	the £245,000,000 7.881 per cent. Guaranteed Non-voting Non-cumulative Preferred Securities issued by the Sterling Issuer with the benefit of a subordinated guarantee given by Halifax Group
“Supplemental Limited Partnership Agreement”	an agreement supplementing and amending the Limited Partnership Agreement to be entered into between the parties to the Limited Partnership Agreement the proposed form of which is set out under the heading “ <i>Proposed Supplemental Limited Partnership Agreement</i> ” below
“Tier 1 Capital” and “Upper Tier 2 Capital”	each has the meaning ascribed to it in the FSA’s “Interim Prudential Sourcebook: Banks” or any successor publication replacing such sourcebook
“UK Listing Authority”	the FSA in its capacity as competent authority under the FSMA
“U.S. person”	has the meaning ascribed to it in Regulation S
“United States”	has the meaning ascribed to it in Regulation S.

The Proposals

Background to, and reasons for, the Proposals

On 10 September 2001, Bank of Scotland and Halifax Group merged under HBOS. HBOS is the holding company for Bank of Scotland and for Halifax Group. Halifax Group in turn is the holding company for Halifax plc. HBOS is also the ultimate holding company for a number of other subsidiaries principally carrying on financial services business.

The following diagram sets out, in simplified form, the current corporate structure of the HBOS Group:



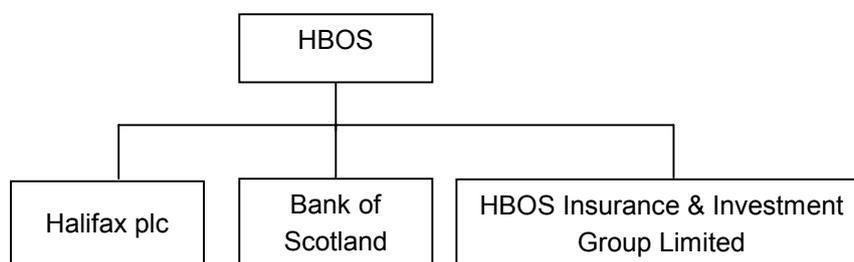
HBOS has reviewed HBOS Group's current corporate structure and believes that there are benefits to eliminating Halifax Group from that corporate structure. Halifax Group was originally established as a holding company for its operating subsidiaries including Halifax plc and Clerical Medical Investment Group Limited. With HBOS established as the ultimate holding company, HBOS considers that the presence of an intermediate holding company such as Halifax Group results in a less efficient organisational structure.

HBOS's proposed strategy is that both of its main operating bank subsidiaries, Halifax plc and Bank of Scotland, should become directly owned by HBOS. HBOS has established HBOS Insurance & Investment Group Limited which is intended will become a direct subsidiary of HBOS acting as an intermediate holding company for all of HBOS Group's investment and insurance operations. HBOS has also set up new subsidiaries to hold HBOS Group's non-regulated activities and dormant company shareholdings respectively.

HBOS considers that this intended structure is optimal from the perspective of managing HBOS Group's capital base and presenting a transparent and easily understood structure to investors.

The Plan

The following diagram sets out, in simplified form, the intended corporate structure of the HBOS Group following implementation of the proposed strategy referred to above:



In order to accomplish these objectives, HBOS and Halifax Group intend, subject to obtaining the necessary consents, to substitute HBOS for Halifax Group as issuer with respect to Halifax Group's outstanding long-term subordinated debt obligations (including, the Halifax Upper Tier 2 Securities) and as guarantor with respect to Halifax Group's two subordinated guarantee obligations (namely, those with respect to the Halifax Preferred Securities and the Sterling Preferred Securities). Halifax Group has commenced a consent-seeking process in respect of its other outstanding long-term subordinated debt obligations and subordinated guarantee obligations. Please see "*The Proposals*" below. The Proposals set out below are therefore being made to you, the Holders, and your consent to, and support for, the Proposals is being requested.

Benefits to Holders

If the Proposals are approved and implemented, Holders would be able to rely on the direct credit of HBOS, which in turn relies on the direct credit of not only all the existing Halifax Group subsidiaries, but also Bank of Scotland and its subsidiaries. This means that Holders, while being part of a larger pool of indebtedness, will have the benefit of a more diverse, and historically larger, earnings stream, cash flow, assets and reserves to support the obligations of the Issuer and HBOS.

In addition, HBOS believes that a simpler capital structure for the HBOS Group would be more efficient, allows better analysis and therefore provides benefits to its stakeholders. Furthermore, the Proposals are consistent with HBOS's view of how to manage capital effectively and its intentions to issue future capital at the HBOS level. More detailed financial information would be available for HBOS on a consolidated basis than for the existing Halifax Group group of companies.

The Proposals

In order to facilitate the reorganisation of the obligations of Halifax Group, the Proposals, which are set out in further detail in the section headed "*Consent Notice*" below, include:

1. the substitution of HBOS for Halifax Group as guarantor of the Halifax Preferred Securities by way of the cancellation of the Halifax Guarantee and its replacement with the Guarantee; and
2. consequential and other amendments to the terms and conditions of the Halifax Preferred Securities, the Limited Partnership Agreement and other ancillary documents relating thereto.

The consent of Holders of at least two-thirds of the outstanding Halifax Preferred Securities is required to implement changes to, or the replacement of, the Halifax Guarantee. Amendments to the terms and conditions of the Halifax Preferred Securities, the Limited Partnership Agreement and

other ancillary documents relating thereto may be approved by the Initial Limited Partner. However, before so approving such amendments, the Initial Limited Partner requires the prior approval of Holders of at least two-thirds of the outstanding Halifax Preferred Securities.

Therefore, as part of the reorganisation, the consent in writing to the Proposals of Holders of at least two-thirds of the outstanding Halifax Preferred Securities is being sought. **It is a condition precedent to the implementation of the Proposals that such consent is given by Holders representing such a proportion of the outstanding Halifax Preferred Securities.**

In addition, and to reflect the terms of the Preferred Securities, it is intended that HBOS be substituted for Halifax Group as issuer of the Notes with consequential amendments to reflect the fact that HBOS will become the issuer of the Amended Notes. Subject to the Proposals being implemented, such substitution and amendment to the Notes will be effected by the General Partner in reliance upon the authorities granted to it in the Limited Partnership Agreement. It is also intended that, in conjunction with the implementation of the Proposals, Halifax Group transfers its interests in the General Partner to HBOS, the name of the General Partner be changed to "HBOS Management (Jersey) Limited" and the name of the Issuer be changed to "HBOS Euro Finance (Jersey) L.P.". The consent of Holders or the Initial Limited Partner is not required for these matters.

Similar proposals are to be made to the holders of the Sterling Preferred Securities.

Proposals for the substitution of HBOS for Halifax Group as issuer of the £300,000,000 7.50 per cent. Undated Subordinated Step-up Notes and the €300,000,000 Floating Rate Undated Subordinated Step-up Notes have also been made to the trustee for the holders of such securities. Pursuant to the terms of such securities, the trustee is entitled, without the previous consent or sanction of the holders of such securities and subject to certain conditions, to agree to the substitution of any "Successor in Business" of Halifax Group in place of Halifax Group as issuer of such securities. The trustee has agreed that HBOS is the "Successor in Business" of Halifax Group and accordingly, following the receipt of independent financial advice, has executed a supplemental trust deed to effect the substitution of HBOS as issuer of such securities in place of Halifax Group subject to certain conditions including, the implementation of the Proposals described herein and the corresponding proposals to be made to the holders of the Sterling Preferred Securities and the ¥42,500,000,000 3.50 per cent. Undated Subordinated Step-up Notes.

Proposals for the substitution of HBOS for Halifax Group as issuer of the ¥42,500,000,000 3.50 per cent. Undated Subordinated Step-up Notes have also been made to the holder of such securities.

Pre-conditions to Implementation of the Proposals

The implementation of the Proposals is conditional upon:

1. written consent to the Proposals being duly given by Holders of at least two-thirds of the outstanding Halifax Preferred Securities
2. the General Partner approving the substitution of HBOS for Halifax Group as issuer of the Notes
3. confirmation from the UK Listing Authority and the London Stock Exchange that the Amended Notes will be listed on the Official List and admitted to trading on the London Stock Exchange's market for listed securities
4. approval of the FSA and
5. approval of the Jersey Financial Services Commission.

Implementation of the Proposals

The General Partner, on behalf of the Issuer, and Halifax Group shall, as soon as practicable after the Closing Time, determine the extent to which the requisite approval of Holders has been obtained and, if necessary, whether or not to extend the period for giving such approval.

If it is determined that the period for giving such approvals should be extended, the General Partner, on behalf of the Issuer, and Halifax Group will, as soon as practicable after the Expiration Date, notify the Holders of such determination by giving notice thereof through Euroclear and Clearstream, Luxembourg and in the *Luxemburger Wort* and *The Financial Times*.

As soon as practicable after the end of the extended period or, if no extension is determined to be necessary, as soon as practicable after the Expiration Date, as the case may be, the General Partner, on behalf of the Issuer, and Halifax Group will determine whether or not to proceed with the implementation of the Proposals.

The General Partner, on behalf of the Issuer, and Halifax Group will, as soon as practicable after the end of the extended period or the Expiration Date, as the case may be, notify the Holders of such determination by giving notice thereof through Euroclear and Clearstream, Luxembourg and in the *Luxemburger Wort* and *The Financial Times*.

It is intended that, provided the requisite consents, approvals and confirmations are obtained and the General Partner, on behalf of the Issuer, and Halifax Group decide to proceed with implementation, the Proposals will be implemented and take effect and will be binding on all Holders, whether or not they have consented, on or about 31 May 2002 or such later date as the General Partner, on behalf of the Issuer, and Halifax Group may specify in their notice to Holders referred to above.

Provided the General Partner, on behalf of the Issuer, and Halifax Group have determined to proceed with implementation, the effect of Holders giving the requisite consent to the Proposals will be to authorise, direct, empower and request each party to the relevant agreements to execute and deliver such agreements, and carry out any further acts, necessary or desirable in order to give effect to the Proposals. In this regard, the Initial Limited Partner shall be authorised to execute and deliver such agreements and carry out such further acts on behalf of Holders.

Set out under the sections headed "*Description of the Preferred Securities*", "*Proposed Guarantee*" and "*Proposed Supplemental Limited Partnership Agreement*" are, respectively, the description of the Preferred Securities and the terms of the Guarantee that would each take effect in the event that the Proposals are approved and implemented (showing, in strikethrough text for ease of reference, the current corresponding description in the Halifax Preferred Securities Offering Circular and the provisions thereof that would be modified or deleted as a result of implementation of the Proposals and showing, in underlined text, the new description and provisions) and the terms of the agreement supplementing and amending the Limited Partnership Agreement.

Certain consequences in connection with the Proposals

If the Proposals are approved and implemented:

- By virtue of the Guarantee, the Preferred Securities will effectively rank *pari passu* with the HBOS Preference Shares, the New HBOS Preferred Securities and, assuming the holders of the Sterling Preferred Securities consent to the substitution of the guarantor thereof and other changes relating thereto and the General Partner, on behalf of the Sterling Issuer, and Halifax Group have determined to proceed with such substitution, the Amended Sterling Preferred Securities.
- The Preferred Securities will have substantially the same economic risks as an investment in non-cumulative perpetual preference shares issued directly by HBOS having the same liquidation preference and rate of distribution as the Preferred Securities. It is expected that the Issuer's sole source of funds to pay distributions on the Preferred Securities will be the payments it receives under the Amended Notes. The rights of holders of the Preferred Securities to payment shall be represented solely by the Guarantee and the Preferred Securities, the terms of which provide that the Amended Notes will not be delivered or otherwise made available to holders. The Preferred Securities will be guaranteed on a subordinated basis by HBOS pursuant to the terms of the Guarantee. Accordingly, if HBOS's financial condition were to deteriorate, the Issuer and the holders of the Preferred Securities may suffer direct and materially adverse consequences, including non-payment of distributions on the Preferred Securities and/or non-payments under the Guarantee.
- The Preferred Securities may, in certain circumstances, be substituted by directly issued preference shares of HBOS. Although HBOS will undertake in the Guarantee to take all reasonable steps to have a sufficient number of authorised but unissued preference shares, and to procure the listing of, the substitute preference shares, there can be no assurance that shareholders of HBOS will approve the issue of, or that a recognised stock exchange will agree to list, the substitute preference shares. In addition, under its articles of association, HBOS is only authorised to issue further preference shares which rank *pari passu* with the HBOS Preference Shares at a time and in circumstances where (a) the nominal amount of the preference shares proposed to be issued, taken together with the nominal amount of the HBOS Preference Shares and any other preference shares ranking *pari passu* therewith (together, the "Priority Preference Shares") at that time, does not exceed an amount equal to 25 per cent. of the Adjusted Capital and Reserves (as defined in the articles of association of HBOS) of HBOS and (b) the average of the profit after taxation and before extraordinary items and dividends for the preceding three financial periods of HBOS exceeds four and a half times the aggregate annual amount of the dividends payable in the then current financial period on the whole of the issued share capital of HBOS which has priority to or ranks equally with the Priority Preference Shares including those preference shares proposed to be issued (all as more fully described herein under the section "*General Information - Articles of Association - Additional Preference Shares*"). If these conditions cannot be met at the time of issue, any preference shares issued by HBOS must rank junior to the Priority Preference Shares. Accordingly, there can be no assurance that any substitute preference shares issued to holders of the Preferred Securities following the occurrence of an event requiring such issue under the terms of the Preferred Securities will not rank junior to the Priority Preference Shares and the Guarantee. In addition, the tax treatment for holders of substitute preference shares may be different from that for holders of the Preferred Securities.
- By approving the substitution of HBOS in place of Halifax Group as guarantor of the Preferred Securities, holders of the Preferred Securities will have recourse to the credit of

HBOS in accordance with the terms of the Guarantee and Halifax Group shall be released from its obligations under the Halifax Guarantee. HBOS is the holding company of a group of companies which comprises not only Halifax Group and its subsidiaries but also Bank of Scotland and its subsidiaries. Accordingly, Holders would be able to rely on the direct credit of HBOS, which in turn relies on the direct credit of not only all the existing Halifax Group subsidiaries, but also Bank of Scotland and its subsidiaries. This means that Holders, while being part of a larger pool of indebtedness, will have the benefit of a more diverse, and historically larger, earnings stream, cash flow, assets and reserves to support the obligations of the Issuer and HBOS.

- In order to consent to the Proposals, a Holder will be required to block its Halifax Preferred Securities in the securities account to which they are credited in accordance with the procedures of the clearing system through which the Halifax Preferred Securities are held. Consequently, it will not be possible to trade Halifax Preferred Securities once the relevant account has been blocked until the date upon which the General Partner, on behalf of the Issuer, and Halifax Group give notice of their determination whether or not to implement the Proposals in accordance with the provisions of this Explanatory Memorandum described in "*Implementation of the Proposals*" above.
- The Preferred Securities are expected to be assigned the same rating as the Halifax Preferred Securities, namely, A by Standard & Poor's, A1 by Moody's and AA- (AA minus) by Fitch.
- A Holder may suffer adverse tax consequences as a result of the implementation of the Proposals. Holders should see the details of certain tax consequences arising from the implementation of the Proposals described in the section headed "*Taxation*" below. All Holders should inform themselves as to the tax consequences of the Proposals within the countries of their residence and domicile.
- A Holder may suffer other adverse consequences resulting from the implementation of the Proposals, due to that Holder's individual circumstances. It is for each Holder to inform itself as to such consequences.

If the Proposals are not approved or implemented:

- The Halifax Preferred Securities will continue to have substantially the same economic risks as an investment in non-cumulative perpetual preference shares issued directly by Halifax Group having the same liquidation preference and rate of distribution as the Halifax Preferred Securities. The Issuer's sole source of funds to pay distributions on the Halifax Preferred Securities will continue to be the payments it receives under the Notes. The rights of Holders to payment will continue to be represented solely by the Halifax Guarantee and the Halifax Preferred Securities, the terms of which provide that the Notes will not be delivered or otherwise made available to Holders. The Halifax Preferred Securities will continue to be guaranteed on a subordinated basis by Halifax Group pursuant to the terms of the Halifax Guarantee. Accordingly, if Halifax Group's financial condition were to deteriorate, the Issuer and the Holders may suffer direct and materially adverse consequences, including non-payment of distributions on the Halifax Preferred Securities and/or of non-payments under the Halifax Guarantee.
- HBOS would need to consider other alternatives for reorganising HBOS Group to achieve its objectives. Two possibilities are:

- Halifax Group may proceed with its plans to move the existing assets of Halifax Group, principally the shareholdings in Halifax Group's operating subsidiaries, to other companies within HBOS Group. In that event, such assets would be replaced with intercompany loans, which may be senior or subordinated, dated or undated. These intercompany loans would provide the cash flows to service the remaining debt issues within Halifax Group; and/or
- the voluntary dissolution, liquidation or winding up of Halifax Group. As the Notes issued by Halifax Group are the only source of income enabling the Issuer to service its obligations under the Halifax Preferred Securities, the Issuer would need to redeem the Halifax Preferred Securities in accordance with their terms should Halifax Group be voluntarily dissolved, liquidated or wound up. This may have adverse consequences for Holders due to a Holder's individual circumstances. It is for each Holder to inform itself as to such consequences.

None of HBOS, Halifax Group, the Issuer, the General Partner, the Initial Limited Partner, the Common Depositary, the Solicitation Agent nor any of their respective directors or employees makes any recommendation as to whether Holders should take any action with regard to the Proposals or expresses any opinion as to the merits of approving or not approving the Proposals.

Consent period

The time for the giving of consent to the Proposals shall begin on 16 April 2002 and shall end at the Closing Time (subject to any extension as further described herein). It is currently intended that completion of the steps necessary to give effect to the Proposals shall take place on or about 31 May 2002 or such later date as the General Partner, on behalf of the Issuer, and Halifax Group may specify in the notice to Holders notifying them of the decision to implement the Proposals.

The General Partner, on behalf of the Issuer, and Halifax Group expressly reserve the right, in their sole and absolute discretion to (i) terminate, cancel, withdraw from or not implement the Proposals (in whole but not in part) whether or not the requisite consent of Holders is obtained, (ii) waive any of the procedural steps set out under the heading "*Action to be Taken*" below or any failure by a Holder to comply with the terms for the giving of consent to the Proposals set out in this Explanatory Memorandum or (iii) extend the Expiration Date or the date by which the Proposals will take effect or be implemented at any time or from time to time. Any such termination, cancellation, withdrawal, non-implementation or extension will be followed as soon as practicable by the General Partner, on behalf of the Issuer, and Halifax Group giving notice thereof to Holders through Euroclear and Clearstream, Luxembourg and in the *Luxemburger Wort* and *The Financial Times*. In the case of an extension to the Expiration Date, such notice must be given as soon as practicable following the Expiration Date.

Action to be taken

General

Holders are being asked to consider and, if thought fit, consent to the Proposals on the terms of this Explanatory Memorandum and the written consent set out under the section headed “*Consent Notice*” below. Holders wishing to consent must consent to the Proposals as a whole and may not consent to parts only of them. Any consent received will relate to the holding of the Halifax Preferred Securities of that Holder specified in such consent. Only Holders are entitled to consent to the Proposals. Any consent given by a Holder will be irrevocable. All questions as to the validity, form or eligibility of any consent shall be resolved by the General Partner, on behalf of the Issuer, and Halifax Group, in their sole and absolute discretion, and such resolution shall be final and binding on all Holders. The General Partner, on behalf of the Issuer, and Halifax Group reserve the right not to count any consent the acceptance of which by the General Partner, on behalf of the Issuer, and Halifax Group could, in the opinion of the General Partner, on behalf of the Issuer, and Halifax Group, be unlawful.

To consent to the Proposals, Holders should deliver their approval (which may be in the form of an electronic consent) in accordance with the instructions being sent to them by Euroclear or Clearstream, Luxembourg (as the case may be).

Beneficial owners of Halifax Preferred Securities who are not direct accountholders in Euroclear or Clearstream, Luxembourg wishing to consent to the Proposals must arrange through their broker, dealer, commercial bank, trust company or other nominee to contact the direct accountholder and instruct such direct accountholder to give the necessary consent to the Proposals in accordance with the operating requirements of such clearing systems. Instructions to the direct accountholder must be given sufficiently in advance of the deadlines required by Euroclear and Clearstream, Luxembourg to enable the direct accountholder to give the necessary consent to the Proposals.

All consents must be sent to the relevant clearing system in accordance with its instructions and not directly to the General Partner, the Issuer (at its registered office or otherwise), Halifax Group, HBOS, the Paying and Transfer Agents, the Solicitation Agent or the Common Depositary.

Each Holder should also ensure that the relevant clearing system has received irrevocable instructions to inform the Initial Limited Partner as to the Holder’s response to the request for written consent and the total amount in liquidation preference of Halifax Preferred Securities in respect of which such consent is given.

Blocking of securities accounts

Holders wishing to consent to the Proposals, should ensure that the relevant clearing system has received irrevocable instructions (either directly from the Holder or through the direct accountholder through which such Holder holds the Halifax Preferred Securities) to block the Halifax Preferred Securities in the securities account to which they are credited with effect from and including the day on which the consent (which may be given in electronic form) is delivered. Euroclear or Clearstream, Luxembourg (as the case may be) will block each account for the Halifax Preferred Securities in respect of which they receive instructions from Holders.

Instructions to block the Halifax Preferred Securities will be irrevocable and, therefore, it will not be possible to trade Halifax Preferred Securities once the relevant account has been blocked until the date upon which the General Partner, on behalf of the Issuer, and Halifax Group give notice of their

determination whether or not to implement the Proposals in accordance with the provisions of this Explanatory Memorandum.

The General Partner, on behalf of the Issuer, and Halifax Group may extend the period for giving consent. In such case, the relevant securities accounts which are blocked will remain so blocked and the relevant securities accounts which become blocked thereafter will remain so blocked until the date on which the General Partner, on behalf of the Issuer, and Halifax Group give notice of their determination as to whether or not to implement the Proposals.

Certification

Holders may only consent to the Proposals if they certify, in the manner outlined under the section headed "*Consent Notice*" below, that they are either:

1. a non-U.S. person located outside the United States; or
2. a U.S. person and either a QIB or an IAI that makes the appropriate representations, warranties and covenants set forth in "*Consent Notice*" below.

Timetable

Set out below is the expected timetable of principal events in relation to the Proposals, assuming the requisite consent is given by Holders and it is determined by the General Partner, on behalf of the Issuer, and Halifax Group to proceed with implementation. All times specified below and used elsewhere throughout this Explanatory Memorandum are London times. All dates and times are subject to change in accordance with the terms of this Explanatory Memorandum.

16 April 2002	Notice of Proposals given to Holders and copies of this Explanatory Memorandum to be available from the clearing systems at the request of Holders. Additional copies of the Explanatory Memorandum to be made available from the Solicitation Agent.
5.00 p.m. on 14 May 2002	Last time for giving consent.
As soon as practicable	Determination of whether or not the period for giving consent is to be extended.
As soon as practicable	If it is determined that the period for giving consent should be extended, notice of such extension to be published through Euroclear and Clearstream, Luxembourg and in the <i>Luxemburger Wort</i> and <i>The Financial Times</i> .
As soon as practicable	Determination as to whether or not the requisite consent has been achieved and whether or not the Proposals will be implemented.
As soon as practicable	Notice as to whether or not the requisite consent has been achieved and whether or not the Proposals will be implemented to be published through Euroclear and Clearstream, Luxembourg and in the <i>Luxemburger Wort</i> and <i>The Financial Times</i> .
	Blocking of accounts by clearing systems ends.*
On or following 29 May 2002*	Execution and delivery of the amending agreements.
On or about 31 May 2002*	Implementation becomes effective.
On or about 31 May 2002*	Notice to be published through Euroclear and Clearstream, Luxembourg and in the <i>Luxemburger Wort</i> and <i>The Financial Times</i> if the Proposals have been implemented.

* If the period for giving consent is extended, these dates and times may be postponed accordingly.

Description of the Preferred Securities

The following is a description of the Preferred Securities if the Proposals are approved and implemented (showing, in strikethrough text for ease of reference, the current description of the Preferred Securities as set out in the Halifax Preferred Securities Offering Circular that would be modified or deleted as a result of implementation of the Proposals and showing, in underlined text, the new provisions) and as such would constitute the description of the Preferred Securities

The Preferred Securities are limited partnership interests in ~~Halifax~~HBOS Euro Jersey. The following ~~summary~~description should be read in conjunction with, and is subject to the terms of, the Limited Partnership Agreement (as defined below) a copy of which is available as described under “General Information” and the Supplemental Limited Partnership Agreement (as defined above).

1. Definitions

In this Description of the Preferred Securities, except to the extent that the context otherwise requires:

“Adjusted Distributable Reserves” means, at any time, the lawful distributable reserves of HBOS at such time less the cumulative amount in relation to Halifax Group plc for the period from 9 December 1999 until 10 September 2001 and in relation to HBOS since 10 September 2001 of all redemptions of and payments on (a) any preference shares or other obligations of Halifax Group plc or HBOS (as the case may be) that are accounted for under the then generally accepted accounting practice in the U.K. as shareholders’ funds in the accounts of Halifax Group plc or HBOS (as the case may be) and (b) all securities or other obligations of an undertaking which are accounted for under the then generally accepted accounting practice in the U.K. as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or otherwise) to, Halifax Group plc or HBOS (as the case may be) that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Securities, except in each case for such amounts as have been either charged to the lawful distributable reserves of Halifax Group plc or HBOS (as the case may be) or funded at that time by an issue of Replacement Capital made for the purposes of funding a redemption;

“Agent Bank” means HSBC Bank plc or its successor;

“Calculation Agent” means Citibank, N.A. or its successor;

“Capital Redemption Date” means any date designated for optional redemption of the Preferred Securities as described under paragraph 4.4 below;

“Capital Redemption Price” means, in respect of each Preferred Security, the higher of (a) the liquidation preference of €1,000 per Preferred Security and (b) the price, expressed as a percentage (rounded to three decimal places, 0.0005 being rounded upwards), at which the gross redemption yield (as calculated by the Calculation Agent) on the Preferred Securities, if they were to be purchased at such price on the third dealing day prior to the date fixed for redemption, would be equal to the gross redemption yield on such dealing day of the Reference Bond plus 0.5 per cent., on the basis of the middle market price of the Reference Bond prevailing at 11.00 a.m. (Central European time) on such dealing day as determined by the Calculation Agent, plus any due and accrued but unpaid Distribution calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, 9 December 1999) to (but excluding) the relevant Capital Redemption Date and any ~~Halifax~~HBOS Euro Jersey Additional Amounts payable thereon;

“Clearstream, Luxembourg” means Clearstream Banking, société anonyme or its successor;

“Determination Date”, in relation to a Distribution Calculation Period, means the second TARGET Business Day prior to 9 December 2011 and every 9 March, 9 June, 9 September and 9 December in each year thereafter;

~~“Distributable Profits” means at any time the profits then available for distribution as defined by section 263(3) of the U.K. Companies Act 1985 of Halifax Group;~~

“Distributions” means the non-cumulative distributions in respect of the Preferred Securities as described under paragraph 2 below;

“Distribution Calculation Period” means each Distribution Period from and including the Distribution Period beginning on (and including) the Distribution Re-Set Date;

“Distribution Calculation Period Date” means 9 December 2011 and every 9 March, 9 June, 9 September and 9 December in each year thereafter;

“Distribution Determination Date” means the day ten London Business Days prior to each Distribution Payment Date on which ~~Halifax Group~~ HBOS will determine whether sufficient Adjusted Distributable Profits Reserves exist to allow a payment of some or all of the relevant Distribution;

“Distribution Payment Date” means 9 December in each year up to and including the Distribution Re-Set Date and thereafter every 9 March, 9 June, 9 September and 9 December in each year, commencing on 9 December 2000;

“Distribution Period” means the period from (and including) 9 December 1999 to (but excluding) the first Distribution Payment Date and each period thereafter from (and including) one Distribution Payment Date to (but excluding) the next following Distribution Payment Date;

“Distribution Re-Set Date” means the Distribution Payment Date falling on 9 December 2011;

“euro” and “€” mean the currency introduced at the start of the third stage of European and Economic Monetary Union pursuant to the Treaty and the smallest subdivision of which shall be one hundredth of a euro or “cent”;

“Euro-zone” means the region comprised of member states of the European Union that adopt the single currency in accordance with the Treaty;

“Euroclear” means Euroclear Bank S.A./N.V. as operator of the Euroclear system or its successor;

“Existing Preference Shares” means the 300,000,000 9¼% and 100,000,000 9¾% Non-cumulative Irredeemable Preference Shares of £1 each in the capital of HBOS in issue at the date hereof and in each case any further preference shares required to be issued pursuant to the terms of such aforementioned preference shares;

“Fixed Distribution Rate” means, in respect of the period from (and including) 9 December 1999 to (but excluding) 9 December 2011, 7.627 per cent. per annum;

“Floating Distribution Rate” means, in respect of a Distribution Calculation Period, the percentage rate of three-month EURIBOR plus 2.875 per cent. per annum calculated in the manner described in paragraph 2.3 below;

“FSA” means the Financial Services Authority in the U.K. and shall include any successor organisation responsible for the supervision of banks in the U.K.;

“General Partner” means HBOS Management (Jersey) Limited (formerly known as Halifax Group Management (Jersey) Limited), a Jersey incorporated directly or indirectly wholly owned subsidiary of ~~Halifax Group~~HBOS;

“Group” means ~~Halifax Group~~HBOS together with its Subsidiaries;

“Guarantee” means the subordinated guarantee in respect of the Preferred Securities ~~to be~~ executed by ~~Halifax Group~~HBOS on ~~9 December 1999~~ or about 31 May 2002 as a deed poll;

“HBOS” means HBOS plc, a limited liability company incorporated in Scotland under the Companies Act 1985, and its successors and assigns;

~~“Halifax Euro Jersey” means~~“HBOS Euro Jersey” means HBOS Euro Finance (Jersey) L.P. (formerly known as Halifax Group Euro Finance (Jersey) L.P.), a Jersey limited partnership registered on 8 December 1999, 1999 under the name Halifax Group Euro Finance (Jersey) L.P., established under the Law, as it may from time to time be constituted but not being a legal entity separate from its partners;

“Halifax~~HBOS~~ Euro Jersey Additional Amounts” means the additional amounts which may be payable in respect of the Preferred Securities as described under paragraph 6;

~~“Halifax Group” means Halifax Group plc and its successors and assigns;~~

“Holder” means, in respect of each Preferred Security, each person registered on the Register as the limited partner holding such Preferred Security at the relevant time;

“Involuntary Dissolution” means, in respect of ~~Halifax~~ HBOS Euro Jersey, a dissolution by court order pursuant to the Law;

“Jersey” means the Island of Jersey;

“Jersey Tax” means any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of Jersey or by any authority therein or thereof having power to tax;

“Junior Share Capital” means the ordinary shares of ~~Halifax Group~~HBOS, together with any other securities or obligations expressed to rank junior to the most senior preferred securities or preference shares of ~~Halifax Group~~HBOS whether issued directly ~~or~~ by ~~Halifax Group~~HBOS or by a Subsidiary benefiting from a guarantee or support agreement from HBOS expressed to rank junior to the Guarantee;

“Law” means the Limited Partnerships (Jersey) Law 1994;

“Limited Partnership Agreement” means an agreement dated ~~the date hereof~~8 December 1999 between the General Partner, the Parent Limited Partner and the initial limited partner establishing Halifax Group Euro Finance (Jersey) L.P. (being subsequently renamed HBOS Euro Finance (Jersey) L.P.) as supplemented by a supplemental limited partnership agreement between the same parties dated on or about 31 May 2002;

“Liquidation Distribution” means a liquidation preference of €1,000 per Preferred Security plus (a) any due and accrued but unpaid Distribution calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, 9 December 1999), to (but excluding) the date of payment; and (b) any ~~Halifax~~HBOS Euro Jersey Additional Amounts, in each case in cash only;

“London Business Day” means a day other than a Saturday or Sunday on which banks are open for business in London;

“Notes” means the cumulative €415,000,000 Fixed to Floating Rate Subordinated Extendable Maturity Notes 2048 ~~issued by Halifax Group~~ (or such other aggregate amount thereof as may be outstanding from time to time) of HBOS or any successor ~~security~~ securities issued with the prior written consent of the FSA (if then required);

“Office” means the registered office of ~~Halifax~~ HBOS Euro Jersey for the time being in accordance with the Limited Partnership Agreement;

“Optional Redemption Date” means (a) in the case of optional redemption pursuant to paragraph 4.2, any Distribution Calculation Period Date or (b), prior to 9 December 2011, any date, and thereafter any Distribution Payment Date, designated for redemption for tax reasons of the Preferred Securities as described under paragraph 4.3;

“Optional Redemption Price” means €1,000 per Preferred Security plus (a) any due and accrued but unpaid Distribution calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, 9 December 1999) to (but excluding) the relevant Optional Payment Date and (b) any ~~Halifax~~ HBOS Euro Jersey Additional Amounts payable thereon;

“Parent Limited Partner” means Halifax plc or any other holder of the Preferential Rights from time to time;

“Parity Securities” means any preference shares ~~or~~ (including the Existing Preference Shares), preferred securities (other than the Preferred Securities) or other securities either (a) issued directly by ~~Halifax Group~~ HBOS (and ranking *pari passu* with ~~Halifax Group~~ HBOS's obligations under the Guarantee) or (b) issued by HBOS Euro Jersey or any Subsidiary (and entitled to the benefit of the Guarantee or any other guarantee or support agreement ranking *pari passu* with the Guarantee);

“Paying and Transfer Agent” ~~Agents~~ means ~~Kredietbank~~ Citibank, N.A. and Dexia Banque Internationale à Luxembourg S.A. ~~Luxembourgeoise~~ or such other entities as are appointed by the General Partner on behalf of ~~Halifax~~ HBOS Euro Jersey and notified to the Holders as described under paragraph 10;

“Permitted Reorganisation” means a solvent reconstruction, amalgamation, reorganisation, merger or consolidation with the prior approval of the Holders of not less than two-thirds of outstanding Preferred Securities, whereby all or substantially all the business, undertaking and assets of ~~Halifax Group~~ HBOS are transferred to a successor entity, which assumes all the obligations under the Guarantee;

“Preferential Rights” means the limited partnership interests in ~~Halifax~~ HBOS Euro Jersey held by the Parent Limited Partner and entitling the holder thereof to receive in preference to the rights of Holders all amounts received by ~~Halifax~~ HBOS Euro Jersey in excess of those required to make payments in respect of the Preferred Securities by reason of the provisions of paragraphs 2.4, 2.6, 3.1 or 4.5 other than any amounts to be used by the General Partner in subscribing for Substituted Preference Shares in accordance with paragraph 5 or in relation to the acquisition of redeemable preference shares as referred to in paragraph 4.5;

“Preferred Capital Contribution” means, in relation to the Preferred Securities, the aggregate contribution to the assets of ~~Halifax~~ HBOS Euro Jersey (being a whole multiple of €1,000) paid in cash by the Holders;

“Preferred Security” means an interest of a Holder in [HalifaxHBOS](#) Euro Jersey attributable to each €1,000 of the Preferred Capital Contribution;

“Reference Bond” means, in relation to any Capital Redemption Price calculation, the 5% per cent. Bundesobligationen due January 2010, or if such bond is no longer in issue, such other European government bond as the Calculation Agent may, with the advice of the Reference Dealers, decide to be appropriate;

“Reference Dealer” means three brokers of, and/or market makers in, European government bonds selected by the Calculation Agent;

“Register” means the register of Holders maintained outside the U.K. on behalf of [HalifaxHBOS](#) Euro Jersey under the Law;

“Registrar” means HSBC Bank International Limited or such other entity appointed by [HalifaxHBOS](#) Euro Jersey having its office outside the U.K. and notified to the Holders as described under paragraph 10;

“Regulatory Event” means ~~Halifax Group~~[HBOS](#)’s total capital ratio declines below any minimum requirement then prescribed by the FSA for all banks in the U.K.;

“Relevant Proportion” means (a), in relation to any partial payment of a Distribution on a Preferred Security, the amount of [Adjusted Distributable Profits Reserves as determined in accordance with paragraph 2.10](#) on the Distribution Determination Date divided by the sum of (i) the amount originally scheduled to be paid by way of Distributions on the Preferred Securities on the relevant Distribution Payment Date and (ii) the amount of any distributions or dividends originally scheduled to be payable to holders of Parity Securities on the relevant Distribution Payment Date, converted where necessary into the same currency in which [Adjusted Distributable Profits Reserves](#) are reported by ~~Halifax Group~~[HBOS](#) and (b), in relation to any partial payment of any Liquidation Distribution on a Preferred Security, the amount available for any such payment [and for making any corresponding payment of a liquidation distribution or its equivalent on any Parity Securities](#) divided by the sum of (i) the full Liquidation Distributions before any reduction or abatement in respect of the Preferred Securities and (ii) the amount of the full liquidation distribution before any reduction or abatement in respect of any Parity Securities, converted where necessary into the same currency in which liquidation payments are made to creditors of ~~the Halifax Group~~[HBOS](#);

“Replacement Capital” means ~~any (a) ordinary shares of Halifax Group, (b) preferred or preference shares of Halifax Group or (c) preference shares or preferred securities or other securities issued by any~~[shares or other securities issued by HBOS or shares or other securities issued by a Subsidiary entitled to the benefit of a guarantee or support agreement from Halifax Group expressed to rank pari passu with or junior to the Guarantee and qualifying to be accounted for as a minority interest under which would, under the then generally accepted accounting practice in the U.K., qualify as at the date hereof](#)~~hereof, made for the purpose of funding any Optional Redemption Price, Capital Redemption Price or, treatment as the case may be, Liquidation Distribution pursuant to paragraph 4.5~~[a minority interest or shareholders’ funds in HBOS’s accounts](#);

“Restricted Person” means a person to whom Substituted Preference Shares will not be available for issue being (a) Euroclear, [CedelbankClearstream, Luxembourg](#), First Chicago Clearing Center or any other person providing a clearance service within Section 96 of the Finance Act 1986 of the U.K. or any nominee thereof or (b) a person, or nominee or agent for a person, whose business is or includes issuing depositary receipts within Section 93 of the Finance Act 1986 of the U.K., in each case at any time prior to the “abolition day” as defined in Section 111(1) of the Finance Act 1990 of the U.K.;

“Special Representative” means the representative of the Holders as described under paragraph 8;

“Stock Exchange” means the Luxembourg Stock Exchange or such other stock exchange approved by the General Partner on which the Preferred Securities (or any Substituted Preference Shares) may be listed from time to time;

“Subsidiary” means any entity which is for the time being a subsidiary undertaking of ~~Halifax Group~~[HBOS](#) (within the meaning of the ~~English~~ Companies Acts 1985 and 1989);

“Substituted Preference Shares” means the preference shares issued by ~~Halifax Group~~[HBOS](#) in substitution for the Preferred Securities and the Guarantee as described under paragraph 5;

“TARGET” means the Trans European Real-Time Gross Settlement Express Transfer (TARGET) System;

“TARGET Business Day” means a day on which TARGET is operating;

“Tax Event” means (a) any amendment to, or change (including any announced prospective change) in, the laws (or any regulations thereunder) of Jersey or the U.K. or any political sub-division or taxing authority of Jersey or the U.K., (b) any amendment to, or change in, an interpretation or application of any such laws or regulations by any legislative body, court, governmental agency or regulatory authority (including the enactment of any legislation, any judicial decision or any regulatory determination), (c) any interpretation or pronouncement by any relevant tax authority that provides for a position with respect to such laws or regulations that differs from the theretofore generally accepted position in relation to similar transactions or (d) any action taken by any governmental agency or regulatory authority, which amendment or change is enacted, promulgated, issued or effective or which interpretation or pronouncement is issued or announced or which action is taken, in each case on or after 9 December 1999, and as a result of which there is more than an insubstantial risk that (i) ~~Halifax Group~~[HBOS](#) will not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes or (ii) ~~Halifax~~[HBOS](#) Euro Jersey will be liable to U.K. tax on its profits or ~~Halifax Group~~[HBOS](#), ~~Halifax~~[HBOS](#) Euro Jersey or the General Partner shall become liable to account for tax in respect of all or any part of the profits of ~~Halifax~~[HBOS](#) Euro Jersey which are distributed to a Holder or (iii) to the extent that the Notes are owned by ~~Halifax~~[HBOS](#) Euro Jersey, ~~Halifax Group~~[HBOS](#) is or would be required to withhold or deduct tax in respect of interest payments made in respect of or in connection with such Notes;

[“Tier 1 Capital” has the meaning ascribed to it in the FSA’s Interim Prudential Sourcebook: Banks or any successor publication replacing such sourcebook;](#)

“Treaty” means the Treaty establishing the European Community, as amended from time to time; and

“U.K.” means the United Kingdom of Great Britain and Northern Ireland.

2. Distributions

2.1 Subject as provided by the Law and in ~~paragraph 2.4,~~[paragraphs 2.4 and 2.10](#), non-cumulative distributions (“Distributions”) on the Preferred Securities will accrue from 9 December 1999 and shall be payable annually in arrear on each Distribution Payment Date up to, and including, the Distribution Re-Set Date and thereafter quarterly in arrear on each Distribution Payment Date. Distributions will be calculated in accordance with the Fixed Distribution Rate in respect of Distribution Payment Dates up to (and including) the Distribution Re-Set Date and thereafter in

accordance with the Floating Distribution Rate, in the manner described in paragraphs 2.2 and 2.3, respectively. On the Distribution Re-Set Date and every quarter thereafter, the General Partner will, so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, notify the Luxembourg Stock Exchange of the Distribution Rate.

2.2 Subject to the Law and paragraph 2.4, the Distributions payable on any Distribution Payment Date up to (and including) the Distribution Re-Set Date will be payable at the Fixed Distribution Rate on the amount of the liquidation preference of €1,000 per Preferred Security. The amount of Distribution payable for any period of less than one year ending prior to the Distribution Re-Set Date will be calculated on the basis of the actual number of days elapsed divided by the actual number of days in the relevant Distribution Period.

2.3 Subject to the Law and paragraph 2.4, the Distributions in respect of each Distribution Calculation Period will be payable quarterly in arrear on the relevant Distribution Payment Date at the Floating Distribution Rate on the amount of the liquidation preference of €1,000 per Preferred Security. If any Distribution Payment Date after the Distribution Re-Set Date would otherwise fall on a day which is not a TARGET Business Day, it shall be postponed to the next day which is a TARGET Business Day. The amount of Distribution payable for each Distribution Calculation Period and for any period less than a Distribution Calculation Period beginning on or after the Distribution Re-Set Date will be calculated on the basis of the actual number of days elapsed divided by 360 and rounding the resultant figure to the nearest cent (half a cent being rounded upwards).

2.3.1 The Floating Distribution Rate from time to time in respect of the Preferred Securities will be determined for each Distribution Calculation Period in accordance with the following provisions:

(a) On the Determination Date the Agent Bank will record the offered rate (expressed as a rate per annum) for three-month euro deposits (notwithstanding that such Distribution Calculation Period happens to fall short of or exceed three months) as at 11.00 a.m. (Central European time) on such Determination Date, as displayed on the display designated as page "248" on the Bridge/Telerate Monitor (or such other page or pages as may replace it for the purpose of displaying such information). The Floating Distribution Rate for such Distribution Calculation Period shall be such offered rate, as determined by the Agent Bank, plus 2.875 per cent.;

(b) If such offered rate does not so appear, or if the relevant page is unavailable, the Agent Bank will, on such date, request the principal Euro-zone office of four major banks in the Euro-zone interbank market (the "Reference Banks") to provide the Agent Bank with its offered quotation to leading banks in the Euro-zone inter bank market for three-month euro deposits as at 11.00 a.m. (Central European time) on the Determination Date in question. If at least two of the Reference Banks provide the Agent Bank with such offered quotations, the Floating Distribution Rate for such Distribution Calculation Period shall be the rate determined by the Agent Bank to be the arithmetic mean (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of such offered quotations plus 2.875 per cent.;

(c) If on any Determination Date to which the provisions of sub-paragraph (b) above apply, one only or none of the Reference Banks provides the Agent

Bank with such a quotation, the Floating Distribution Rate for that Distribution Calculation Period shall be the rate which the Agent Bank determines to be the aggregate of 2.875 per cent. and the arithmetic mean (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of the euro lending rates which leading banks in the Euro-zone selected by the Agent Bank are quoting, on the relevant Determination Date, to leading European banks for a period of three months, except that, if the banks so selected by the Agent Bank are not quoting as mentioned above, the Floating Distribution Rate shall be either (i) the Floating Distribution Rate in effect for the last preceding Distribution Calculation Period to which one of the preceding sub-paragraphs of this paragraph shall have applied or (ii) if none, the Fixed Distribution Rate.

- 2.3.2 ~~Halifax~~[HBOS](#) Euro Jersey shall cause notice of the Floating Distribution Rate determined in accordance with this paragraph 2.3 to be given to the Holders in accordance with paragraph 10 as soon as practicable after its determination but in any event not later than the fourth business day thereafter;
- 2.3.3 ~~Halifax~~[HBOS](#) Euro Jersey may from time to time replace the Agent Bank by another leading investment, merchant or commercial bank. If the appointed office of the Agent Bank is unable or unwilling to continue to act as the Agent Bank or (without prejudice to paragraph 2.3.2) failed duly to determine the Floating Distribution Rate in respect of any Distribution Calculation Period as provided in paragraph 2.3, ~~Halifax~~[HBOS](#) Euro Jersey shall forthwith appoint another leading investment, merchant or commercial bank to act as such in its place. The Agent Bank may not resign its duties or be removed without a successor having been appointed as aforesaid.
- 2.3.4 All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this paragraph 2.3 by the Agent Bank shall (in the absence of wilful default, bad faith or manifest error) be binding on ~~Halifax~~[HBOS](#) Euro Jersey, ~~Halifax Group~~[HBOS](#), the Agent Bank and all Holders and (in the absence as aforesaid) no liability to the Holders, ~~Halifax Group~~[HBOS](#) or ~~Halifax~~[HBOS](#) Euro Jersey shall attach to the Agent Bank in connection with the exercise or non-exercise by it of its powers, duties and discretions.
- 2.4 Distributions on the Preferred Securities will be non-cumulative and will accrue on a day by day basis. Distributions on the Preferred Securities will be payable out of ~~Halifax~~[HBOS](#) Euro Jersey's own legally available resources on each Distribution Payment Date. Notwithstanding the existence of resources legally available for distribution by ~~Halifax~~[HBOS](#) Euro Jersey, neither ~~Halifax~~[HBOS](#) Euro Jersey nor ~~Halifax~~[HBOS](#) Group will pay any Distributions or make any payment in respect of Distributions (including any ~~Halifax~~[HBOS](#) Euro Jersey Additional Amounts) under the Preferred Securities or the Guarantee:
- 2.4.1 to the extent that such payment, together with the amount of any distributions or dividends paid or scheduled to be paid to holders of Parity Securities on the relevant Distribution Payment Date would exceed Adjusted Distributable ~~Profits on Reserves~~ as at the Distribution Determination Date immediately preceding such ~~date~~Distribution Payment Date; or

- 2.4.2 even if Adjusted Distributable Profits Reserves are sufficient, to the extent that such payment in respect of the Preferred Securities and/or Parity Securities would breach or cause a breach of the U.K. banking capital adequacy requirements then applicable to Halifax Group HBOS on a consolidated basis.
- 2.5 Halifax Group HBOS has covenanted in the Guarantee in favour of Holders that, in the event that any Distribution is not paid in full as a result of paragraph 2.4, it will not make or pay any distribution or dividend and, where applicable, will procure that no such distribution or dividend is made or paid on any Parity Security (otherwise than in relation to *pro rata* payments as provided in paragraph 2.6 below) or Junior Share Capital, until such time as payment in full of Distributions has been resumed.
- 2.6 If, whether by reason of the provisions of paragraph 2.4 above or any equivalent article or term of a Parity Security, Distributions are not paid in full on the Preferred Securities or dividends or other distributions are not paid in full on any Parity Securities, but there are sufficient Adjusted Distributable Profits Reserves so as to allow payment of part of any Distribution, then each Holder will be entitled to receive the Relevant Proportion of any such Distribution. The entitlement of the Holders to payment by Halifax HBOS Euro Jersey or Halifax Group HBOS of the balance of any Distributions not paid by reason of paragraph 2.4 above shall lapse following payment of such Relevant Proportion, and no payment in respect of any such unpaid Distributions shall be made at any time by Halifax HBOS Euro Jersey or Halifax Group HBOS in such circumstances.
- 2.7 On each Distribution Determination Date, Halifax Group HBOS will determine whether sufficient Adjusted Distributable Profits Reserves exist to allow a payment of some or all of the relevant Distribution. In the event that any Distribution cannot be paid in full, Halifax Group HBOS will notify or procure notification to the Stock Exchange, the General Partner and the Paying and Transfer Agent Agents and to Holders, in accordance with paragraph 10, of the amount, if any, to be paid in respect of that Distribution.
- 2.8 Save as described above, Holders will have no right to participate in the profits of Halifax HBOS Euro Jersey and in particular will have no rights to receive from Halifax HBOS Euro Jersey amounts in excess of Distributions due and payable under the Preferred Securities. In the event that any amounts received by Halifax HBOS Euro Jersey exceed the amount (if any) then due by way of distribution under the Preferred Securities, the amount of such excess will be paid to the Parent Limited Partner and Holders will have no rights in respect thereof.
- 2.9 Without prejudice to the provisions of paragraph 9, the liability of a Holder to contribute to the debts or obligations of Halifax HBOS Euro Jersey (if any) is (subject to the Law) not to exceed the amount of that Holder's Preferred Capital Contribution.
- 2.10 For the purposes of the definition of "Relevant Proportion" in paragraph 1, and paragraphs 2.4.1, 2.6 and 2.7 Adjusted Distributable Reserves as at each Distribution Determination Date shall be determined by reference to whichever is the latest available at that date of the audited accounts for the previous financial year of HBOS or interim accounts for the previous half year of HBOS, adjusted in either case for any of the following events occurring since the date to which such accounts were prepared: (i) any known net losses and (ii) any further redemptions of or payments on (a) any preference shares or other obligations of HBOS that are accounted for under the then generally accepted accounting practice of the U.K. as shareholders' funds in the accounts of HBOS and (b) all securities or other obligations of an undertaking which are accounted for under the then generally accepted accounting practice in the U.K. as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or

otherwise) to, HBOS that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Securities, except in each case for such amounts as have been either charged to the lawful distributable reserves of HBOS or funded at that time by an issue of Replacement Capital made for the purposes of funding a redemption.

2.11 If at any time the General Partner becomes aware that an investor in the Preferred Securities owns, directly or indirectly, 10 per cent. or more of the ordinary shares of HBOS, the General Partner on behalf of HBOS Euro Jersey will have the right to suspend payment of Distributions in respect of such investor's Preferred Securities. An investor is required to provide written notice to the General Partner on behalf of HBOS Euro Jersey if at any time such investor owns, directly or indirectly, 10 per cent. or more of the ordinary shares of HBOS. Any amounts so suspended will be forfeited and may not be subsequently claimed.

3. Liquidation Distributions

3.1 Without prejudice to paragraph 8.6, in the event of the commencement of any dissolution (other than an Involuntary Dissolution) of ~~Halifax~~HBOS Euro Jersey, the Holders at that time will be entitled, subject as set out in paragraph 4.5, to receive the Liquidation Distribution, in respect of each Preferred Security held, out of the assets of ~~Halifax~~HBOS Euro Jersey available for distribution to such Holders under the Law.

Such entitlement will arise (a) after any payments due to the holders of the Preferential Rights and (b) before any distribution of assets is made to the General Partner or the holders of any type of interest in ~~Halifax~~HBOS Euro Jersey ranking junior as regards participation in assets to the Preferred Securities, but such entitlement will rank equally with the entitlement of the holders of other preferred securities, if any, of ~~Halifax~~HBOS Euro Jersey ranking *pari passu* with the Preferred Securities as regards participation in assets of ~~Halifax~~HBOS Euro Jersey.

Notwithstanding the availability of sufficient assets of ~~Halifax~~HBOS Euro Jersey to pay any Liquidation Distribution to the Holders, if, at the time such Liquidation Distribution is to be paid, proceedings have been commenced for the voluntary or involuntary liquidation, dissolution or winding-up of ~~Halifax Group~~HBOS other than pursuant to a Permitted Reorganisation, the Liquidation Distribution per Preferred Security paid to Holders thereof shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of ~~Halifax Group~~HBOS (after payment in full in accordance with ~~English~~Scots law of all creditors of ~~Halifax Group~~HBOS, including any holders of subordinated debt but excluding holders of any liability expressed to rank *pari passu* with or junior to the Guarantee) had the Preferred Securities and all Parity Securities been the most senior class of preference shares issued by ~~Halifax Group~~in HBOS with equivalent rights of participation in the capital of ~~Halifax Group~~HBOS (whether or not HBOS could in fact have issued such securities at such time) and ranked (a) junior to all liabilities of ~~Halifax Group~~HBOS including subordinated liabilities and for the avoidance of doubt all subordinated liabilities expressed to rank ahead on a winding-up of all shares of ~~Halifax Group~~HBOS (in each case other than any liability of ~~Halifax Group~~HBOS which constitutes Tier 1 Capital or which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to the Guarantee), (b) *pari passu* with ~~the most senior preference shares~~Parity Securities, if any, issued by ~~Halifax Group~~HBOS and any guarantee or support agreement of ~~Halifax Group~~HBOS ranking *pari passu* with the Guarantee and issued in respect of Parity Securities issued by HBOS Euro Jersey or any Subsidiary and (c) senior to Junior Share Capital.

3.2 If the Liquidation Distribution and any other such liquidation distributions cannot be made in full by reason of the limitation described in paragraph 3.1 above or any equivalent article or term of

a Parity Security, but there are funds available for payment so as to allow payment of part of the Liquidation Distribution, then each Holder will be entitled to receive the Relevant Proportion of the Liquidation Distribution. After payment of all Liquidation Distributions, as adjusted if applicable, the [Parent Limited Partner will be entitled to any remaining assets of HBOS Euro Jersey representing proceeds of the Notes and the](#) Holders will have no right or claim to any of the remaining assets of ~~Halifax~~[HBOS](#) Euro Jersey or ~~Halifax Group~~[HBOS](#).

3.3 In the event of an order being made for the liquidation, dissolution or winding-up of ~~Halifax Group~~[HBOS](#) other than pursuant to a Permitted Reorganisation or ~~Halifax Group~~[HBOS](#) is declared insolvent, ~~Halifax~~[HBOS](#) Euro Jersey shall be dissolved (by delivery by the General Partner of a statement of dissolution in accordance with the Law), and the amount per Preferred Security to which Holders shall be entitled as a Liquidation Distribution will be as set out in paragraphs 3.1 and 3.2 above.

4. Redemption and Purchase

4.1 The Preferred Securities have no fixed final redemption date and Holders have no rights to call for the redemption of the Preferred Securities.

4.2 The Preferred Securities are redeemable, at the option of the General Partner, subject to the Law, paragraph 4.5 below and to the prior written consent of the FSA (if then required), in whole, but not in part, on any Optional Redemption Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable), each to be redeemed at the Optional Redemption Price on the specified Optional Redemption Date. Upon the expiry of such notice, ~~Halifax~~[HBOS](#) Euro Jersey shall be bound to redeem the Preferred Securities accordingly by payment of an amount equal to the Optional Redemption Price.

4.3 If at any time prior to the Distribution Re-Set Date (a) ~~Halifax~~[HBOS](#) Euro Jersey is or would be required to pay ~~Halifax~~[HBOS](#) Euro Jersey Additional Amounts or, on making payment under the Guarantee, ~~Halifax Group~~[HBOS](#) is required to pay Additional Amounts (as defined in the Guarantee), in either such case as a result of a change in, or amendment to, the laws or regulations of Jersey or the U.K., as the case may be, or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 9 December 1999 or (b) there is a Tax Event, the effect of which in either case cannot be avoided by ~~Halifax~~[HBOS](#) Euro Jersey or ~~Halifax Group~~[HBOS](#) taking reasonable measures available to it, then the Preferred Securities will be redeemable, at the option of the General Partner, at their Optional Redemption Price, subject to the Law, paragraph 4.5 below and the prior written consent of the FSA (if then required), in whole, but not in part, at any time prior to the Distribution Reset Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar and the Paying and Transfer ~~Agent~~[Agents](#) a certificate signed by two Directors of ~~Halifax Group~~[HBOS](#) stating that ~~Halifax~~[HBOS](#) Euro Jersey is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of ~~Halifax~~[HBOS](#) Euro Jersey so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that, in the case of (a), ~~Halifax~~[HBOS](#) Euro Jersey or ~~Halifax Group~~[HBOS](#) has or will become obliged to pay such ~~Halifax~~[HBOS](#) Euro Jersey Additional Amounts or, as the case may be, Additional Amounts as a result of such change or amendment or, in the case of (b), a Tax Event has occurred. Upon the expiry of such notice,

~~Halifax~~HBOS Euro Jersey shall be bound to redeem the Preferred Securities accordingly by the payment of the Optional Redemption Price, in accordance with and subject to the Law.

- 4.4 If at any time prior to the Distribution Re-Set Date (a) the FSA determines that the Preferred Securities no longer qualify as Tier 1 ~~regulatory capital for U.K. banking capital adequacy purposes~~Capital on a consolidated basis the effect of which cannot be avoided by ~~Halifax~~HBOS Euro Jersey or ~~Halifax Group~~HBOS taking reasonable measures available to it or (b) for any reason other than a Tax Event, there is more than an insubstantial risk that ~~Halifax Group~~HBOS will not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes, then the Preferred Securities will be redeemable, in whole, but not in part, at the option of the General Partner at the Capital Redemption Price, subject to the Law, paragraph 4.5 below and the prior written consent of the FSA (if then required), at any time prior to the Distribution Re-Set Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Capital Redemption Date (which notice shall be irrevocable) and the method of calculating the applicable Capital Redemption Price (together with details as to calculation thereof). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar and the Paying and Transfer AgentAgents a certificate signed by two Directors of ~~Halifax Group~~HBOS stating that ~~Halifax~~HBOS Euro Jersey is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of ~~Halifax~~HBOS Euro Jersey so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to that effect. Upon the expiry of such notice, ~~Halifax~~HBOS Euro Jersey shall be bound to redeem the Preferred Securities accordingly by the payment of the Capital Redemption Price in accordance with and subject to the Law.
- 4.5 The Preferred Securities may only be redeemed pursuant to paragraph 4.2, 4.3 or 4.4 and a Liquidation Distribution may only be paid pursuant to paragraph 3.1 or 3.2 in the event of the dissolution of ~~Halifax~~HBOS Euro Jersey (except following any liquidation, dissolution or winding-up of ~~Halifax Group~~HBOS) if the Optional Redemption Price, Capital Redemption Price or, as the case may be, Liquidation Distribution (or the Relevant Proportion) payable is funded (a) by payments received that have themselves been funded by ~~Halifax Group~~HBOS from an issue of Replacement Capital and/or (b) by a payment received by ~~Halifax~~HBOS Euro Jersey from ~~Halifax Group~~HBOS upon the redemption from Adjusted Distributable ProfitsReserves of redeemable preference shares issued by ~~Halifax Group~~HBOS against payment to it by the General Partner.
- 4.6 Under existing FSA requirements, neither ~~Halifax~~HBOS Euro Jersey nor ~~Halifax Group~~HBOS may redeem or purchase any Preferred Securities unless the FSA gives its prior written consent. The FSA may impose conditions on any such redemption or purchase.

5. Substitution for Preference Shares

As soon as reasonably practicable following the occurrence of a Regulatory Event or the Involuntary Dissolution of ~~Halifax~~HBOS Euro Jersey (in circumstances where ~~Halifax Group~~HBOS is itself not insolvent or in liquidation), the General Partner shall take all reasonable steps to cause the substitution for the Preferred Securities of fully-paid preference shares issued directly by ~~Halifax Group~~HBOS (the "Substituted Preference Shares") the terms of which provide the Holder in all material respects with the same economic rights and benefits (including those relating to non-cumulative distributions and status) as are attached to the Preferred Securities and the Guarantee taken together. ~~Halifax Group~~However, in the event that at the time of any such substitution HBOS is unable, by reason of the operation of Article 4.7 of its Articles of Association (or any provision in its Articles of Association

from time to time corresponding thereto) but not otherwise, to issue preference shares which rank as to payments of capital or income equally with the Guarantee, the Substituted Preference Shares shall comprise preference shares of HBOS which provide the Holder in all material commercial respects with the same economic rights and benefits as aforesaid save that they shall rank junior to the Parity Securities issued, if any, by HBOS but senior to all other preference shares issued, if any, by HBOS and all other Junior Share Capital. HBOS has undertaken in the Guarantee that ~~priority will take all reasonable steps~~ to ~~procure that the issue of any~~ Substituted Preference Shares, ~~application~~ will at all times be ~~made for their admission to listing~~ listed on ~~the Stock Exchange~~ a recognised stock exchange. ~~Halifax Group~~ HBOS has undertaken in the Guarantee that as soon as practicable after a Regulatory Event or the Involuntary Dissolution of ~~Halifax~~ HBOS Euro Jersey in circumstances where ~~Halifax Group~~ HBOS is itself not insolvent or in liquidation, it will give written notice to the Holders enclosing a substitution confirmation (the "Substitution Confirmation") which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of each Paying and Transfer Agent. To receive Substituted Preference Shares in respect of some or all of its holding of Preferred Securities, each Holder must deliver to ~~the~~ any Paying and Transfer Agent a Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. ~~Halifax Group~~ HBOS has undertaken in the Guarantee that following such substitution, each Substituted Preference Share allotted will rank for any dividend from the immediately preceding Distribution Payment Date and will have no entitlement to any accrued Distribution or any other payment on the Preferred Securities. In the case of a partial substitution of a Holder's Preferred Securities, the relevant Paying and Transfer Agent will notify the Registrar and the General Partner who shall amend the record of the Holder's interest in ~~Halifax~~ HBOS Euro Jersey on the Register accordingly. On allotment in full of such Substituted Preference Shares the Holder shall cease to be a limited partner of ~~Halifax~~ HBOS Euro Jersey.

~~Halifax Group~~ HBOS has undertaken in the Guarantee that it will pay any taxes or capital duties or stamp duties payable in the U.K. or Jersey arising on the allotment and issue of the Substituted Preference Shares other than to Restricted Persons. ~~Halifax Group~~ HBOS will not be obliged to pay and each Holder delivering Preferred Securities and a duly completed Substitution Confirmation to ~~the~~ a Paying and Transfer Agent must pay any other taxes, stamp duty reserve taxes and capital, stamp, issue and registration duties arising on the relevant substitution. ~~Halifax Group~~ HBOS will not be obliged to pay and each Holder must pay all, if any, taxes arising by reference to any disposal or deemed disposal of a Preferred Security in connection with such substitution. Substituted Preference Shares will not be allotted to Restricted Persons.

The General Partner will use all reasonable endeavours to procure that certificates (if any) for Substituted Preference Shares issued on substitution will be despatched by mail free of charge (but uninsured and at the risk of the person entitled thereto) within one month after receipt of a duly completed Substitution Confirmation. Upon an Involuntary Dissolution of ~~Halifax~~ HBOS Euro Jersey, Holders will have no further rights, title or interest in or to Preferred Securities except ~~the right~~ to have their ~~respective~~ ~~Preferred Securities~~ Security substituted in the manner described above. Notwithstanding the foregoing, if Substituted Preference Shares are required to be issued the Holders will continue to be entitled to receive Distributions and/or a Liquidation Distribution in respect of the Preferred Securities until such time as notice is given by ~~Halifax Group~~ HBOS in accordance with paragraph 10 that Substituted Preference Shares are available for issue upon substitution and thereafter Holders will have no further rights, title or interest in or to their Preferred Securities except to have them substituted in the manner described above.

6. ~~Halifax~~ HBOS Euro Jersey Additional Amounts

All payments in respect of the Preferred Securities by [HalifaxHBOS](#) Euro Jersey will be made without withholding or deduction for, or on account of, any Jersey Tax, unless the withholding or deduction of such Jersey Tax is required by law. In the event of such withholding or deduction, each Holder will be entitled to receive, as further distributions, such additional amounts (“[HalifaxHBOS](#) Euro Jersey Additional Amounts”) as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable in respect of the Preferred Securities in the absence of such withholding or deduction; except that no such [HalifaxHBOS](#) Euro Jersey Additional Amounts will be payable to a Holder (or to a third party on his behalf) with respect to any Preferred Security to the extent that such Jersey Tax is imposed or levied by virtue of such Holder (or the beneficial owner) of such Preferred Security having some connection with Jersey, other than being a Holder (or beneficial owner) of such Preferred Security, and except that [HalifaxHBOS](#) Euro Jersey’s obligations to make any such payments are subject to the Law and to the limitations provided in paragraphs 2.4, 3.1 and 3.2.

7. Payments

7.1 Distributions will be payable on the relevant Distribution Payment Date or (where any Distribution Payment Date is not a TARGET Business Day) on the next TARGET Business Day (without interest in respect of such delay) to the Holders of record as they appear on the Register on the relevant record date, which will be five TARGET Business Days prior to the relevant Distribution Payment Date.

If the General Partner gives a notice of redemption pursuant to paragraphs 4.2, 4.3 or 4.4 in respect of the Preferred Securities, then, by 10.00 a.m. (London time) on the Optional Redemption Date or the Capital Redemption Date, as the case may be, the General Partner shall procure that the Optional Redemption Price or the Capital Redemption Price, as the case may be, will be paid by the Registrar or by [thea](#) Paying and Transfer Agent on behalf of [HalifaxHBOS](#) Euro Jersey to the Holders. Upon such payment, all rights of Holders to participate in the assets of [HalifaxHBOS](#) Euro Jersey or to be returned any amount in respect of the Preferred Securities (including the Preferred Capital Contribution made by or on behalf of the Holders) will be extinguished and the Holder shall thereupon cease to be a limited partner of [HalifaxHBOS](#) Euro Jersey provided its holding of Preferred Securities are redeemed in accordance with the foregoing, and the Preferred Capital Contribution will, on payment of the Optional Redemption Price or the Capital Redemption Price, as the case may be, be deemed repaid.

7.2 Subject to all applicable fiscal or other laws and regulations:

7.2.1 each payment in respect of Distributions will be made by cheque and mailed to the Holder of record at such Holder’s address as it appears on the Register on the relevant record date for the Preferred Securities; and

7.2.2 any payment in respect of the Optional Redemption Price, the Capital Redemption Price or the Liquidation Distribution in respect of any Preferred Security will be made by cheque against presentation and surrender of the relevant certificate of entitlement at the office of the Registrar or [thea](#) Paying and Transfer Agent,

provided, however, that a Holder may receive such payment by direct transfer by [thea](#) Paying and Transfer Agent if appropriate direct transfer instructions have been received by the Registrar in sufficient time prior to the relevant date of payment.

In the event that payment of the Optional Redemption Price or the Capital Redemption Price in respect of any Preferred Security is improperly withheld or refused and not paid by ~~Halifax~~HBOS Euro Jersey, Distributions on such Preferred Security, subject as described in paragraph 2.3 above, will continue to accrue, on a day by day basis compounding annually, from the Optional Redemption Date or Capital Redemption Date, as the case may be, to the date of actual payment of such Optional Redemption Price or Capital Redemption Price.

- 7.3 ~~Halifax~~HBOS Euro Jersey will not, and ~~Halifax Group~~HBOS has undertaken in the Guarantee that it will not and it will procure that no member of the Group will, make any payment to Holders, or procure such a payment, that could not lawfully have been made if Holders had held the most senior preference shares of ~~Halifax Group~~HBOS (if any, and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.
- 7.4 The General Partner will, and ~~Halifax Group~~HBOS has undertaken in the Guarantee that it will procure that the General Partner will, maintain at all times whilst the Preferred Securities are outstanding (a) a Paying and Transfer Agent outside the U.K. and (b) whilst the Preferred Securities are listed on the Luxembourg Stock Exchange, a Paying and Transfer Agent in Luxembourg. The General Partner will, and ~~Halifax Group~~HBOS has undertaken in the Guarantee that it will procure that the General Partner will, if circumstances arise ~~when~~where the General Partner or ~~Halifax Group~~HBOS is able, by the appointment of a Paying and Transfer Agent having a specified office in mainland Europe in a country which is not a member of the European Community, to avoid the obligation to pay ~~Halifax~~HBOS Euro Jersey Additional Amounts ~~or Additional Amounts, as the case may be,~~ to Holders, appoint such a Paying and Transfer Agent.

8. Voting Rights

- 8.1 Except as described below and provided for in the Law, Holders will not be entitled to receive notice of or attend or vote at any meeting of partners in ~~Halifax~~HBOS Euro Jersey or participate in the management of ~~Halifax~~HBOS Euro Jersey.
- 8.2 If for a Distribution Period beginning prior to the Distribution Re-Set Date or for any four consecutive Distribution Calculation Periods:
- 8.2.1 Distributions and any ~~Halifax~~HBOS Euro Jersey Additional Amounts in respect of such Distributions have not been paid in full on the Preferred Securities by ~~Halifax~~HBOS Euro Jersey; and/or
- 8.2.2 ~~Halifax Group~~HBOS breaches any of its payment obligations under the Guarantee in respect of such Distributions or any such ~~Halifax~~HBOS Euro Jersey Additional Amounts thereon,

then the Holders of outstanding Preferred Securities together with the holders of any other preferred securities of ~~Halifax~~HBOS Euro Jersey having the right to vote for the election of a special representative (the "Special Representative") in such event, acting as a single class without regard to series, will be entitled, by written notice to the General Partner at the Office given by the holders of a majority by liquidation preference of such Preferred Securities and any other preferred securities having the said right or by resolution passed by the holders of a majority by liquidation preference of such Preferred Securities and any other such preferred securities present in person or by proxy at a separate general meeting of such holders convened for the purpose, to appoint a Special Representative. The Special Representative shall be authorised to represent the Holders (for this purpose as defined in the Guarantee) to enforce

their statutory rights (if any) as limited partners including provision of information on the affairs of [HalifaxHBOS](#) Euro Jersey; however, it has no rights in addition to those held by Holders, and, for the avoidance of doubt, the Special Representative shall have no authority ~~hereby~~ to participate in the management of [HalifaxHBOS](#) Euro Jersey or to bind [HalifaxHBOS](#) Euro Jersey, or Holders, or any of them. The Special Representative shall not, by virtue only of acting in such capacity, be admitted or authorised to act as a general partner in relation to [HalifaxHBOS](#) Euro Jersey or be admitted as a Holder or otherwise be deemed to be a general partner or a Holder in [HalifaxHBOS](#) Euro Jersey and shall have no liability for the debts, obligations or liabilities of [HalifaxHBOS](#) Euro Jersey or for any unpaid contribution of a partner in such capacity.

Not later than 30 days after such entitlement arises, if the written notice of the Holders of outstanding Preferred Securities and the holders of any other preferred securities of [HalifaxHBOS](#) Euro Jersey having the right to vote for the election of a Special Representative in the circumstances described in the preceding paragraph has not been given as provided for in the preceding paragraph, the General Partner will convene a separate general meeting for the above purpose. If the General Partner fails to convene such meeting within such 30 day period, the holders of 10 per cent. by liquidation preference of the Preferred Securities and such other preferred securities will be entitled to convene such meeting for the above purpose. The Limited Partnership Agreement contains provisions concerning the convening and conduct of meetings of Holders. Any Special Representative so appointed shall, subject to the terms of such other preferred securities, vacate office, if for a Distribution Period beginning prior to the Distribution Re-Set Date or for any four consecutive Distribution Calculation Periods, Distributions and any [HalifaxHBOS](#) Euro Jersey Additional Amounts in respect of such Distributions have resumed with payment in full on the Preferred Securities by [HalifaxHBOS](#) Euro Jersey and/or [Halifax GroupHBOS](#) has made payment of all amounts guaranteed pursuant to the Guarantee in respect of such Distributions and any [HalifaxHBOS](#) Euro Jersey Additional Amounts in respect thereof.

- 8.3 The consent in writing of the Holders of at least two-thirds of the outstanding Preferred Securities or the sanction of a resolution, passed at a separate meeting, by the Holders of at least two-thirds of the outstanding Preferred Securities shall be required in order to give effect to any variation or abrogation of the rights, preferences and privileges of the Preferred Securities by way of amendment of the Limited Partnership Agreement or otherwise (including, without limitation, the authorisation or creation of any securities or ownership interests of [HalifaxHBOS](#) Euro Jersey ranking, as to participation in the profits or assets of [HalifaxHBOS](#) Euro Jersey, senior to the Preferred Securities) (unless otherwise required by applicable law).
- 8.4 Notwithstanding the foregoing, provided that the most recent Distribution has been paid in full by [HalifaxHBOS](#) Euro Jersey (or [Halifax GroupHBOS](#) pursuant to the Guarantee), the General Partner may, without the consent or sanction of the Holders, take such action as is required in order to amend the Limited Partnership Agreement:
- 8.4.1 to allow an increase in the level of Preferred Capital Contributions and the corresponding number of Preferred Securities or to create and issue one or more other series of preferred securities of [HalifaxHBOS](#) Euro Jersey ranking *pari passu* with the Preferred Securities as regards participation in the profits and assets of [HalifaxHBOS](#) Euro Jersey and to admit if relevant new holders in respect thereof; or
- 8.4.2 to authorise, create and issue one or more other classes of securities or partnership interests in [HalifaxHBOS](#) Euro Jersey ranking junior, as regards participation in the

profits and assets of ~~Halifax~~[HBOS](#) Euro Jersey, to the Preferred Securities and to admit if relevant new holders in respect thereof.

- 8.5 Notwithstanding the foregoing, no vote of the Holders will be required for the redemption, cancellation or substitution of the Preferred Securities in accordance with the Limited Partnership Agreement.
- 8.6 Subject to the Law, ~~Halifax~~, [HBOS](#) Euro Jersey may not be voluntarily dissolved by the General Partner or the holder of the Preferential Rights whilst any Preferred Security is outstanding, unless all the Holders and the General Partner have approved such resolution. Such approval shall not be required if the dissolution of ~~Halifax~~[HBOS](#) Euro Jersey is proposed or initiated because of the liquidation, dissolution or winding-up of ~~Halifax Group~~[HBOS](#) or the General Partner.
- 8.7 Any Preferred Security or any such other preferred security referred to in paragraph 8.2 outstanding at such time that is owned by ~~Halifax Group~~[HBOS](#), or any entity of which ~~Halifax Group~~[HBOS](#), either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests, shall not carry a right to vote in a meeting of Holders or at any meeting called to vote for the election of a Special Representative pursuant to paragraph 8.2 and shall, for voting purposes, be treated as if it were not outstanding other than in the case of paragraph 8.6 above.
- 8.8 The General Partner will cause a notice of any meeting at which Holders are entitled to vote and any other voting forms to be mailed to each Holder. Each such notice will include a statement setting forth (a) the date, time and place of such meeting, (b) a description of any resolution to be proposed for adoption at such meeting on which such Holders are entitled to vote and (c) instructions for the delivery of proxies.

9. **Covenant of the General Partner**

The General Partner will undertake not to incur any indebtedness in the name of ~~Halifax~~[HBOS](#) Euro Jersey other than costs and expenses incidental to maintaining the ~~registrar~~[Registrar](#) and paying and listing agents in respect of the Preferred Securities and the administration of ~~Halifax~~[HBOS](#) Euro Jersey.

10. **Notices**

All notices to the Holders will be mailed to the Holder of record and, so long as the Preferred Securities are listed on the [Luxembourg](#) Stock Exchange and the rules of the [Luxembourg](#) Stock Exchange so require, published in a leading Luxembourg daily newspaper which is expected to be the *Luxemburger Wort*.

11. **Transfers and Form**

The Preferred Securities ~~will be~~[are](#) in registered form. ~~On or about 9 December 1999, a~~[A](#) single certificate representing the Preferred Securities ~~will~~[has been](#) deposited with HSBC Bank plc (the "Common Depository") as common depository for Euroclear and ~~Cedelbank~~[Clearstream, Luxembourg](#). The Preferred Securities ~~will be~~[are](#) registered in the name of [HSBC Issuer Services Common Depository Nominee \(UK\) Limited \(formerly MSS \(Common Depository\) Nominees Limited.\)](#) as nominee for the Common Depository. For so long as the Preferred Securities are deposited and registered as described above, book-entry interests in the Preferred Securities will be shown on, and transfers of such interests will be effected only through, records maintained by Euroclear and ~~Cedelbank~~[Clearstream, Luxembourg](#).

If (a) either or both of Euroclear and [CedelbankClearstream, Luxembourg](#) is or are closed for business for a continuous period of 14 days or more (other than for the purposes of a public holiday) or announces an intention permanently to cease business or (b) as a result of a change in law, transfer duties or similar taxes become payable on transfers of the Preferred Securities in Euroclear and/or [CedelbankClearstream, Luxembourg](#), a number of Preferred Securities corresponding to its book-entry interest in the Preferred Securities represented by the certificate held by the Common Depositary referred to above will, subject to such reasonable requirements as the General Partner may require, be transferred to each holder of an interest in the Preferred Securities whose name is notified by a holder of such interest to [HalifaxHBOS](#) Euro Jersey, and each such holder will be registered as a Holder in the Register and receive a certificate made out in its name. Other than in the circumstances referred to in this paragraph, definitive certificates will not be available to Holders.

If definitive certificates are made available in respect of Preferred Securities they will be available from the Registrar and from the Paying and Transfer Agent ~~at its offices~~ in Luxembourg, and will be posted to the relevant Holders at the address shown in the Register or, as applicable, in the relevant instrument of transfer within three London Business Days of issue, by uninsured post at the risk of such Holders. Transfers of Preferred Securities if represented by definitive certificates may be effected by presentation of the relevant certificate (with the transfer certificate relating thereto duly completed on behalf of the transferor and transferee) at the specified office of the Registrar or ~~the~~[any](#) Paying and Transfer Agent. The Preferred Securities may only be transferred in a minimum amount of €50,000 and integral multiples of €1,000 thereafter. Where a Holder transfers some only of the Preferred Securities represented by any such certificate he shall be entitled to a certificate for the balance without charge.

12. Replacement of Certificates

If a certificate is damaged or defaced or alleged to have been lost, stolen or destroyed, a new certificate representing the same Preferred Securities may be issued on payment of such fee and on such terms (if any) as to evidence and indemnity and the payment of out-of-pocket expenses as the General Partner may think fit and on payment of the costs of the General Partner incidental to its investigation of the evidence and, if damaged or defaced, on delivery up of the old certificate at the office of the Paying and Transfer Agent in Luxembourg.

13. Prescription

Unclaimed Distributions, Optional Redemption Price, Capital Redemption Price and Liquidation Distributions will be prescribed after ten years in accordance with Jersey law.

14. Governing Law

The Limited Partnership Agreement [and the Preferred Securities](#) shall be governed by, and construed in accordance with, Jersey law, ~~however.~~ [However](#), determinations in respect of amounts of [Adjusted](#) Distributable [ProfitsReserves](#) shall be ~~made subject~~[construed with regard](#) to [HBOS \(where applicable\) in accordance with Scots law and with regard to Halifax Group plc \(where applicable\) in accordance with](#) English law.

Proposed Guarantee

The following are the terms of the Guarantee if the Proposals are approved and implemented (showing, in strikethrough text for ease of reference, the current provisions of the Halifax Guarantee that would be modified or deleted as a result of implementation of the Proposals and showing, in underlined text, the new provisions) and as such would constitute the terms of the Guarantee.

THIS DEED OF GUARANTEE (the “**Guarantee**”), dated ~~9-December-1999, [●]~~ on or about 31 May 2002, is executed and delivered by ~~HALIFAX GROUP PLC~~HBOS plc (“~~Halifax Group~~HBOS”), a company incorporated ~~under the laws of England~~in Scotland, for the benefit of the Holders (as defined below).

WHEREAS, ~~Halifax Group~~HBOS desires to issue this Guarantee for the benefit of the Holders, as provided herein.

NOW, THEREFORE ~~Halifax Group~~HBOS executes and delivers this Guarantee for the benefit of the Holders.

1 Definitions

As used in this Guarantee, capitalised terms not defined herein shall have the meaning ascribed to them in the Limited Partnership Agreement in respect to the Preferred Securities and otherwise the following terms shall, unless the context otherwise requires, have the following meanings:

“**Additional Amounts**” is as defined in clause 2.1.3;

“**Clearstream, Luxembourg**” means Clearstream Banking, société anonyme or its successor;

“**Euroclear**” means Euroclear Bank S.A./N.V. as operator of the Euroclear system or its successor;

“**Guarantee Payments**” means (without duplication) in respect of each Preferred Security payments by ~~Halifax Group~~HBOS under this Guarantee in respect of (a) any accrued but unpaid Distribution on any such Preferred Security for the most recent Distribution Period; (b) the Optional Redemption Price or the Capital Redemption Price, as the case may be, payable with respect to such Preferred Security where such Preferred Security is redeemed or due to be redeemed; (c) the Liquidation Distribution due with respect to any such Preferred Security on the Liquidation Date; and (d) any ~~Halifax~~HBOS Euro Jersey Additional Amounts (as defined in the Limited Partnership Agreement) payable by ~~Halifax~~HBOS Euro Jersey with respect to any such Preferred Security, in each case to the extent not paid by ~~Halifax~~HBOS Euro Jersey and subject to the exceptions contained in clause 2.1 hereof;

“**HalifaxHBOS Euro Jersey” means HBOS Euro Finance (Jersey) L.P., (formerly known as Halifax Group Euro Finance (Jersey) L.P.) a Jersey limited partnership registered on 8 December 1999, established under the Law, as it may from time to time be constituted but not being a legal entity separate from its partners;**

“**Holder**” means any holder from time to time of any Preferred Security save for as long as the Preferred Securities are registered in the name of a common depository ~~for Cedelbank and Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear System (“or a nominee for a common depository) for Euroclear”)~~ and Clearstream, Luxembourg, in which case each person who is for the time being shown in the records of Euroclear and ~~Cedelbank~~Clearstream, Luxembourg as the holder of any Preferred Securities (in which regard any certificate or other document issued by Euroclear or ~~Cedelbank~~Clearstream, Luxembourg as to the number of Preferred Securities standing to the account of any person shall be conclusive and

binding for all purposes) shall be treated as the Holder of such number of Preferred Securities for all purposes other than with respect to payments, the right to which shall be vested in the name of the person appearing as the relative limited partner in the register maintained on behalf of ~~Halifax~~HBOS Euro Jersey under the Law;

“**Limited Partnership Agreement**” means the Principal Limited Partnership Agreement ~~dated as supplemented and amended by the date hereof establishing Halifax Euro Jersey~~Supplemental Limited Partnership Agreement;

“**Liquidation Date**” means the date of final distribution of the assets of ~~Halifax~~HBOS Euro Jersey in the case of a dissolution of ~~Halifax~~HBOS Euro Jersey (whether voluntary or involuntary); ~~and~~

“**Preferred Securities**” means the €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities of ~~Halifax~~HBOS Euro Jersey from time to time, whether or not in issue on the date of this Guarantee, the Holders of which are entitled to the benefits of this Guarantee as evidenced by the execution of this Guarantee~~;~~

“Principal Limited Partnership Agreement” means the agreement dated 8 December 1999 establishing HBOS Euro Jersey; and

“Supplemental Limited Partnership Agreement” means the agreement dated on or about the date hereof supplementing and amending the Principal Limited Partnership Agreement.

2 Guarantee

2.1 Subject to the exceptions and limitations contained in the following provisions of this clause 2.1, ~~Halifax Group~~HBOS irrevocably agrees to pay in full to the Holders the Guarantee Payments, as and when due, regardless of any defence, right of set-off or counterclaim which ~~Halifax~~HBOS Euro Jersey may have or assert. This Guarantee is continuing, irrevocable and absolute.

2.1.1 Notwithstanding clause 2.1, ~~Halifax Group~~HBOS will not be obliged to make any Guarantee Payment in respect of Distributions and any ~~Halifax~~HBOS Euro Jersey Additional Amounts on any Preferred Securities:

(a) to the extent that such payment, together with the amount of any distributions or dividends paid or scheduled to be paid to holders of Parity Securities on the relevant Distribution Payment Date would exceed Adjusted Distributable Profits ~~on Reserves as at the Distribution Determination Date immediately preceding~~ such ~~date~~Distribution Payment Date; or

(b) even if Adjusted Distributable ProfitsReserves are sufficient, to the extent that such payment in respect of any Preferred Securities and/or Parity Securities would breach or cause a breach of the U.K. banking capital adequacy requirements then applicable to ~~Halifax Group~~HBOS on a consolidated basis.

2.1.2 Notwithstanding clause 2.1, if, at the time that any Liquidation Distributions are to be paid by ~~Halifax Group~~HBOS in respect of any Preferred Securities, proceedings are pending or have been commenced for the voluntary or involuntary liquidation, dissolution or winding-up of ~~Halifax Group~~HBOS other than pursuant to a Permitted Reorganisation, payment under this Guarantee of such Liquidation Distributions and payment by ~~Halifax Group~~HBOS in respect of liquidation distributions on any Parity Securities shall not exceed the amount per security that would have been

paid as a liquidation distribution out of the assets of ~~Halifax Group~~HBOS (after payment in full in accordance with ~~English~~Scots law of all creditors of ~~Halifax Group~~HBOS, including any holders of subordinated debt but excluding holders of any liability expressed to rank *pari passu* with or junior to this Guarantee) had the Preferred Securities and all such Parity Securities been the most senior class of preference shares in HBOS (whether or not HBOS could in fact have issued by ~~Halifax Group~~ such securities at such time) with equivalent rights of participation in the capital of ~~Halifax Group~~HBOS and ranked (a) junior to all liabilities of ~~Halifax Group~~HBOS including subordinated liabilities and for the avoidance of doubt all subordinated liabilities expressed to rank ahead on a winding-up of all shares of ~~Halifax Group~~HBOS (in each case other than any liability of ~~Halifax Group~~HBOS which constitutes Tier 1 Capital or which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to this Guarantee), (b) *pari passu* with ~~the most senior preference shares~~Parity Securities, if any, issued by ~~Halifax Group~~HBOS and any guarantee or support agreement of ~~Halifax Group~~HBOS ranking *pari passu* with this Guarantee and issued in respect of Parity Securities issued by HBOS Euro Jersey or any Subsidiary and (c) senior to Junior Share Capital.

2.1.3 All Guarantee Payments made hereunder in respect of the Preferred Securities will be made without withholding or deduction for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the U.K. or any political sub-division thereof or by any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event, ~~Halifax Group~~HBOS will pay such additional amounts (“Additional Amounts”) as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable in respect of the Preferred Securities in the absence of such withholding or deduction; except that no such Additional Amounts will be payable to a Holder (or a third party on his behalf) with respect to any Preferred Security to the extent that such taxes, duties, assessments or governmental charges are imposed or levied by virtue of such Holder (or the beneficial owner of such Preferred Security) (a) having some connection with the U.K., other than being a Holder (or beneficial owner) of such Preferred Security or (b) presenting ~~the~~ Preferred Security for payment in the U.K., and except that ~~Halifax Group~~HBOS’s obligation to pay any Additional Amounts is subject to the exceptions relating to Guarantee Payments set forth in clauses 2.1.1 and 2.1.2.

2.1.4 In the event that the amounts described in clauses 2.1 and 2.1.3 cannot be made in full by reason of either of the exceptions referred to in clause 2.1.1 or 2.1.2, such amounts will be payable *pro rata* in the ~~proportion that the amount available for payment bears to the full amount that would have been payable but for such exception~~Relevant Proportion and the obligations of ~~Halifax Group~~HBOS in respect of any such unpaid balance shall lapse.

The determination of any such limitation of ~~Halifax Group’s~~the obligations of HBOS under this Guarantee as set forth will be made on the relevant Distribution Determination Date, Optional Redemption Date, Capital Redemption Date or Liquidation Date, as the case may be.

- 2.2 ~~Halifax Group~~HBOS hereby waives notice of acceptance of this Guarantee and of any liability to which it applies or may apply, presentment, demand for payment, protest, notice of non-payment, notice of dishonour, notice of redemption and all other notices and demands.
- 2.3 The obligations, covenants, agreements and duties of ~~Halifax Group~~HBOS under this Guarantee shall in no way be affected or impaired by reason of the happening from time to time of any of the following:
- 2.3.1 the release or waiver, by operation of law or otherwise, of the performance or observance by ~~Halifax~~HBOS Euro Jersey of any express or implied agreement, covenant, term or condition relating to the Preferred Securities to be performed or observed by or on behalf of ~~Halifax~~HBOS Euro Jersey or ~~Halifax Group~~HBOS; or
 - 2.3.2 the extension of time for the payment by or on behalf of ~~Halifax~~HBOS Euro Jersey of all or any portion of the Distributions, Optional Redemption Price, Capital Redemption Price, Liquidation Distributions or any other sums payable under the terms of the Preferred Securities or the extension of time for the performance of any other obligation under, arising out of, or in connection with, the Preferred Securities; or
 - 2.3.3 any failure, omission, delay or lack of diligence on the part of Holders to enforce, assert or exercise any right, privilege, power or remedy conferred on the Holders pursuant to the terms of the Preferred Securities, or any action on the part of ~~Halifax~~HBOS Euro Jersey granting indulgence or extension of any kind; or
 - 2.3.4 the voluntary or involuntary liquidation, dissolution, amalgamation, reconstruction, sale of any collateral, receivership, insolvency, bankruptcy, assignment for the benefit of creditors, reorganisation, arrangement, composition or readjustment of debt of, or other similar proceedings affecting, ~~Halifax~~HBOS Euro Jersey or any of the assets of ~~Halifax~~HBOS Euro Jersey; or
 - 2.3.5 any invalidity of, or defect or deficiency in, the Preferred Securities; or
 - 2.3.6 the settlement or compromise of any obligation guaranteed hereby or hereby incurred.

There shall be no obligation on the Holders to give notice to, or obtain consent of, ~~Halifax Group~~HBOS with respect to the happening of any of the foregoing.

- 2.4 This Guarantee shall be deposited with and held by ~~HSBC Bank International Limited~~the Registrar until all the obligations of ~~Halifax Group~~HBOS have been discharged in full. ~~Halifax Group~~HBOS hereby acknowledges the right of every Holder to the production of, and the right of every Holder to obtain a copy of, this Guarantee from ~~HSBC Bank International Limited~~the Registrar.

A Holder may enforce this Guarantee directly against ~~Halifax Group~~HBOS, and ~~Halifax Group~~HBOS waives any right or remedy to require that any action be brought against ~~Halifax~~HBOS Euro Jersey or any other person or entity before proceeding against ~~Halifax Group~~HBOS. Subject to clause 2.5, all waivers contained in this Guarantee shall be without prejudice to the right to proceed against the assets of ~~Halifax~~HBOS Euro Jersey and the General Partner. ~~Halifax Group~~HBOS agrees that this Guarantee shall not be discharged except by payment of the Guarantee Payments in full and by complete performance of all obligations of ~~Halifax Group~~HBOS under this Guarantee.

- 2.5 ~~Halifax Group~~HBOS shall be subrogated to any and all rights of the Holders against the assets of ~~Halifax~~HBOS Euro Jersey in respect of any amounts paid to the Holders by ~~Halifax~~

~~Group~~HBOS under this Guarantee. ~~Halifax-Group~~HBOS shall not (except to the extent required by mandatory provisions of law) exercise any rights which it may acquire by way of subrogation or any indemnity, reimbursement or other agreement, in all cases as a result of a payment under this Guarantee, if, at the time of any such payment, any amounts are due and unpaid under this Guarantee. If ~~Halifax-Group~~HBOS shall receive or be paid any amount with respect to the Preferred Securities in violation of the preceding sentence, ~~Halifax-Group~~HBOS agrees to pay over such amount to the Holders.

- 2.6 ~~Halifax-Group~~HBOS acknowledges that its obligations hereunder are several and independent of the obligations of ~~Halifax~~HBOS Euro Jersey with respect to the Preferred Securities and that ~~Halifax-Group~~HBOS shall be liable as principal and sole debtor hereunder to make Guarantee Payments pursuant to the terms of this Guarantee, notwithstanding the occurrence of any event referred to in clause 2.3.
- 2.7 Subject to applicable law, ~~Halifax-Group~~HBOS agrees that ~~Halifax-Group~~HBOS's obligations hereunder constitute unsecured obligations of ~~Halifax-Group~~HBOS and rank and will at all times rank (a) junior to all liabilities of ~~Halifax-Group~~HBOS including subordinated liabilities, and for the avoidance of doubt all subordinated liabilities expressed to rank ahead on a winding-up of all shares of ~~Halifax-Group~~HBOS (in each case other than any liability of ~~Halifax-Group~~HBOS which constitutes Tier 1 Capital or which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to this Guarantee), (b) *pari passu* with ~~the most senior preference shares~~Parity Securities, if any, issued by ~~Halifax-Group~~HBOS and any guarantee or support agreement of ~~Halifax-Group~~HBOS ranking *pari passu* with this Guarantee and issued in respect of Parity Securities issued by HBOS Euro Jersey or any Subsidiary and (c) senior to Junior Share Capital.
- 2.8 Following a breach by HBOS of its payment obligations under this Guarantee, a Holder may petition for the winding-up of HBOS and claim in the liquidation of HBOS but no other remedy shall be available to the Holder.
- 2.9 No Holder shall, following any breach by HBOS of any of its obligations under this Guarantee, be entitled to exercise any right of set-off or counterclaim which may be available to it against amounts owing by HBOS to such Holder.

3 Undertakings

- 3.1 ~~Halifax-Group~~HBOS undertakes that it will not issue any preferred securities or preference shares ranking senior to its obligations under this Guarantee or enter into any support agreement or give any guarantee in respect of any preferred securities or preference shares or other securities issued by any Subsidiary if such support agreement or guarantee would rank senior to this Guarantee (including, without limitation, any guarantee that would provide a priority of payment with respect to Adjusted Distributable ~~Profits~~Reserves) unless, in each case, (a) this Guarantee is changed to give the Holders such rights and entitlements as are contained in or attached to such preferred securities or preference shares or other securities or such other support agreement or guarantee so that this Guarantee ranks *pari passu* with, and contains substantially equivalent rights of priority as to payment on, any such preferred or preference shares or other support agreement or guarantee and (b) the most recent payment of Distributions on the Preferred Securities has been made in full either by ~~Halifax~~HBOS Euro Jersey or by ~~Halifax-Group~~HBOS pursuant to this Guarantee.
- 3.2 ~~Halifax-Group~~HBOS undertakes that, in the event that Distributions have not been paid in full to Holders in accordance with the rights attaching to the Preferred Securities in accordance with the Limited Partnership Agreement, ~~Halifax-Group~~HBOS will not make or pay any

distribution or dividend and, where applicable, will procure that no such distribution or dividend is made or paid on any Parity Security (otherwise than partial *pro rata* payments made in circumstances where ~~payments~~payment of Relevant Proportions are made pursuant to the Limited Partnership Agreement) or Junior Share Capital until such time as payment in full of Distributions has resumed.

- 3.3 ~~Halifax Group~~HBOS undertakes that any amount required to be paid pursuant to this Guarantee in respect of the most recent Distribution will be paid prior to any payment or other distribution upon Junior Share Capital.

~~Halifax Group~~HBOS also undertakes that Junior Share Capital will not be redeemed, repurchased or otherwise acquired for any consideration (or any moneys be paid to or made available for a sinking fund for the redemption of any such shares) by ~~Halifax Group~~HBOS or any Subsidiary (except by conversion into or in exchange for other Junior Share Capital), at any time whilst ~~Halifax~~HBOS Euro Jersey is unable to pay Distributions in full until such time as ~~Halifax~~HBOS Euro Jersey or ~~Halifax Group~~HBOS pursuant to this Guarantee shall have resumed the payment of, or set aside amounts sufficient to pay, full Distributions on all outstanding Preferred Securities.

- 3.4 ~~Halifax Group~~HBOS undertakes that, so long as any of the Preferred Securities is outstanding (a) unless ~~Halifax Group~~HBOS is itself in liquidation, ~~Halifax Group~~HBOS will not permit, or take any action to cause, the liquidation, dissolution or winding-up of the General Partner or ~~Halifax~~HBOS Euro Jersey otherwise than with the prior written approval of the FSA (if then required) and (b) the General Partner will at all times be a directly or indirectly wholly owned subsidiary of ~~Halifax Group~~HBOS with sufficient funds to meet the expenses incurred by the General Partner under the Limited Partnership Agreement, and in the case of (a) or (b) otherwise than with the prior approval of all Holders. Notwithstanding the foregoing, in the event that the Guarantor is unable, having taken all reasonable steps, to prevent the liquidation, dissolution or winding-up of the General Partner it will take all reasonable steps to elect a new General Partner in accordance with the Law and the terms of the Limited Partnership Agreement.

- 3.5 ~~Halifax Group~~HBOS undertakes to take all reasonable steps to ensure that (a), with effect from the date of its annual general meeting to be held in ~~2000,2003~~, it will have a sufficient number of authorised but unissued preference shares at any time to permit the substitution of preference shares for all outstanding Preferred Securities at that time and (b) ~~that~~ all corporate authorisations have been taken for the allotment and issue of the same free from pre-emptive rights. ~~Halifax Group~~HBOS further undertakes that (i), to the extent it is legally able to do so at the relevant time, it will allot and issue and deliver such preference shares in satisfaction of the rights of the Holders in the circumstances described in the Limited Partnership Agreement, such preference shares having the rights and being subject to the conditions set out in the Limited Partnership Agreement which will rank for dividends from the immediately preceding Distribution Payment Date, (ii) it will take all reasonable steps to procure that such preference shares will at the relevant time be listed on a recognised stock exchange and (iii) it will pay any taxes or capital duties or stamp duties payable in the U.K. or Jersey arising on the allotment and issue of such preference shares other than to Restricted Persons. ~~Halifax Group~~HBOS undertakes that upon the occurrence of a Regulatory Event or an Involuntary Dissolution it will give notice to Holders of such event, enclosing a Substitution Confirmation, as described in the Limited Partnership Agreement.

- 3.6 Neither ~~Halifax Group~~HBOS nor any other member of the Group will make any payment to Holders, or procure such a payment, that could not lawfully have been made if Holders had

held the most senior preference shares of ~~Halifax Group~~HBOS (if any, and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.

- 3.7 ~~Halifax Group~~HBOS undertakes that it will procure that the General Partner will maintain at all times whilst the Preferred Securities are outstanding (a) a Paying and Transfer Agent outside the U.K. and (b) whilst the Preferred Securities are listed on the Luxembourg Stock Exchange, a Paying and Transfer Agent in Luxembourg. ~~Halifax Group~~HBOS undertakes that it will procure that the General Partner will, if circumstances arise where the General Partner or ~~Halifax Group~~HBOS is able, by the appointment of a Paying and Transfer Agent having a specified office in mainland Europe in a country which is not a member of the European Community, to avoid the obligation to pay ~~Halifax~~HBOS Euro Jersey Additional Amounts or Additional Amounts, as the case may be, to Holders, appoint such a Paying and Transfer Agent.

4 Termination

With respect to the Preferred Securities, this Guarantee shall terminate and be of no further force and effect upon payment of the Optional Redemption Price or Capital Redemption Price, as the case may be, on, or purchase and cancellation of, all Preferred Securities or full payment of the Liquidation Distribution and liquidation of ~~Halifax~~HBOS Euro Jersey, provided however that this Guarantee will continue to be effective or will be reinstated, as the case may be, if at any time payment of any sums paid in respect of the Preferred Securities or under this Guarantee must be restored by a Holder for any reason whatsoever.

5 Transfer; Amendment; Notices

- 5.1 Subject to operation of law, all guarantees and agreements contained in this Guarantee shall bind the successors, assigns, receivers, trustees and representatives of ~~Halifax Group~~HBOS and shall inure to the benefit of the Holders. ~~Halifax Group~~HBOS shall not transfer its obligations hereunder without the prior approval of the Holders of not less than two-thirds of outstanding Preferred Securities (excluding any Preferred Securities held by ~~Halifax Group~~HBOS or any entity of which ~~Halifax Group~~HBOS, either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests), which approval shall be obtained in accordance with procedures contained in the Limited Partnership Agreement and applicable law of Jersey.
- 5.2 Except for those changes (a) required by clause 3.1 hereof; or (b) which do not adversely affect the rights of Holders (in any of which cases no agreement will be required), this Guarantee shall be changed only by agreement in writing signed by ~~Halifax Group~~HBOS with the prior approval of the Holders of not less than two-thirds of outstanding Preferred Securities (excluding any Preferred Securities held by ~~Halifax Group~~HBOS or any entity of which ~~Halifax Group~~HBOS, either directly or indirectly, owns 20 per cent. or more of the voting shares or other similar ownership interests), which approval shall be obtained in accordance with the procedures contained in the Limited Partnership Agreement and applicable law of Jersey.
- 5.3 Any notice, request or other communication required or permitted to be given hereunder to ~~Halifax Group~~HBOS shall be given in writing by delivering the same against receipt therefor or be addressed to ~~Halifax Group~~HBOS, as follows, to:

~~Halifax Group~~HBOS plc
TrinityThe RoadMound
HalifaxEdinburgh
West Yorkshire

~~HXEH1 2RG1YZ~~

Attn: Company Secretary's Department

Tel: ~~01422 333 179/333 394~~0131 442 7777

Fax: ~~01422 332 765~~0131 243 5516

with a copy to:

~~Halifax plc~~

~~Group Treasury~~

~~33 Old Broad Street~~

~~London EC2N 1HQ~~

~~Attn: Treasury Legal Services~~

~~Fax: 0171 574 8133~~

The address of ~~Halifax Group~~HBOS may be changed at any time and from time to time and shall be the most recent such address furnished in writing by ~~Halifax Group~~HBOS to ~~HSBC Bank International Limited as registrar~~the Registrar for the Preferred Securities.

Any notice, request or other communication required or permitted to be given hereunder to the Holders shall be given by ~~Halifax Group~~HBOS in the same manner as notices sent on behalf of ~~Halifax~~HBOS Euro Jersey to Holders.

- 5.4 This Guarantee is solely for the benefit of the Holders and is not separately transferable from their interests in respect of the Preferred Securities.
- 5.5 ~~Halifax Group~~HBOS will furnish any Holder, upon request of such Holder, with a copy of its annual report, and any interim reports made generally available by ~~Halifax Group~~HBOS to holders of the ordinary shares of ~~Halifax Group~~HBOS.

6 Governing Law

This Guarantee shall be governed by, and construed in accordance with, English law.

IN WITNESS WHEREOF this Guarantee has been executed as a deed poll on behalf of ~~Halifax Group~~HBOS.

~~The Common Seal of~~

~~HALIFAX GROUP PLC~~

~~was affixed to this deed in the presence of:~~

Executed as a deed by

HBOS plc

Acting by:

~~J. A. LEE~~ _____ ~~A. H. HORNBY~~

Director :

Director/Company Secretary:

Proposed Supplemental Limited Partnership Agreement

The following are the terms of the Supplemental Limited Partnership Agreement which would be executed if the Proposals are approved and implemented. Scheduled to the Supplemental Limited Partnership Agreement are the terms of the Preferred Securities if the Proposals are approved and implemented and as such would constitute the terms of the Preferred Securities in conjunction with and subject to the terms of the Limited Partnership Agreement, as amended.

THIS SUPPLEMENTAL LIMITED PARTNERSHIP AGREEMENT is made on or about 31 May 2002

BETWEEN:

1. HBOS Management (Jersey) Limited (formerly known as Halifax Group Management (Jersey) Limited), a company incorporated in Jersey with registered number 75730 whose registered office is at 22 Grenville Street, St Helier, Jersey, JE4 8PX (the "**General Partner**");
2. Halifax plc, a company incorporated in England with registered number 2367076 whose registered office is at Trinity Road, Halifax, West Yorkshire, HX1 2RG (the "**Parent Limited Partner**"); and
3. HSBC Issuer Services Common Depositary Nominee (UK) Limited (formerly known as MSS (Common Depositary) Nominees Limited) (acting as common depositary) whose registered office is at 10 Lower Thames Street, London EC3R 6AE (the "**Initial Limited Partner**").

WHEREAS:

- (A) The parties to this Agreement entered into a limited partnership agreement dated 8 December 1999 (the "**Limited Partnership Agreement**") establishing a limited partnership under Jersey law under the name of Halifax Group Euro Finance (Jersey) L.P. (the "**Limited Partnership**");
- (B) the parties to this supplemental limited partnership agreement (the "**Supplemental Limited Partnership Agreement**") wish to make certain amendments to the Limited Partnership Agreement as more particularly described herein; and
- (C) this Supplemental Limited Partnership Agreement records the consent in writing of the Initial Limited Partner (as the Holder of at least two-thirds of the outstanding Preferred Securities) to the amendments to the Limited Partnership Agreement contained in this Supplemental Limited Partnership Agreement in accordance with paragraph 8.3 of Schedule 3 of the Limited Partnership Agreement. In connection with its execution of this Supplemental Limited Partnership Agreement, the Initial Limited Partner has obtained the consent of at least two-thirds of the Holders (as defined in the Guarantee) of the Preferred Securities to the amendments to the Limited Partnership Agreement contained in this Supplemental Limited Partnership Agreement and the authority of such Holders (as defined in the Guarantee) to execute this Supplemental Limited Partnership Agreement to give effect to the amendments to the Limited Partnership Agreement contained herein.

NOW IT IS HEREBY AGREED as follows:

1. Interpretation

Capitalised terms appearing herein and not otherwise defined in this Supplemental Limited Partnership Agreement shall have the meanings ascribed to them in the Limited Partnership Agreement.

2. Amendments

2.1 The Limited Partnership Agreement is hereby amended as of the date hereof as follows:

- (a) all references therein to "Halifax Group Euro Finance (Jersey) L.P." other than in the recital thereof are replaced with the words "HBOS Euro Finance (Jersey) L.P." and all references to "Halifax Group" are replaced with the words "HBOS" and all references to "Halifax Euro Jersey" are replaced with the words "HBOS Euro Jersey";
- (b) Clause 1.2 of the Limited Partnership Agreement is amended by the insertion of the following sub-paragraph (e): "a reference to the General Partner, the Parent Limited Partner, the Initial Limited Partner or any Holder shall include their respective successors and assigns to the extent permitted hereunder" and the consecutive re-numbering of the sub-paragraphs of that Clause 1.2 following immediately thereafter;
- (c) all references therein to "Halifax Group Management (Jersey) Limited" are replaced with the words "HBOS Management (Jersey) Limited" other than in paragraph 1 of the parties clause and the execution clause thereof in which such reference is replaced with "HBOS Management (Jersey) Limited (formerly Halifax Group Management (Jersey) Limited)";
- (d) all references therein to "Distributable Profits" are replaced with the words "Adjusted Distributable Reserves";
- (e) all references therein to "Cedelbank" are amended to read "Clearstream, Luxembourg";
- (f) all references therein to "Morgan Guaranty Trust Company of New York (Brussels office)" are replaced with the words "Euroclear Bank S.A./N.V.";
- (g) all references therein to "MSS (Common Depository) Nominees Limited" are replaced with the words "HSBC Issuer Services Common Depository Nominee (UK) Limited";
- (h) the definition of "Offering Circular" in Clause 1.1 of the Limited Partnership Agreement is amended to read "means the offering circular dated 8 December 1999 and the explanatory memorandum dated 16 April 2002 setting out information in relation to the Preferred Securities";
- (i) in Schedule 2 to the Limited Partnership Agreement, the words "as supplemented by a Supplemental Limited Partnership Agreement dated on or about 31 May 2002" are inserted immediately after the words "establishing Halifax Euro Jersey"; and
- (j) Schedule 3 to the Limited Partnership Agreement is amended as set out in the Schedule hereto (with the amendments thereto blacklined only in this Agreement for ease of reference).

2.2 The Initial Limited Partner hereby records its consent to the amendments set out in Clause 2.1 hereof for the purposes of paragraph 8.3 of Schedule 3 to the Limited Partnership Agreement.

3. Further Assurances

3.1 Each party agrees to do all things and execute all further documents necessary to give full effect to this Supplemental Limited Partnership Agreement.

4. Counterparts

4.1 This Supplemental Limited Partnership Agreement may be executed by the parties hereto in separate counterparts, each of which when executed and delivered shall constitute an original, but which shall together constitute one and the same instrument.

5. Governing Law

5.1 This Supplemental Limited Partnership Agreement is governed by and shall be construed in accordance with the laws of Jersey.

5.2 Each of the parties hereto irrevocably submits to the non-exclusive jurisdiction of the courts of Jersey in connection herewith.

SCHEDULE

Schedule 3 The Preferred Securities

1. Definitions

In this Schedule 3, except to the extent that the context otherwise requires:

“Adjusted Distributable Reserves” means, at any time, the lawful distributable reserves of HBOS at such time less the cumulative amount in relation to Halifax Group plc for the period from 9 December 1999 until 10 September 2001 and in relation to HBOS since 10 September 2001 of all redemptions of and payments on (a) any preference shares or other obligations of Halifax Group plc or HBOS (as the case may be) that are accounted for under the then generally accepted accounting practice in the U.K. as shareholders’ funds in the accounts of Halifax Group plc or HBOS (as the case may be) and (b) all securities or other obligations of an undertaking which are accounted for under the then generally accepted accounting practice in the U.K. as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or otherwise) to, Halifax Group plc or HBOS (as the case may be) that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Securities, except in each case for such amounts as have been either charged to the lawful distributable reserves of Halifax Group plc or HBOS (as the case may be) or funded at that time by an issue of Replacement Capital made for the purposes of funding a redemption;

“Agent Bank” means HSBC Bank plc or its successor;

“Calculation Agent” means Citibank, N.A. or its successor;

“Capital Redemption Date” means any date designated for optional redemption of the Preferred Securities as described under paragraph 4.4 below;

“Capital Redemption Price” means, in respect of each Preferred Security, the higher of (a) the liquidation preference of €1,000 per Preferred Security and (b) the price, expressed as a percentage (rounded to three decimal places, 0.0005 being rounded upwards), at which the gross redemption yield (as calculated by the Calculation Agent) on the Preferred Securities, if they were to be purchased at such price on the third dealing day prior to the date fixed for redemption, would be equal to the gross redemption yield on such dealing day of the Reference Bond plus 0.5 per cent., on the basis of the middle market price of the Reference Bond prevailing at 11.00 a.m. (Central European time) on such dealing day as determined by the Calculation Agent, plus any due and accrued but unpaid Distribution calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, 9 December 1999) to (but excluding) the relevant Capital Redemption Date and any HBOS Euro Jersey Additional Amounts payable thereon;

“Clearstream, Luxembourg” means Clearstream Banking, société anonyme or its successor;

“Determination Date”, in relation to a Distribution Calculation Period, means the second TARGET Business Day prior to 9 December 2011 and every 9 March, 9 June, 9 September and 9 December in each year thereafter;

“Distributions” means the non-cumulative distributions in respect of the Preferred Securities as described under paragraph 2 below;

“Distribution Calculation Period” means each Distribution Period from and including the Distribution Period beginning on (and including) the Distribution Re-Set Date;

“Distribution Calculation Period Date” means 9 December 2011 and every 9 March, 9 June, 9 September and 9 December in each year thereafter;

“Distribution Determination Date” means the day ten London Business Days prior to each Distribution Payment Date on which HBOS will determine whether sufficient Adjusted Distributable Reserves exist to allow a payment of some or all of the relevant Distribution;

“Distribution Payment Date” means 9 December in each year up to and including the Distribution Re-Set Date and thereafter every 9 March, 9 June, 9 September and 9 December in each year, commencing on 9 December 2000;

“Distribution Period” means the period from (and including) 9 December 1999 to (but excluding) the first Distribution Payment Date and each period thereafter from (and including) one Distribution Payment Date to (but excluding) the next following Distribution Payment Date;

“Distribution Re-Set Date” means the Distribution Payment Date falling on 9 December 2011;

“euro” and “€” mean the currency introduced at the start of the third stage of European and Economic Monetary Union pursuant to the Treaty and the smallest subdivision of which shall be one hundredth of a euro or “cent”;

“Euro-zone” means the region comprised of member states of the European Union that adopt the single currency in accordance with the Treaty;

“Euroclear” means Euroclear Bank S.A./N.V. as operator of the Euroclear system or its successor;

“Existing Preference Shares” means the 300,000,000 9¼% and 100,000,000 9¾% Non-cumulative Irredeemable Preference Shares of £1 each in the capital of HBOS in issue at the date hereof and in each case any further preference shares required to be issued pursuant to the terms of such aforementioned preference shares;

“Fixed Distribution Rate” means, in respect of the period from (and including) 9 December 1999 to (but excluding) 9 December 2011, 7.627 per cent. per annum;

“Floating Distribution Rate” means, in respect of a Distribution Calculation Period, the percentage rate of three-month EURIBOR plus 2.875 per cent. per annum calculated in the manner described in paragraph 2.3 below;

“FSA” means the Financial Services Authority in the U.K. and shall include any successor organisation responsible for the supervision of banks in the U.K.;

“General Partner” means HBOS Management (Jersey) Limited (formerly known as Halifax Group Management (Jersey) Limited), a Jersey incorporated directly or indirectly wholly owned subsidiary of HBOS;

“Group” means HBOS together with its Subsidiaries;

“Guarantee” means the subordinated guarantee in respect of the Preferred Securities to be executed by HBOS on or about 31 May 2002 as a deed poll;

“HBOS” means HBOS plc, a limited liability company incorporated in Scotland under the Companies Act 1985, and its successors and assigns;

“HBOS Euro Jersey” means HBOS Euro Finance (Jersey) L.P. (formerly known as Halifax Group Euro Finance (Jersey) L.P.), a Jersey limited partnership registered on 8 December 1999 under the name Halifax Group Euro Finance (Jersey) L.P., established under the Law, as it may from time to time be constituted but not being a legal entity separate from its partners;

“HBOS Euro Jersey Additional Amounts” means the additional amounts which may be payable in respect of the Preferred Securities as described under paragraph 6;

“Holder” means, in respect of each Preferred Security, each person registered on the Register as the limited partner holding such Preferred Security at the relevant time;

“Involuntary Dissolution” means, in respect of HBOS Euro Jersey, a dissolution by court order pursuant to the Law;

“Jersey” means the Island of Jersey;

“Jersey Tax” means any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of Jersey or by any authority therein or thereof having power to tax;

“Junior Share Capital” means the ordinary shares of HBOS, together with any other securities or obligations expressed to rank junior to the most senior preferred securities or preference shares of HBOS whether issued directly by HBOS or by a Subsidiary benefiting from a guarantee or support agreement from HBOS expressed to rank junior to the Guarantee;

“Law” means the Limited Partnerships (Jersey) Law 1994;

“Limited Partnership Agreement” means an agreement dated 8 December 1999 between the General Partner, the Parent Limited Partner and the initial limited partner establishing Halifax Group Euro Finance (Jersey) L.P. (being subsequently renamed HBOS Euro Finance (Jersey) L.P.) as supplemented by a supplemental limited partnership agreement between the same parties on or about 31 May 2002;

“Liquidation Distribution” means a liquidation preference of €1,000 per Preferred Security plus (a) any due and accrued but unpaid Distribution calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, 9 December 1999), to (but excluding) the date of payment and (b) any HBOS Euro Jersey Additional Amounts, in each case in cash only;

“London Business Day” means a day other than a Saturday or Sunday on which banks are open for business in London;

“Notes” means the cumulative €415,000,000 Fixed to Floating Rate Subordinated Extendable Maturity Notes 2048 (or such other aggregate amount thereof as may be outstanding from time to time) of HBOS or any successor securities issued with the prior written consent of the FSA (if then required);

“Office” means the registered office of HBOS Euro Jersey for the time being in accordance with the Limited Partnership Agreement;

“Optional Redemption Date” means (a) in the case of optional redemption pursuant to paragraph 4.2, any Distribution Calculation Period Date or (b), prior to 9 December 2011, any date, and thereafter

any Distribution Payment Date, designated for redemption for tax reasons of the Preferred Securities as described under paragraph 4.3;

“Optional Redemption Price” means €1,000 per Preferred Security plus (a) any due and accrued but unpaid Distribution calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, 9 December 1999) to (but excluding) the relevant Optional Payment Date and (b) any HBOS Euro Jersey Additional Amounts payable thereon;

“Parent Limited Partner” means Halifax plc or any other holder of the Preferential Rights from time to time;

“Parity Securities” means any preference shares (including the Existing Preference Shares), preferred securities (other than the Preferred Securities) or other securities either (a) issued directly by HBOS (and ranking *pari passu* with HBOS’s obligations under the Guarantee) or (b) issued by HBOS Euro Jersey or any Subsidiary (and entitled to the benefit of the Guarantee or any other guarantee or support agreement ranking *pari passu* with the Guarantee);

“Paying and Transfer Agents” means Citibank, N.A. and Dexia Banque Internationale à Luxembourg S.A. or such other entities as are appointed by the General Partner on behalf of HBOS Euro Jersey and notified to the Holders as described under paragraph 10;

“Permitted Reorganisation” means a solvent reconstruction, amalgamation, reorganisation, merger or consolidation with the prior approval of the Holders of not less than two-thirds of outstanding Preferred Securities whereby all or substantially all the business, undertaking and assets of HBOS are transferred to a successor entity, which assumes all the obligations under the Guarantee;

“Preferential Rights” means the limited partnership interests in HBOS Euro Jersey held by the Parent Limited Partner and entitling the holder thereof to receive in preference to the rights of Holders all amounts received by HBOS Euro Jersey in excess of those required to make payments in respect of the Preferred Securities by reason of the provisions of paragraphs 2.4, 2.6, 3.1 or 4.5 other than any amounts to be used by the General Partner in subscribing for Substituted Preference Shares in accordance with paragraph 5 or in relation to the acquisition of redeemable preference shares as referred to in paragraph 4.5;

“Preferred Capital Contribution” means, in relation to the Preferred Securities, the aggregate contribution to the assets of HBOS Euro Jersey (being a whole multiple of €1,000) paid in cash by the Holders;

“Preferred Security” means an interest of a Holder in HBOS Euro Jersey attributable to each €1,000 of the Preferred Capital Contribution;

“Reference Bond” means, in relation to any Capital Redemption Price calculation, the $5\frac{3}{8}$ per cent. Bundesobligationen due January 2010, or if such bond is no longer in issue, such other European government bond as the Calculation Agent may, with the advice of the Reference Dealers, decide to be appropriate;

“Reference Dealer” means three brokers of, and/or market makers in, European government bonds selected by the Calculation Agent;

“Register” means the register of Holders maintained outside the U.K. on behalf of HBOS Euro Jersey under the Law;

“Registrar” means HSBC Bank International Limited or such other entity appointed by HBOS Euro Jersey having its office outside the U.K. and notified to the Holders as described under paragraph 10;

“Regulatory Event” means HBOS’s total capital ratio declines below any minimum requirement then prescribed by the FSA for all banks in the U.K.;

“Relevant Proportion” means (a), in relation to any partial payment of a Distribution on a Preferred Security, the amount of Adjusted Distributable Reserves as determined in accordance with paragraph 2.8 on the Distribution Determination Date divided by the sum of (i) the amount originally scheduled to be paid by way of Distributions on the Preferred Securities on the relevant Distribution Payment Date and (ii) the amount of any distributions or dividends originally scheduled to be payable to holders of Parity Securities on the relevant Distribution Payment Date, converted where necessary into the same currency in which Adjusted Distributable Reserves are reported by HBOS and (b), in relation to any partial payment of any Liquidation Distribution on a Preferred Security, the amount available for any such payment and for making any corresponding payment of a liquidation distribution or its equivalent on any Parity Securities divided by the sum of (i) the full Liquidation Distributions before any reduction or abatement in respect of the Preferred Securities and (ii) the amount of the full liquidation distribution before any reduction or abatement in respect of any Parity Securities, converted where necessary into the same currency in which liquidation payments are made to creditors of HBOS;

“Replacement Capital” means shares or other securities issued by HBOS or shares or other securities issued by a Subsidiary which would, under the then generally accepted accounting practice in the U.K., qualify as at the date thereof, for treatment as a minority interest or shareholders’ funds in HBOS’s accounts;

“Restricted Person” means a person to whom Substituted Preference Shares will not be available for issue being (a) Euroclear, Clearstream, Luxembourg, First Chicago Clearing Center or any other person providing a clearance service within Section 96 of the Finance Act 1986 of the U.K. or any nominee thereof or (b) a person, or nominee or agent for a person, whose business is or includes issuing depository receipts within Section 93 of the Finance Act 1986 of the U.K., in each case at any time prior to the “abolition day” as defined in Section 111(1) of the Finance Act 1990 of the U.K.;

“Special Representative” means the representative of the Holders as described under paragraph 8;

“Stock Exchange” means the Luxembourg Stock Exchange or such other stock exchange approved by the General Partner on which the Preferred Securities (or any Substituted Preference Shares) may be listed from time to time;

“Subsidiary” means any entity which is for the time being a subsidiary undertaking of HBOS (within the meaning of the Companies Acts 1985 and 1989);

“Substituted Preference Shares” means the preference shares issued by HBOS in substitution for the Preferred Securities and the Guarantee as described under paragraph 5;

“TARGET” means the Trans European Real-Time Gross Settlement Express Transfer (TARGET) System;

“TARGET Business Day” means a day on which TARGET is operating;

“Tax Event” means (a) any amendment to, or change (including any announced prospective change) in, the laws (or any regulations thereunder) of Jersey or the U.K. or any political sub-division or

taxing authority of Jersey or the U.K., (b) any amendment to, or change in, an interpretation or application of any such laws or regulations by any legislative body, court, governmental agency or regulatory authority (including the enactment of any legislation, any judicial decision or any regulatory determination), (c) any interpretation or pronouncement by any relevant tax authority that provides for a position with respect to such laws or regulations that differs from the theretofore generally accepted position in relation to similar transactions or (d) any action taken by any governmental agency or regulatory authority, which amendment or change is enacted, promulgated, issued or effective or which interpretation or pronouncement is issued or announced or which action is taken, in each case on or after 9 December 1999, and as a result of which there is more than an insubstantial risk that (i) HBOS will not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes or (ii) HBOS Euro Jersey will be liable to U.K. tax on its profits or HBOS, HBOS Euro Jersey or the General Partner shall become liable to account for tax in respect of all or any part of the profits of HBOS Euro Jersey which are distributed to a Holder or (iii) to the extent that the Notes are owned by HBOS Euro Jersey, HBOS is or would be required to withhold or deduct tax in respect of interest payments made in respect of or in connection with such Notes;

“Tier 1 Capital” has the meaning ascribed to it in the FSA’s Interim Prudential Sourcebook: Banks or any successor publication replacing such sourcebook;

“Treaty” means the Treaty establishing the European Community, as amended from time to time; and

“U.K.” means the United Kingdom of Great Britain and Northern Ireland.

2. Distributions

- 2.1 Subject as provided by the Law and in paragraphs 2.4 and 2.8, non-cumulative distributions (“Distributions”) on the Preferred Securities will accrue from 9 December 1999 and shall be payable annually in arrear on each Distribution Payment Date up to, and including, the Distribution Re-Set Date and thereafter quarterly in arrear on each Distribution Payment Date. Distributions will be calculated in accordance with the Fixed Distribution Rate in respect of Distribution Payment Dates up to (and including) the Distribution Re-Set Date and thereafter in accordance with the Floating Distribution Rate, in the manner described in paragraphs 2.2 and 2.3, respectively. On the Distribution Re-Set Date and every quarter thereafter, the General Partner will, so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, notify the Luxembourg Stock Exchange of the Distribution Rate.
- 2.2 Subject to the Law and paragraph 2.4, the Distributions payable on any Distribution Payment Date up to (and including) the Distribution Re-Set Date will be payable at the Fixed Distribution Rate on the amount of the liquidation preference of €1,000 per Preferred Security. The amount of Distribution payable for any period of less than one year ending prior to the Distribution Re-Set Date will be calculated on the basis of the actual number of days elapsed divided by the actual number of days in the relevant Distribution Period.
- 2.3 Subject to the Law and paragraph 2.4, the Distributions in respect of each Distribution Calculation Period will be payable quarterly in arrear on the relevant Distribution Payment Date at the Floating Distribution Rate on the amount of the liquidation preference of €1,000 per Preferred Security. If any Distribution Payment Date after the Distribution Re-Set Date would otherwise fall on a day which is not a TARGET Business Day, it shall be postponed to the next day which is a TARGET Business Day. The amount of Distribution payable for each Distribution Calculation Period and for any period less than a Distribution Calculation Period beginning on or after the Distribution Re-Set Date will be calculated on the basis of the actual number of days

elapsed divided by 360 and rounding the resultant figure to the nearest cent (half a cent being rounded upwards).

2.3.1 The Floating Distribution Rate from time to time in respect of the Preferred Securities will be determined for each Distribution Calculation Period in accordance with the following provisions:

- (a) On the Determination Date the Agent Bank will record the offered rate (expressed as a rate per annum) for three-month euro deposits (notwithstanding that such Distribution Calculation Period happens to fall short of or exceed three months) as at 11.00 a.m. (Central European time) on such Determination Date, as displayed on the display designated as page "248" on the Bridge/Telerate Monitor (or such other page or pages as may replace it for the purpose of displaying such information). The Floating Distribution Rate for such Distribution Calculation Period shall be such offered rate as determined by the Agent Bank, plus 2.875 per cent.;
- (b) If such offered rate does not so appear, or if the relevant page is unavailable, the Agent Bank will, on such date, request the principal Euro-zone office of four major banks in the Euro-zone interbank market (the "Reference Banks") to provide the Agent Bank with its offered quotation to leading banks in the Euro-zone inter bank market for three-month euro deposits as at 11.00 a.m. (Central European time) on the Determination Date in question. If at least two of the Reference Banks provide the Agent Bank with such offered quotations, the Floating Distribution Rate for such Distribution Calculation Period shall be the rate determined by the Agent Bank to be the arithmetic mean (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of such offered quotations plus 2.875 per cent.;
- (c) If on any Determination Date to which the provisions of sub-paragraph (b) above apply, one only or none of the Reference Banks provides the Agent Bank with such a quotation, the Floating Distribution Rate for that Distribution Calculation Period shall be the rate which the Agent Bank determines to be the aggregate of 2.875 per cent. and the arithmetic mean (rounded, if necessary, up to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of the euro lending rates which leading banks in the Euro-zone selected by the Agent Bank are quoting, on the relevant Determination Date, to leading European banks for a period of three months, except that, if the banks so selected by the Agent Bank are not quoting as mentioned above, the Floating Distribution Rate shall be either (i) the Floating Distribution Rate in effect for the last preceding Distribution Calculation Period to which one of the preceding sub-paragraphs of this paragraph shall have applied or (ii) if none, the Fixed Distribution Rate;

2.3.2 HBOS Euro Jersey shall cause notice of the Floating Distribution Rate determined in accordance with this paragraph 2.3 to be given to the Holders in accordance with paragraph 10 as soon as practicable after its determination but in any event not later than the fourth business day thereafter.

2.3.3 HBOS Euro Jersey may from time to time replace the Agent Bank by another leading investment, merchant or commercial bank. If the appointed office of the Agent Bank is

unable or unwilling to continue to act as the Agent Bank or (without prejudice to paragraph 2.3.2) failed duly to determine the Floating Distribution Rate in respect of any Distribution Calculation Period as provided in paragraph 2.3, HBOS Euro Jersey shall forthwith appoint another leading investment, merchant or commercial bank to act as such in its place. The Agent Bank may not resign its duties or be removed without a successor having been appointed as aforesaid.

- 2.3.4 All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this paragraph 2.3 by the Agent Bank shall (in the absence of wilful default, bad faith or manifest error) be binding on HBOS Euro Jersey, HBOS, the Agent Bank and all Holders and (in the absence as aforesaid) no liability to the Holders, HBOS or HBOS Euro Jersey shall attach to the Agent Bank in connection with the exercise or non-exercise by it of its powers, duties and discretions.
- 2.4 Distributions on the Preferred Securities will be non-cumulative and will accrue on a day by day basis. Distributions on the Preferred Securities will be payable out of HBOS Euro Jersey's own legally available resources on each Distribution Payment Date. Notwithstanding the existence of resources legally available for distribution by HBOS Euro Jersey, neither HBOS Euro Jersey nor HBOS will pay any Distributions or make any payment in respect of Distributions (including any HBOS Euro Jersey Additional Amounts) under the Preferred Securities:
- 2.4.1 to the extent that such payment, together with the amount of any distributions or dividends paid or scheduled to be paid to holders of Parity Securities on the relevant Distribution Payment Date would exceed Adjusted Distributable Reserves as at the Distribution Determination Date immediately preceding such Distribution Payment Date; or
- 2.4.2 even if Adjusted Distributable Reserves are sufficient, to the extent that such payment in respect of the Preferred Securities and/or Parity Securities would breach or cause a breach of the U.K. banking capital adequacy requirements then applicable to HBOS on a consolidated basis,
- in each case as notified by HBOS to the General Partner within two London Business Days of the Distribution Determination Date.
- 2.5 If, whether by reason of the provisions of paragraph 2.4 above or any equivalent article or term of a Parity Security, Distributions are not paid in full on the Preferred Securities or dividends or other distributions are not paid in full on any Parity Securities, but there are sufficient Adjusted Distributable Reserves so as to allow payment of part of any Distribution, then each Holder will be entitled to receive the Relevant Proportion of any such Distribution. The entitlement of the Holders to payment by HBOS Euro Jersey or HBOS of the balance of any Distributions not paid by reason of paragraph 2.4 above shall lapse following payment of such Relevant Proportion, and no payment in respect of any such unpaid Distributions shall be made at any time by HBOS Euro Jersey or HBOS in such circumstances.
- 2.6 Save as described above, Holders will have no right to participate in the profits of HBOS Euro Jersey and in particular will have no rights to receive from HBOS Euro Jersey amounts in excess of Distributions due and payable under the Preferred Securities. In the event that any amounts received by HBOS Euro Jersey exceed the amount (if any) then due by way of distribution under the Preferred Securities, the amount of such excess will be paid to the Parent Limited Partner and Holders will have no rights in respect thereof.

- 2.7 Without prejudice to the provisions of paragraph 9, the liability of a Holder to contribute to the debts or obligations of HBOS Euro Jersey (if any) is (subject to the Law) not to exceed the amount of that Holder's Preferred Capital Contribution.
- 2.8 For the purposes of the definition of "Relevant Proportion" in paragraph 1, and paragraphs 2.4.1 and 2.5 Adjusted Distributable Reserves as at each Distribution Determination Date shall be determined by reference to whichever is the latest available at that date of the audited accounts for the previous financial year of HBOS or interim accounts for the previous half year of HBOS, adjusted in either case for any of the following events occurring since the date to which such accounts were prepared: (i) any known net losses and (ii) any further redemptions of or payments on (a) any preference shares or other obligations of HBOS that are accounted for under the then generally accepted accounting practice of the U.K. as shareholders' funds in the accounts of HBOS and (b) all securities or other obligations of an undertaking which are accounted for under the then generally accepted accounting practice in the U.K. as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or otherwise) to, HBOS that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Securities, except in each case for such amounts as have been either charged to the lawful distributable reserves of HBOS or funded at that time by an issue of Replacement Capital made for the purposes of funding a redemption.
- 2.9 If at any time the General Partner becomes aware that an investor in the Preferred Securities owns, directly or indirectly, 10 per cent. or more of the ordinary shares of HBOS, the General Partner on behalf of HBOS Euro Jersey will have the right to suspend payment of Distributions in respect of such investor's Preferred Securities. An investor is required to provide written notice to the General Partner on behalf of HBOS Euro Jersey if at any time such investor owns, directly or indirectly, 10 per cent. or more of the ordinary shares of HBOS. Any amounts so suspended will be forfeited and may not be subsequently claimed.

3. Liquidation Distributions

- 3.1 Without prejudice to paragraph 8.6, in the event of the commencement of any dissolution (other than an Involuntary Dissolution) of HBOS Euro Jersey, the Holders at that time will be entitled, subject as set out in paragraph 4.5, to receive the Liquidation Distribution, in respect of each Preferred Security held, out of the assets of HBOS Euro Jersey available for distribution to such Holders under the Law.

Such entitlement will arise (a) after any payments due to the holders of the Preferential Rights and (b) before any distribution of assets is made to the General Partner or the holders of any type of interest in HBOS Euro Jersey ranking junior as regards participation in assets to the Preferred Securities, but such entitlement will rank equally with the entitlement of the holders of other preferred securities, if any, of HBOS Euro Jersey ranking *pari passu* with the Preferred Securities as regards participation in assets of HBOS Euro Jersey.

Notwithstanding the availability of sufficient assets of HBOS Euro Jersey to pay any Liquidation Distribution to the Holders, if, at the time such Liquidation Distribution is to be paid, proceedings have been commenced for the voluntary or involuntary liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation, the Liquidation Distribution per Preferred Security paid to Holders thereof shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of HBOS (after payment in full in accordance with Scots law of all creditors of HBOS, including any holders of subordinated debt but excluding holders of any liability expressed to rank *pari passu* with or junior to the Guarantee) had the Preferred Securities and all Parity Securities been the most senior class of

preference shares in HBOS with equivalent rights of participation in the capital of HBOS (whether or not HBOS could in fact have issued such securities at such time) and ranked (a) junior to all liabilities of HBOS including subordinated liabilities and for the avoidance of doubt all subordinated liabilities expressed to rank ahead on a winding-up of all shares of HBOS (in each case other than any liability of HBOS which constitutes Tier 1 Capital or which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to the Guarantee), (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with the Guarantee and issued in respect of Parity Securities issued by HBOS Euro Jersey or any Subsidiary and (c) senior to Junior Share Capital.

- 3.2 If the Liquidation Distribution and any other such liquidation distributions cannot be made in full by reason of the limitation described in paragraph 3.1 above or any equivalent article or term of a Parity Security, but there are funds available for payment so as to allow payment of part of the Liquidation Distribution, then each Holder will be entitled to receive the Relevant Proportion of the Liquidation Distribution. After payment of all Liquidation Distributions, as adjusted if applicable, the Parent Limited Partner will be entitled to any remaining assets of HBOS Euro Jersey representing proceeds of the Notes and the Holders will have no right or claim to any of the remaining assets of HBOS Euro Jersey or HBOS.
- 3.3 In the event of an order being made for the liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation or HBOS is declared insolvent, HBOS Euro Jersey shall be dissolved by delivery by the General Partner of a statement of dissolution in accordance with the Law, and the amount per Preferred Security to which Holders shall be entitled as a Liquidation Distribution will be as set out in paragraphs 3.1 and 3.2 above.

4. Redemption and Purchase

- 4.1 The Preferred Securities have no fixed final redemption date and Holders have no rights to call for the redemption of the Preferred Securities.
- 4.2 The Preferred Securities are redeemable, at the option of the General Partner, subject to the Law, paragraph 4.5 below and to the prior written consent of the FSA (if then required), in whole, but not in part, on any Optional Redemption Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable), each to be redeemed at the Optional Redemption Price on the specified Optional Redemption Date. Upon the expiry of such notice, HBOS Euro Jersey shall be bound to redeem the Preferred Securities accordingly by payment of an amount equal to the Optional Redemption Price.
- 4.3 If at any time prior to the Distribution Re-Set Date (a) HBOS Euro Jersey is or would be required to pay HBOS Euro Jersey Additional Amounts or, on making payment under the Guarantee, HBOS is required to pay Additional Amounts (as defined in the Guarantee), in either such case as a result of a change in, or amendment to, the laws or regulations of Jersey or the U.K., as the case may be, or any political subdivision or any authority thereof or therein having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 9 December 1999 or (b) there is a Tax Event, the effect of which in either case cannot be avoided by HBOS Euro Jersey or HBOS taking reasonable measures available to it, then the Preferred Securities will be redeemable, at the option of the General Partner, at their Optional Redemption Price, subject to the Law, paragraph 4.5 below and the prior written consent of the FSA (if then required), in whole, but not in part, at any time prior to the Distribution Reset Date upon not less than 30 nor more than 60

days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar and the Paying and Transfer Agents a certificate signed by two Directors of HBOS stating that HBOS Euro Jersey is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of HBOS Euro Jersey so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that, in the case of (a), HBOS Euro Jersey or HBOS has or will become obliged to pay such HBOS Euro Jersey Additional Amounts or, as the case may be, Additional Amounts as a result of such change or amendment or, in the case of (b), a Tax Event has occurred. Upon the expiry of such notice, HBOS Euro Jersey shall be bound to redeem the Preferred Securities accordingly by the payment of the Optional Redemption Price, in accordance with and subject to the Law.

- 4.4 If at any time prior to the Distribution Re-Set Date (a) the FSA determines that the Preferred Securities no longer qualify as Tier 1 Capital on a consolidated basis the effect of which cannot be avoided by HBOS Euro Jersey or HBOS taking reasonable measures available to it or (b) for any reason other than a Tax Event, there is more than an insubstantial risk that HBOS will not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes, then the Preferred Securities will be redeemable, in whole, but not in part, at the option of the General Partner at the Capital Redemption Price, subject to the Law, paragraph 4.5 below and the prior written consent of the FSA (if then required), at any time prior to the Distribution Re-Set Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Capital Redemption Date (which notice shall be irrevocable) and the method of calculating the applicable Capital Redemption Price (together with details as to calculation thereof). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar and the Paying and Transfer Agents a certificate signed by two Directors of HBOS stating that HBOS Euro Jersey is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of HBOS Euro Jersey so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to that effect. Upon the expiry of such notice, HBOS Euro Jersey shall be bound to redeem the Preferred Securities accordingly by the payment of the Capital Redemption Price in accordance with and subject to the Law.
- 4.5 The Preferred Securities may only be redeemed pursuant to paragraph 4.2, 4.3 or 4.4 and a Liquidation Distribution may only be paid pursuant to paragraph 3.1 or 3.2 in the event of the dissolution of HBOS Euro Jersey (except following any liquidation, dissolution or winding-up of HBOS) if the Optional Redemption Price, Capital Redemption Price or, as the case may be, Liquidation Distribution (or the Relevant Proportion) payable is funded (a) by payments received that have themselves been funded by HBOS from an issue of Replacement Capital and/or (b) by a payment received by HBOS Euro Jersey from HBOS upon the redemption from Adjusted Distributable Reserves of redeemable preference shares issued by HBOS against payment to it by the General Partner.

5. Substitution for Preference Shares

As soon as reasonably practicable following the occurrence of a Regulatory Event or the Involuntary Dissolution of HBOS Euro Jersey (in circumstances where HBOS is itself not insolvent or in liquidation), the General Partner shall take all reasonable steps to cause the substitution for the Preferred Securities of fully-paid preference shares issued directly by HBOS (the "Substituted Preference Shares") the terms of which provide the Holder in all material respects with the same economic rights and benefits (including those relating to non-cumulative distributions and status) as are

attached to the Preferred Securities and the Guarantee taken together. However, in the event that at the time of any such substitution HBOS is unable, by reason of the operation of Article 4.7 of its Articles of Association (or any provision in its Articles of Association from time to time corresponding thereto) but not otherwise, to issue preference shares which rank as to payments of capital or income equally with the Guarantee, the Substituted Preference Shares shall comprise preference shares of HBOS which provide the Holder in all material commercial respects with the same economic rights and benefits as aforesaid save that they shall rank junior to the Parity Securities issued, if any, by HBOS but senior to all other preference shares issued, if any, by HBOS and all other Junior Share Capital. HBOS has undertaken in the Guarantee that it will take all reasonable steps to procure that the Substituted Preference Shares will at all times be listed on a recognised stock exchange. HBOS has undertaken in the Guarantee that as soon as practicable after a Regulatory Event or the Involuntary Dissolution of HBOS Euro Jersey in circumstances where HBOS is itself not insolvent or in liquidation, it will give written notice to the Holders enclosing a substitution confirmation (the "Substitution Confirmation") which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of each Paying and Transfer Agent. To receive Substituted Preference Shares in respect of some or all of its holding of Preferred Securities, each Holder must deliver to any Paying and Transfer Agent a Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. HBOS has undertaken in the Guarantee that following such substitution, each Substituted Preference Share allotted will rank for any dividend from the immediately preceding Distribution Payment Date and will have no entitlement to any accrued Distribution or any other payment on the Preferred Securities. In the case of a partial substitution of a Holder's Preferred Securities, the relevant Paying and Transfer Agent will notify the Registrar and the General Partner who shall amend the record of the Holder's interest in HBOS Euro Jersey on the Register accordingly. On allotment in full of such Substituted Preference Shares the Holder shall cease to be a limited partner of HBOS Euro Jersey and the Register shall be amended accordingly.

Each Holder delivering Preferred Securities and a duly completed Substitution Confirmation to a Paying and Transfer Agent must pay any other taxes, stamp duty reserve taxes and capital, stamp, issue and registration duties arising on the relevant substitution. Each Holder must pay all, if any, taxes arising by reference to any disposal or deemed disposal of a Preferred Security in connection with such substitution. Substituted Preference Shares will not be allotted to Restricted Persons.

The General Partner will use all reasonable endeavours to procure that certificates (if any) for Substituted Preference Shares issued on substitution will be despatched by mail free of charge (but uninsured and at the risk of the person entitled thereto) within one month after receipt of a duly completed Substitution Confirmation. Upon an Involuntary Dissolution of HBOS Euro Jersey, Holders will have no further rights title or interest in or to Preferred Securities except to have their Preferred Security substituted in the manner described above. Notwithstanding the foregoing if Substituted Preference Shares are required to be issued the Holders will continue to be entitled to receive Distributions and/or a Liquidation Distribution in respect of the Preferred Securities until such time as notice is given by HBOS and the General Partner in accordance with paragraph 10 that Substituted Preference Shares are available for issue upon substitution and thereafter Holders will have no further rights, title or interest in or to their Preferred Securities except to have them substituted in the manner described above.

6. HBOS Euro Jersey Additional Amounts

All payments in respect of the Preferred Securities by HBOS Euro Jersey will be made without withholding or deduction for, or on account of, any Jersey Tax, unless the withholding or deduction of such Jersey Tax is required by law. In the event of such withholding or deduction, each Holder will be

entitled to receive, as further distributions, such additional amounts (“HBOS Euro Jersey Additional Amounts”) as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable in respect of the Preferred Securities in the absence of such withholding or deduction; except that no such HBOS Euro Jersey Additional Amounts will be payable to a Holder (or to a third party on his behalf) with respect to any Preferred Security to the extent that such Jersey Tax is imposed or levied by virtue of such Holder (or the beneficial owner) of such Preferred Security having some connection with Jersey, other than being a Holder (or beneficial owner) of such Preferred Security, and except that HBOS Euro Jersey’s obligations to make any such payments are subject to the Law and to the limitations provided in paragraphs 2.4, 3.1 and 3.2.

7. Payments

7.1 Distributions will be payable on the relevant Distribution Payment Date or (where any Distribution Payment Date is not a TARGET Business Day) on the next TARGET Business Day (without interest in respect of such delay) to the Holders of record as they appear on the Register on the relevant record date, which will be five TARGET Business Days prior to the relevant Distribution Payment Date.

If the General Partner gives a notice of redemption pursuant to paragraphs 4.2, 4.3 or 4.4 in respect of the Preferred Securities, then, by 10.00 a.m. (London time) on the Optional Redemption Date or the Capital Redemption Date, as the case may be, the General Partner shall procure that the Optional Redemption Price or the Capital Redemption Price, as the case may be, will be paid by the Registrar or by a Paying and Transfer Agent on behalf of HBOS Euro Jersey to the Holders. Upon such payment, all rights of Holders to participate in the assets of HBOS Euro Jersey or to be returned any amount in respect of the Preferred Securities (including the Preferred Capital Contribution made by or on behalf of the Holders) will be extinguished and the Holder shall thereupon cease to be a limited partner of HBOS Euro Jersey provided its holding of Preferred Securities is redeemed in accordance with the foregoing, and the Preferred Capital Contribution will, on payment of the Optional Redemption Price or the Capital Redemption Price, as the case may be, be deemed repaid and the General Partner shall delete the names of the Holders from the register of limited partners required to be kept pursuant to the Law.

7.2 Subject to all applicable fiscal or other laws and regulations:

7.2.1 each payment in respect of Distributions will be made by cheque and mailed to the Holder of record at such Holder’s address as it appears on the Register on the relevant record date for the Preferred Securities; and

7.2.2 any payment in respect of the Optional Redemption Price, the Capital Redemption Price or the Liquidation Distribution in respect of any Preferred Security will be made by cheque against presentation and surrender of the relevant certificate of entitlement at the office of the Registrar or a Paying and Transfer Agent,

provided, however, that a Holder may receive such payment by direct transfer by a Paying and Transfer Agent if appropriate direct transfer instructions have been received by the Registrar in sufficient time prior to the relevant date of payment.

In the event that payment of the Optional Redemption Price or the Capital Redemption Price in respect of any Preferred Security is improperly withheld or refused and not paid by HBOS Euro Jersey, Distributions on such Preferred Security, subject as described in paragraph 2.3 above,

will continue to accrue, on a day by day basis compounding annually, from the Optional Redemption Date or Capital Redemption Date, as the case may be, to the date of actual payment of such Optional Redemption Price or Capital Redemption Price.

- 7.3 HBOS Euro Jersey will not, make any payment to Holders, or procure such a payment, that could not lawfully have been made if Holders had held the most senior preference shares of HBOS (if any, and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.
- 7.4 The General Partner will maintain at all times whilst the Preferred Securities are outstanding (a) a Paying and Transfer Agent outside the U.K. and (b) whilst the Preferred Securities are listed on the Luxembourg Stock Exchange, a Paying and Transfer Agent in Luxembourg. The General Partner will, if circumstances arise where the General Partner or HBOS is able, by the appointment of a Paying and Transfer Agent having a specified office in mainland Europe in a country which is not a member of the European Community, to avoid the obligation to pay HBOS Euro Jersey Additional Amounts to Holders, appoint such a Paying and Transfer Agent.

8. Voting Rights

- 8.1 Except as described below and provided for in the Law, Holders will not be entitled to receive notice of or attend or vote at any meeting of partners in HBOS Euro Jersey or participate in the management of HBOS Euro Jersey.
- 8.2 If for a Distribution Period beginning prior to the Distribution Re-Set Date or for any four consecutive Distribution Calculation Periods:
- 8.2.1 Distributions and any HBOS Euro Jersey Additional Amounts in respect of such Distributions have not been paid in full on the Preferred Securities by HBOS Euro Jersey; and/or
- 8.2.2 HBOS breaches any of its payment obligations under the Guarantee in respect of such Distributions or any such HBOS Euro Jersey Additional Amounts thereon,

then the Holders of outstanding Preferred Securities together with the holders of any other preferred securities of HBOS Euro Jersey having the right to vote for the election of a special representative (the "Special Representative") in such event, acting as a single class without regard to series, will be entitled, by written notice to the General Partner at the Office given by the holders of a majority by liquidation preference of such Preferred Securities and any other preferred securities having the said right or by resolution passed by the holders of a majority by liquidation preference of such Preferred Securities and any other such preferred securities present in person or by proxy at a separate general meeting of such holders convened for the purpose, to appoint a Special Representative. The Special Representative shall be authorised to represent the Holders (for this purpose as defined in the Guarantee) to enforce their statutory rights (if any) as limited partners including provision of information on the affairs of HBOS Euro Jersey; however, it has no rights in addition to those held by Holders, and for the avoidance of doubt, the Special Representative shall have no authority to participate in the management of HBOS Euro Jersey or to bind the General Partner, HBOS Euro Jersey, the Holders, or any of them. The Special Representative shall not, by virtue only of acting in such capacity, be admitted or authorised to act as a general partner in relation to HBOS Euro Jersey or be admitted as a Holder or otherwise be deemed to be a general partner or a Holder in HBOS Euro Jersey and shall have no liability for the debts, obligations or liabilities of HBOS Euro Jersey or for any unpaid contribution of a partner in such capacity.

Not later than 30 days after such entitlement arises, if the written notice of the Holders of outstanding Preferred Securities and the holders of any other preferred securities of HBOS Euro Jersey having the right to vote for the election of a Special Representative in the circumstances described in the preceding paragraph has not been given as provided for in the preceding paragraph, the General Partner will convene a separate general meeting for the above purpose in accordance with clause 17 of this Agreement. If the General Partner fails to convene such meeting within such 30 day period, the holders of 10 per cent. by liquidation preference of the Preferred Securities and such other preferred securities will be entitled to convene such meeting for the above purpose. Any Special Representative so appointed shall, subject to the terms of such other preferred securities, vacate office, if for a Distribution Period beginning prior to the Distribution Re-Set Date or for any four consecutive Distribution Calculation Periods, Distributions and any HBOS Euro Jersey Additional Amounts in respect of such Distributions have resumed with payment in full on the Preferred Securities by HBOS Euro Jersey and/or HBOS has made payment of all amounts guaranteed pursuant to the Guarantee in respect of such Distributions and any HBOS Euro Jersey Additional Amounts in respect thereof.

- 8.3 The consent in writing of the Holders of at least two-thirds of the outstanding Preferred Securities or the sanction of a resolution, passed at a separate meeting, by the Holders of at least two-thirds of the outstanding Preferred Securities shall be required in order to give effect to any variation or abrogation of the rights, preferences and privileges of the Preferred Securities by way of amendment of the Limited Partnership Agreement or otherwise (including, without limitation, the authorisation or creation of any securities or ownership interests of HBOS Euro Jersey ranking, as to participation in the profits or assets of HBOS Euro Jersey, senior to the Preferred Securities) (unless otherwise required by applicable law).
- 8.4 Notwithstanding the foregoing, provided that the most recent Distribution has been paid in full by HBOS Euro Jersey (or HBOS pursuant to the Guarantee), the General Partner may, without the consent or sanction of the Holders, take such action as is required in order to amend the Limited Partnership Agreement:
- 8.4.1 to allow an increase in the level of Preferred Capital Contributions and the corresponding number of Preferred Securities or to create and issue one or more other series of preferred securities of HBOS Euro Jersey ranking *pari passu* with the Preferred Securities as regards participation in the profits and assets of HBOS Euro Jersey and to admit if relevant new holders in respect thereof; or
- 8.4.2 to authorise, create and issue one or more other classes of securities or partnership interests in HBOS Euro Jersey ranking junior, as regards participation in the profits and assets of HBOS Euro Jersey, to the Preferred Securities and to admit if relevant new holders in respect thereof.
- 8.5 Notwithstanding the foregoing, no vote of the Holders will be required for the redemption, cancellation or substitution of the Preferred Securities in accordance with the Limited Partnership Agreement.
- 8.6 Subject to the Law and Clause 17 of this Agreement, HBOS Euro Jersey may not be voluntarily dissolved by the General Partner or the holder of the Preferential Rights whilst any Preferred Security is outstanding, unless all the Holders and the General Partner have approved such resolution. Such approval shall not be required if the dissolution of HBOS Euro Jersey is proposed or initiated because of the liquidation, dissolution or winding-up of HBOS or the General Partner.

- 8.7 Any Preferred Security or any such other preferred security referred to in paragraph 8.2 outstanding at such time that is owned by HBOS, or any entity of which HBOS, either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests, shall not carry a right to vote in a meeting of Holders or at any meeting called to vote for the election of a Special Representative pursuant to paragraph 8.2 and shall, for voting purposes, be treated as if it were not outstanding other than in the case of paragraph 8.6 above.
- 8.8 The General Partner will cause a notice of any meeting at which Holders are entitled to vote and any other voting forms to be mailed to each Holder. Each such notice will include a statement setting forth (a) the date, time and place of such meeting, (b) a description of any resolution to be proposed for adoption at such meeting on which such Holders are entitled to vote and (c) instructions for the delivery of proxies.

9. Covenant of the General Partner

The General Partner undertakes not to incur any indebtedness in the name of HBOS Euro Jersey other than costs and expenses incidental to maintaining the Registrar and paying and listing agents in respect of the Preferred Securities and the administration of HBOS Euro Jersey.

10. Notices

All notices to the Holders will be mailed to the Holder of record and, so long as the Preferred Securities are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, published in a leading Luxembourg daily newspaper which is expected to be the *Luxemburger Wort*.

11. Transfers and Form

The Preferred Securities are in registered form. A single certificate representing the Preferred Securities has been deposited with HSBC Bank plc (the "Common Depositary") as common depositary for Euroclear and Clearstream, Luxembourg. The Preferred Securities are registered in the name of HSBC Issuer Services Common Depositary Nominee (UK) Limited (formerly MSS (Common Depositary) Nominees Limited) as nominee for the Common Depositary. For so long as the Preferred Securities are deposited and registered as described above, book-entry interests in the Preferred Securities will be shown on, and transfers of such interests will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg.

If (a) either or both of Euroclear and Clearstream, Luxembourg is or are closed for business for a continuous period of 14 days or more (other than for the purposes of a public holiday) or announces an intention permanently to cease business or (b) as a result of a change in law, transfer duties or similar taxes become payable on transfers of the Preferred Securities in Euroclear and/or Clearstream, Luxembourg, a number of Preferred Securities corresponding to its book-entry interest in the Preferred Securities represented by the certificate held by the Common Depositary referred to above will, subject to such reasonable requirements as the General Partner may require, be transferred to each holder of an interest in the Preferred Securities whose name is notified by a holder of such interest to HBOS Euro Jersey, and each such holder will be registered as a Holder in the Register and receive a certificate made out in its name. Other than in the circumstances referred to in this paragraph, definitive certificates will not be available to Holders.

If definitive certificates are made available in respect of Preferred Securities they will be available from the Registrar and from the Paying and Transfer Agent in Luxembourg, and will be posted to the relevant Holders at the address shown in the Register or, as applicable, in the relevant instrument of transfer within three London Business Days of issue, by uninsured post at the risk of such Holders.

Transfers of Preferred Securities if represented by definitive certificates may be effected by presentation of the relevant certificate (with the transfer certificate relating thereto duly completed on behalf of the transferor and transferee) at the specified office of the Registrar or any Paying and Transfer Agent. The Preferred Securities may only be transferred in an amount representing not less than €50,000 of Capital Contribution by the Holder (or its predecessor in title) and integral multiples of €1,000 thereafter. Where a Holder transfers some only of the Preferred Securities represented by any such certificate he shall be entitled to a certificate for the balance without charge.

12. Replacement of Certificates

If a certificate is damaged or defaced or alleged to have been lost, stolen or destroyed, a new certificate representing the same Preferred Securities may be issued on payment of such fee and on such terms (if any) as to evidence and indemnity and the payment of out-of-pocket expenses as the General Partner may think fit and on payment of the costs of the General Partner incidental to its investigation of the evidence and, if damaged or defaced, on delivery up of the old certificate at the office of the Paying and Transfer Agent in Luxembourg.

13. Prescription

Unclaimed Distributions, Optional Redemption Price, Capital Redemption Price and Liquidation Distributions will be prescribed after ten years in accordance with Jersey law.

14. Governing Law

The Limited Partnership Agreement and the Preferred Securities shall be governed by, and construed in accordance with, Jersey law. However, determinations in respect of amounts of Adjusted Distributable Reserves shall be construed with regard to HBOS (where applicable) in accordance with Scots law and with regard to Halifax Group plc (where applicable) in accordance with English law.

Description of the Business of HBOS and the HBOS Group

Introduction

On 10 September 2001, Bank of Scotland and Halifax Group merged under HBOS. HBOS is the ultimate holding company for Halifax Group and Bank of Scotland and a number of other subsidiaries principally carrying on financial services business. HBOS is a public limited company incorporated in Scotland (registered number SC218813) under the Companies Act 1985 with its head office, corporate headquarters and registered office at The Mound, Edinburgh, EH1 1YZ.

The HBOS Group's products and services can be categorised into five key business sectors:

- Retail Banking
- Business Banking
- Corporate Banking
- Insurance & Investment
- Treasury

Retail Banking

The retail operations and consumer credit businesses of Halifax Group were combined with the personal banking division of Bank of Scotland to form the Retail Banking Division of the HBOS Group employing over 32,000 people in over 1,100 branches and 11 call centres throughout the United Kingdom

The HBOS Group has over 20 million customers and offers an extensive range of personal finance products and services including mortgages, savings, current accounts, credit cards, online services, share dealing and estate agency. In addition to Halifax and Bank of Scotland, other brands within the Retail Banking Division include Intelligent Finance and Birmingham Midshires.

The HBOS Group is the largest mortgage provider in the United Kingdom, with residential mortgage assets of approximately £119 billion and the United Kingdom's largest savings provider with savings and banking balances of over £102 billion as at 31 December 2001.

Business Banking

The Business Banking Division provides a range of finance products and services principally to small and medium-sized enterprises ("SMEs") through a network of branches and business centres in the United Kingdom and Ireland as well as through internet banking, mail and telephone. The HBOS Group provides a full banking service to SMEs including deposits and investments, business finance, commercial mortgages, free internet banking, merchant services and business insurance. The Business Banking Division also provides specialist services such as asset finance, cashflow finance, motor finance, vehicle management and contract hire. The Business Banking Division employs over 5,500 employees in the United Kingdom, Ireland and Australia.

The HBOS Group provides finance products and services to approximately 33 per cent. (as of September 2001) of the SME market in Scotland and is aiming to capture a significant amount of SME business in England and Wales. It has already begun to pilot SME business services initially via 12 Halifax branches, with the intention of having more than 85 dedicated business banking relationship advisers in branches in strategic locations across England and Wales by early 2002.

Corporate Banking

The Corporate Banking Division focuses on larger businesses (typically those with an annual turnover in excess of £10 million) and comprises a number of relationship banking and specialist lending teams with responsibilities including working capital finance, term loans, asset finance, multi-currency loans and deposits, project and specialist finance, acquisition finance and syndicated lending. The key objective of these teams is to expand and strengthen the HBOS Group's corporate market share by creating new products and delivering specialist services to existing and new customers.

The HBOS Group employs over 1,000 staff in the Corporate Banking Division in over 20 locations in Scotland and England, with international operations in New York, Chicago, Houston, Los Angeles, Boston, Seattle, Minneapolis, Paris, Frankfurt, Amsterdam, Singapore and Sydney.

The HBOS Group was the leader, of deals by volume, in the provision of acquisition finance to the United Kingdom and European management buy-out sector for the year ended 31 December 2001 and is one of the leading providers of debt for public to private transactions.

Insurance & Investment

The Insurance & Investment Division ("IID") comprises a number of different brands including Halifax Financial Services, Bank of Scotland, Clerical Medical Investment Group, St James's Place Capital, St Andrew's and esure.

Products offered by the companies within IID include, investments and pensions, life and repayment insurance and household, travel and motor insurance distributed through a number of different channels, branches, independent financial advisers, company agents and by telephone.

Treasury

Treasury represents the combined treasury businesses of Halifax Group and Bank of Scotland. Treasury manages liquidity and provides wholesale multi-currency funding for the HBOS Group and manages the market risk arising from the HBOS Group's Retail Banking, Business Banking and Corporate divisions. Treasury also arranges the HBOS Group's debt capital issuance and asset securitisations. In addition, Treasury provides a range of treasury services to customers of the Business Banking and Corporate Banking divisions and to its own customer base.

Management and Organisation

The names and positions of the HBOS Directors, all of The Mound, Edinburgh EH1 1YZ, are as follows:

Director's Name	Responsibilities
Henry Dennistoun Stevenson (Lord Stevenson of Coddanham)	Chairman
Peter Alexander Burt	Executive Deputy Chairman
James Robert Crosby	Chief Executive
Michael Henry Ellis	Group Finance Director
Philip Andrew Hodkinson	Chief Executive, Insurance & Investment
Andrew Hedley Hornby	Chief Executive, Retail Banking
Colin Matthew	Chief Executive, Business Banking
William Gordon McQueen	Chief Executive, Treasury

Director's Name	Responsibilities
George Edward Mitchell	Chief Executive, Corporate Banking
Charles William Dunstone	Non-Executive Director
Sir Ronald Garrick	Non-Executive Director
Anthony John Hobson	Non-Executive Director
Brian Gammell Ivory	Non-Executive Director
John Neil Maclean	Non-Executive Director
Coline Lucille McConville	Non-Executive Director
Sir Robert Paul Reid	Non-Executive Director
Peter Louis Michael Sherwood	Non-Executive Director
George Simpson (Lord Simpson of Dunkeld)	Non-Executive Director
Philip Edward Yea	Non-Executive Director

HBOS has two banking direct subsidiaries. Certain of their details are set out below:

Company Name	Activity	Country of Incorporation or Registration	Registered Office /Head Office
Halifax Group plc	Retail financial services	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
The Governor & Company of the Bank of Scotland	Banking	Scotland	The Mound Edinburgh EH1 1YZ

Certain details of the principal subsidiary undertakings of Halifax Group are set out below:

Company Name	Activity	Country of Incorporation or Registration	Registered Office	Total % held by Halifax Group
Halifax plc and its subsidiaries	Banking services	England and Wales	Trinity Road Halifax HX1 2RG West Yorkshire	100% - ordinary 75% - preference
Halifax General Insurance Services Limited	General insurance brokerage	England and Wales	Trinity Road Halifax HX1 2RG West Yorkshire	100%
Halifax Share Dealing Limited	Execution only stockbroking	England and Wales	Trinity Road Halifax HX1 2RG	100%

Company Name	Activity	Country of Incorporation or Registration	Registered Office	Total % held by Halifax Group
Clerical Medical Investment Group (Holdings) Limited and its subsidiaries	Life assurance	England and Wales	West Yorkshire 33 Old Broad Street London EC2N 1HZ	100%
Halifax Financial Services (Holdings) Limited and its subsidiaries	Financial services	England and Wales	Trinity Road Halifax HX1 2RG West Yorkshire	100%
St James's Place Capital PLC and its subsidiaries	Financial services	England and Wales	J Rothschild House Dollar Street Cirencester GL7 2AQ	60%*

* diluted to 52 per cent. if all employee share options currently granted were fully exercised.

Certain details of the principal subsidiary undertakings of Bank of Scotland are set out below:

Company Name	Activity	Country of Incorporation or Registration	Registered Office	Total % held by Bank of Scotland
Bank of Scotland Treasury Services PLC	Banking	England and Wales	33 Old Broad Street London EC2N 1HZ	100%
Capital Bank plc	Personal finance and banking services	England and Wales	Queens Park Road Handbridge Chester CH88 3AN	100%
Bank of Western Australia Limited	Retail and commercial banking	Australia	Bankwest Tower 108 St Georges Terrace, Perth Australia WA 6000	56.3%*

* as at 31 December 2001

Recent Developments

On 27 February 2002, HBOS successfully executed a placement of 172.5 million ordinary shares (such placement being settled with respect to 150 million ordinary shares on 5 March 2002 and with respect to 22.5 million ordinary shares on 7 March 2002). The ordinary shares were placed with a wide range of U.K. and international institutional investors at a price of £7.40 per share raising proceeds of £1,258 million (net of expenses). The ordinary shares were issued in order to provide additional capital to support the continued business growth of HBOS.

On 19 March 2002, the Board of Directors of Halifax plc, Bank of Scotland Treasury Services PLC ("BOSTS") and Bank of Scotland decided that the treasury business of HBOS Group will, so far as possible, be carried on through a single entity, being BOSTS, a wholly owned subsidiary of Bank of Scotland. To effect integration, it is proposed that substantially the whole of the treasury operations of Halifax plc be transferred to BOSTS.

Consequently, on 2 April 2002, Halifax plc applied to the High Court of Justice to sanction, under Part VII of the Financial Services and Markets Act 2000 by way of a banking business transfer scheme, the transfer of substantially the whole of the treasury business carried on by it to BOSTS. The application is directed to be heard before a Judge of the High Court on 3 May 2002 to consider the sanctioning of the transfer.

Financial Information of HBOS

The following financial information of HBOS has been extracted without material adjustment from HBOS's Annual Report and Accounts.

Consolidated Profit and Loss Account

For the year ended 31 December 2001

	Notes	2001 £ million	2000 £ million
Interest receivable			
Interest receivable and similar income arising from debt securities		1,426	1,745
Other interest receivable		14,689	13,366
		16,115	15,111
Interest payable		(11,942)	(11,080)
Net interest income		4,173	4,031
Fees and commissions receivable		1,921	1,711
Fees and commissions payable		(517)	(407)
Dealing profits	1	82	66
Other operating income	3(i)	1,213	843
Net operating income			
(all from continuing operations)	1	6,872	6,244
Administrative expenses	2,3(ii)	(2,967)	(2,580)
Depreciation and amortisation			
Tangible fixed assets		(260)	(237)
Operating lease assets		(210)	(210)
Goodwill amortisation		(68)	(43)
		(538)	(490)
Operating expenses		(3,505)	(3,070)
General insurance claims		(68)	(11)
Provisions for bad and doubtful debts	18	(608)	(471)
Amounts written off fixed asset investments	20,21	(21)	(9)
Operating profit			
(all from continuing operations)		2,670	2,683
Before exceptional items and Intelligent Finance		2,971	2,895
Exceptional items	3	(147)	(124)
Intelligent Finance	4	(154)	(88)

	Notes	2001 £ million	2000 £ million
Share of operating profits/(losses) of joint ventures	3(iv)	20	(35)
Share of operating profits of associated undertakings		16	20
Merger costs - exceptional	3(iii)	(76)	
Profit on ordinary activities before taxation		2,630	2,668
Before exceptional items and Intelligent Finance		3,007	2,925
Exceptional items	3	(223)	(169)
Intelligent Finance	4	(154)	(88)
Tax on profit on ordinary activities	10	(765)	(757)
Profit on ordinary activities after taxation		1,865	1,911
Before exceptional items and Intelligent Finance		2,155	2,062
Exceptional items	3	(182)	(89)
Intelligent Finance	4	(108)	(62)
Minority interests (equity)		(77)	(54)
(non-equity)		(112)	(79)
Profit attributable to shareholders		1,676	1,778
Dividends	11		
Preference		37	37
Ordinary		993	789
		1,030	826
Retained profit of the year	12	646	952
Underlying earnings per share	13	56.6p	55.6p
Basic earnings per share	13	46.4p	49.9p
Diluted earnings per share	13	45.9p	49.7p

There were no material gains or losses other than the profit shown above in either year.

It is estimated that Group profit on ordinary activities before taxation and retained profit of the year calculated solely on a historical cost basis would not differ materially from those stated in the consolidated profit and loss account above.

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110, in each case, of the audited consolidated accounts of HBOS for the financial year ended 31 December 2001, form part of these accounts.

Consolidated Balance Sheet

As at 31 December 2001

	Notes	2001 £ million	2000 £ million
Assets			
Cash and balances at central banks		1,150	1,252
Items in course of collection		983	754
Treasury bills and other eligible bills	14	4,071	3,196
Loans and advances to banks	15	12,929	18,117
Loans and advances to customers	16	201,034	171,009
Less: non-returnable finance	16	(3,141)	(1,121)
		197,893	169,888
Operating lease assets	19	2,042	1,519
Debt securities	20	42,449	29,543
Equity shares	21	224	147
Interest in joint ventures	22(i)		
Share of gross assets		2,214	1,737
Share of gross liabilities		(1,998)	(1,553)
		216	184
Interest in associated undertakings	22(ii)	134	123
Intangible fixed assets	24	1,245	1,047
Tangible fixed assets	25	1,627	1,576
Other assets	26	4,205	2,703
Prepayments and accrued income		2,241	2,636
Long-term assurance business attributable to shareholders	29	3,265	2,400
		274,674	235,085
Long-term assurance assets attributable to policyholders	29	37,601	31,058
Total Assets		312,275	266,143
Liabilities			
Deposits by banks	30	30,449	25,328
Customer accounts	31	140,516	127,012
Debt securities in issue	32	69,528	53,678
Notes in circulation		737	653
Corporate taxation		69	425
Dividends payable		679	547
Other liabilities	33	5,153	2,837
	73		

	Notes	2001 £ million	2000 £ million
Accruals and deferred income		5,167	5,948
Provisions for liabilities and charges			
Deferred taxation	34(i)	628	497
Other provisions	34(ii)	<u>252</u>	<u>163</u>
		880	660
Subordinated liabilities	35		
Dated loan capital		4,966	3,854
Undated loan capital		<u>2,660</u>	<u>2,131</u>
		7,626	5,985
		260,804	223,073
Capital and Reserves			
Called up share capital	36		
Preference shares (non-equity)		400	400
Ordinary shares		<u>892</u>	<u>878</u>
		1,292	1,278
Share premium account	38	27	
Other reserves	38	492	209
Profit and loss account	38	<u>9,657</u>	<u>9,051</u>
Shareholders' funds (including non-equity interests)	39	11,468	10,538
Minority interests (equity)		415	377
Minority and other interests (non- equity)	37	1,987	1,097
		13,870	12,012
		274,674	235,085
Long-term assurance liabilities attributable to policyholders	29	37,601	31,058
Total Liabilities		312,275	266,143
Memorandum Items			
Contingent liabilities	40		
Acceptances and endorsements		202	160
Guarantees and assets pledged as collateral security		2,133	1,713
		2,335	1,873
Commitments			
Other commitments		37,272	27,532

Approved by the Board on 26 February 2002 and signed on its behalf by:

Lord Stevenson A J Hobson	P A Burt	J R Crosby	M H Ellis
Chairman	Chairman of Audit Committee	Executive Deputy Chairman	Chief Executive
			Group Finance Director

The statement of accounting policies on pages 65 and 66 are the notes on pages 72 to 110, in each case, of the audited consolidated accounts of HBOS for the financial year ended 31 December 2001, form part of these accounts.

Balance Sheet

As at 31 December 2001

	Notes	2001 £ million
Fixed Assets		
Investments		
Shares in Group undertakings	23	1,301
Own shares	27	5
		1,306
Current Assets		
Debtors		
Amounts owed by Group undertakings		974
Dividends receivable		679
Other debtors		7
		1,660
Current Liabilities		
Creditors: Amounts falling due within one year		
Amounts owed to Group undertakings		27
Dividends payable		679
Accruals		2
Other creditors		4
		712
Net Current Assets		948
Total Assets Less Current Liabilities		2,254
Creditors: Amounts falling due after more than one year		

	Notes	2001 £ million
Subordinated liabilities	35	902
Net Assets		1,352
Capital and Reserves		
Called up share capital	36	
Preference shares (non-equity)		400
Ordinary shares		<u>892</u>
		1,292
Share premium account	38	27
Profit and loss account	38	33
Shareholders' Funds	39	1,352

Approved by the Board on 26 February 2002 and signed on its behalf by:

Lord Stevenson	A J Hobson	P A Burt	J R Crosby	M H Ellis
Chairman	Chairman of Audit Committee	Executive Deputy Chairman	Chief Executive	Group Finance Director

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110, in each case, of the audited consolidated accounts of HBOS for the financial year ended 31 December 2001, form part of these accounts.

Consolidated Cash Flow Statement

For the year ended 31 December 2001

	Notes	2001 £ million	2000 £ million
Net cash inflow from operating activities	48	671	4,781
Merger costs - exceptional		(76)	
Dividends received from joint ventures		16	11
Returns on investments and servicing of finance	49(i)	(638)	(534)
Taxation		(860)	(801)
Capital expenditure and financial investment	49(ii)	(1,076)	(1,554)
		(1,963)	1,903
Acquisitions and disposals	49(iii)	(739)	(986)
Equity dividends paid		(837)	(654)
		(3,539)	263
Financing	49(iv)	2,662	1,184
(Decrease)/Increase in cash	51	(877)	1,447

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110, in each case, of the audited consolidated accounts of HBOS for the financial year ended 31 December 2001, form part of these accounts.

Notes on the Accounts

1 Net Operating Income

	Notes	2001 £ million	2000 £ million
Net operating income includes:			
Mortgage incentives		(1,027)	(805)
Interest payable on subordinated liabilities		(467)	(422)
Dealing profits			
Foreign exchange		44	32
Interest rate related		<u>38</u>	<u>34</u>
Finance lease rental income		671	615
Income from long-term assurance business	29	470	288
Operating lease rental income		369	311
General insurance premium income		265	95
Profit on sale of investment securities		92	116
Dividend income from equity shares		7	8

Dealing profits arise from the Group's trading book. The types of instrument in which the Group trade are as set out in Note 41.

2 Administrative Expenses

	Notes	2001 £ million	2000 £ million
Administrative expenses (excluding exceptional items) includes:			
Staff costs	5	1,425	1,311
Property rentals		135	111
Hire of equipment		24	32
Gain on sale of fixed assets		(7)	(19)

The Group operates Inland Revenue approved Savings-Related Stock Option Schemes and has utilised the exemption under UITF Abstract 17.

3 Exceptional Items

Exceptional items include the following:

- (i) Included within other operating income is an exceptional credit of £27 million (tax - £8 million) arising from St. James's Place Capital plc's share of profits from an arrangement to transfer Life Assurance Holding Corporation Ltd's (LAHC) investment management business to Aberdeen Asset Management plc. LAHC is an associated undertaking of St. James's Place Capital plc.

- (ii) Included within administrative expenses, exceptional costs have been charged as follows:

	Notes	2001 £ million	2000 £ million
HBOS merger integration costs	(a)	(132)	
Equitable Life integration costs	(b)	(42)	
Restructuring costs	(c)		(124)
		(174)	(124)
Tax effect		49	31

- (a) The HBOS merger integration costs cover the costs of integrating and reorganising Bank of Scotland Group and Halifax Group following the merger.
- (b) The Equitable Life integration costs relate to expenses incurred during the integration of The Equitable sales force, acquired on 1 March 2001 (see Note 50(b)) into the new Halifax Equitable structure together with other ancillary integration costs associated with the transaction.
- (c) During 2000, Bank of Scotland Group charged £80 million relating to the restructuring of the Bank of Scotland UK Group; costs of £31 million were incurred to cover Halifax Group's rationalisation programmes instigated across central sites, regional offices and Birmingham Midlands. Halifax Group charged a further £13 million during 2000 for the rationalisation of the Halifax retail branch network.
- (iii) Merger costs of £76 million (tax - £nil) comprise the deal costs incurred in connection with the merger of Bank of Scotland Group and Halifax Group.
- (iv) During 2000, the Group's share of operating losses of joint ventures included an exceptional charge of £45 million (tax - £9 million) reflecting a provision against Lex Vehicle Leasing Ltd's impairment of the residual value of leased vehicles.
- (v) At a hearing in March 2000, the Special Commissioners decided in favour of Halifax Group that the costs of conversion to listed company status were a deductible expense for tax purposes and an exceptional tax credit of £40 million was recognised and included within the Group's 2000 tax on profit on ordinary activities.

4 Intelligent Finance

Intelligent Finance commenced trading in September 2000. The result for 2001 was an operating loss before taxation of £154 million (2000 - £88 million) and an operating loss after taxation of £108 million (2000 - £62 million). The results in 2001 and 2000 have been presented separately on the face of the profit and loss account. This disclosure was made due to the business still being in its start-up phase and thus to aid comparability of existing business performance.

5 Staff

	2001 Number	2000 Number
The average number of persons employed by the Group during the year was:		
Full time	47,979	45,378
Part time	14,869	14,909
	62,848	60,287

	2001 £ million	2000 £ million
The aggregate remuneration payable to those employees comprises:		
Wages and salaries	1,432	1,264
Social security costs	112	99
Other pension costs (Note 9)	73	60
Other post retirement benefits (Note 9)	2	6
	1,619	1,429
Less: long-term assurance business staff costs	(194)	(118)
Staff costs charged to administrative expenses	1,425	1,311

Staff costs in respect of long-term assurance business are not charged to administrative expenses but are taken into account in determining the increase in value of long-term assurance business (Note 1).

6 Directors' Remuneration

	2001	2000
	£000	£000
Total emoluments	6,581	3,830
Total potential pre-tax gains on stock options exercised	1,195	735
Highest paid Director		
- emoluments	994	682
- potential pre-tax gains on stock option exercised	1,195	735
- accrued pension entitlement per annum	296	216

Retirement benefits accrued to 8 Directors under pension schemes in the year to 31 December 2001.

The figures for the years to 31 December 2000 and 2001 include the emoluments of the Directors of Bank of Scotland and Halifax Group plc who were appointed to the Board of HBOS plc.

A detailed analysis of Directors' emoluments, pension entitlements, stock interests and stock options is given on pages 51 to 60 in the Report of the Board in relation to remuneration policy and practice.

7 Auditors' Remuneration

The aggregate remuneration of KPMG Audit Plc and its associates for audit and other services (excluding VAT) is analysed below. KPMG Audit Plc were the auditors of both Halifax Group and Bank of Scotland Group for 2000 and 2001, and since 5 June 2001 have been the auditors of HBOS plc.

	Within UK	Outwith UK	2001 Total	Within UK	Outwith UK	2000 Total
	£ million	£ million	£ million	£ million	£ million	£ million
Group						
Statutory audits	2.9	0.5	3.4	2.7	0.2	2.9
As auditors or reporting accountants	3.4	0.1	3.5	2.6		2.6
	6.3	0.6	6.9	5.3	0.2	5.5
Merger and acquisitions	8.1		8.1	1.1		1.1
Tax advisory	0.5	0.3	0.8	0.9	0.2	1.1
Other accounting, advisory and consultancy	6.6	0.6	7.2	3.8	0.3	4.1
	21.5	1.5	23.0	11.1	0.7	11.8

Statutory audit fees include £10,000 within the UK in respect of the Company.

Non-audit fees include £2.0 million which has been capitalised by the Group in the year ended 31 December 2001 (2000 - £0.4 million). The increase in non-audit fees relates primarily to work conducted in connection with the merger of Bank of Scotland Group and Halifax Group and the acquisition of the operating assets, salesforce and unit linked and certain non-profit business of The Equitable.

The Group has a policy of requiring a competitive tendering process for the appointment of consultants where the expected fee exceeds £50,000. If the tendering process results in the external auditors being the recommended supplier, the decision has to be approved by the Chief Executive and the Group Finance Director. The Chief Executive and the Group Finance Director also have the authority to appoint the external auditors for consultancy or advisory roles in cases where an urgent appointment is necessary or for certain specific areas of work where they consider that the auditors' experience of the Group's activities is required. Immediately following the merger, this latter authority was used to ensure that urgent projects and tasks arising from the merger were initiated and completed in time.

Fees payable to the external auditors are reported regularly to the Audit Committee, which reviews the background to the use of KPMG Audit Plc and its associates for non-audit work and considers the impact of these fees on their independence as auditors.

8 Operating Leases

	Group			
	2001	2001	2000	2000
	Property	Other	Property	Other
	£ million	£ million	£ million	£ million
There are commitments to make payments in the following year in respect of non-cancellable operating leases which expire:				
within 1 year	3	3	3	4
between 1 and 5 years	18	13	15	21
after 5 years	106	3	91	3
	127	19	109	28

9 Pension Costs

The Group operates several pension schemes, all of which are funded.

The principal schemes are the Halifax Retirement Fund and the Bank of Scotland 1976 Pension Scheme (together, "the Schemes"). These Schemes cover 84 per cent of the Group's pensionable employees, and provide defined benefits based on final pensionable salary. The assets of the Schemes are held in Trust Funds which are independent of the Group's own assets.

In determining the level of contributions required to be made to the Schemes and the relevant charges to the Group's profit and loss account, the Group has been advised by Watson Wyatt

Partners, Actuaries and Consultants. The most recently published formal valuation of the Halifax Retirement Fund took place as at 31 March 2000; a formal valuation of the Bank of Scotland 1976 Pension Scheme was carried out as at 31 December 1998. The main financial assumptions adopted for these calculations were as follows:

	Halifax Retirement Fund Rates per annum	Bank of Scotland 1976 Pension Scheme Rates per annum
Future price inflation	3.00 per cent	3.00 per cent
Return on new investments	7.25 per cent	7.10 per cent
Return on existing investments	5.75 per cent	5.80 per cent
Increases in earnings	4.50 per cent	4.50 per cent
Increases in pensions*	3.00 per cent	3.00 per cent

* on the excess over the Guaranteed Minimum Pension

The pension costs for accounting purposes have been calculated using the same assumptions as those adopted for the formal valuations.

The following disclosures are based on these assumptions using the projected unit method of valuation:

	Halifax Retirement Fund	Bank of Scotland 1976 Pension Scheme
Effective date of valuation	31/3/2000	31/12/1998
Market value of assets	£2,148m	£1,343m
Asset cover level	119 per cent	116 per cent
Regular pension charge (as a percentage of pensionable salaries)	16.75 per cent	19.4 per cent

The asset cover levels disclosed in the above table represent the ratios of the respective Schemes' assets to the value of the benefits that had accrued to members and pensioners at the valuation dates after allowing for expected future increases in earnings and pensions.

The regular pension charge for the Halifax Retirement Fund is inclusive of employee contributions which were increased from 2% to 3% of pensionable salaries from 1 May 2001. The regular pension charge for the Bank of Scotland 1976 Pension Scheme increased to 19.8% from 1 July 2001 following changes made to the Scheme's benefit structure at that date.

These charges have been reduced by spreading surplus assets in each of the Schemes over the average future working lifetimes of the memberships (15 years for the Halifax Retirement Fund and 14 years for the Bank of Scotland 1976 Pension Scheme) by fixed capital instalments plus interest on the reducing balances. These elements, together with interest on the opening balance sheet positions amount to £15 million (2000 - £20 million) in respect of the Halifax Retirement Fund and £30 million (2000 - £15 million) in respect of the Bank of Scotland 1976 Pension Scheme. The Bank of Scotland 1976 Pension Scheme charge takes account of the merger of the Capital Bank Pension Scheme and Bank of Wales plc 1973 Pension and Life Assurance Scheme into that Scheme on 1 January 2001.

Contributions to the Schemes of £22 million were paid during the year. As contributions overall differ from the amount charged in the Profit and Loss Account a provision of £53 million (2000 - £29 million) for future contributions is included in the Balance Sheet, net of prepayments. Included in prepayments and accrued income is a pension prepayment of £25 million (2000 - £27 million) which relates to excess pension contributions.

The pension costs charged in the Profit and Loss Account include £28 million (2000 - £25 million) relating to schemes other than the Schemes.

Other Post-Retirement Benefits

The Group also provides post-retirement health care benefits and concessionary rate mortgages for certain pensioners and dependent spouses.

An independent actuarial review as at 31 December 2001 estimated the present value of the accumulated other post-retirement benefit obligations at £37 million for the Group (2000 - £36 million). The main additional financial assumption used was that over the long-term the rate of increase in health care costs would be 7.25% per annum, being 4.25% per annum higher than the rate of inflation. The charge for the year ended 31 December 2001 for other post-retirement benefits was £2 million (2000 - £6 million). Included in provisions for liabilities and charges is £33 million (2000 - £31 million) which represents the accrued amount for other post-retirement benefits.

FRS 17

The actuarial valuations used in assessing the FRS 17 disclosures are:

- the Halifax Retirement Fund valuation as at 31 March 2000, updated by Watson Wyatt Partners to take account of the requirements of FRS 17 and to assess the assets and liabilities of that Fund as at 31 December 2001
- the preliminary results of the valuation of the Bank of Scotland 1976 Pension Scheme as at 31 December 2001

Scheme assets are stated at their market value at 31 December 2001.

The liabilities of the Schemes under FRS 17 were calculated using the Projected Unit method using the following financial assumptions:

	Rates per annum
Future price inflation	2.50 per cent
Discount rate	6.00 per cent

	Rates per annum
Increases in earnings	3.50 per cent
Increases in pensions*	2.50 per cent

* on the excess over the Guaranteed Minimum Pension. Pensions which are guaranteed to increase at a rate of 3.0 per cent per annum have been assumed to increase at 3.0 per cent.

The assets of the Schemes and the expected rates of return were:

	Long-term expected rate of return per annum at 31 December 2001	Value at 31 December 2001 £ million
Equities	7.75 per cent	2,715
Bonds	5.25 per cent	305
Property	6.50 per cent	88
Cash	4.50 per cent	88
Total market value of assets at 31 December 2001		3,196
Present value of liabilities of the Schemes		3,194
Surplus in the Schemes		2

The remaining defined benefit schemes in the Group account for less than 17% of the Group's total defined benefit pension liabilities.

Other Post-Retirement Benefits

An independent actuarial review as at 31 December 2001 estimated the present value of the accumulated other post-retirement benefit obligations under FRS 17 at £40 million for the Group. There are no assets backing these obligations, and hence the notional balance sheet provision under FRS 17 is also £40 million. The main additional financial assumption used was that over the long-term the rate of increase in health care costs would be 6% per annum, being 3.5% per annum higher than the rate of inflation.

10 Taxation

	2001 £ million	2000 £ million
UK Corporation Tax at 30 per cent (2000 - 30 per cent)	429	589
Relief for overseas taxation	(12)	(11)
	417	578
Tax relating to change in value of long-term assurance business (Note 29)	115	67
	532	645
Overseas taxation	97	59
Deferred taxation (Note 34(i))	121	92
Share of joint ventures' taxation	11	(6)
Share of associated undertakings' taxation	4	7
	765	797
Exceptional credit - UK Corporation Tax (Note 3(v))		(40)
Tax on profit on ordinary activities	765	757

11 Dividends

	2001 £ million	2000 £ million
Preference dividends paid	25	25
payable	12	12
	37	37
Ordinary dividend		
Interim dividend of 9.30p per ordinary share (2000 - 7.35p)	330	258
Proposed final dividend of 18.70p per ordinary share (2000 - 15.05p)	667	535
Adjustments	(4)	(4)
	993	789
	1,030	826

Of the adjustment in 2001 £2 million reflects a credit for dividends declared on unclaimed Halifax Group plc ordinary shares that were sold by Halifax Group plc in 2001. The dividends accrued on these shares are no longer required to be paid.

The other adjustments in 2001 and 2000 result from the waiver of dividends by the QUEST (Note 27(b)) which took place subsequent to the dividends being accrued but before the ex-dividend date.

12 Retained Profit

	2001	2000
	£ million	£ million
The profit of the Group has been retained by		
HBOS plc	43	
Subsidiary undertakings	598	979
	641	979
Associated undertakings and joint ventures	5	(27)
	646	952

By virtue of the exemption contained within Section 230 of the Companies Act 1985, the Profit and Loss Account of the Company is not presented.

13 Earnings per Ordinary Share

Basic and diluted earnings per Ordinary Share are based upon Group profit attributable to Ordinary Shareholders of £1,639 million (2000 - £1,741 million). The underlying earnings per Ordinary Share are based upon Group profit attributable to Ordinary Shareholders (before exceptional items, Intelligent Finance and goodwill amortisation but after tax) of £2,003 million (2000 - £1,941 million). For the basic and underlying earnings per Ordinary Share the weighted average number of 25p Ordinary Shares of 3,536 million (2000 - 3,488 million) is used and for the diluted earnings per Ordinary Share the weighted average number of actual and potential 25p Ordinary Shares of 3,568 million (2000 - 3,505 million) is used. Group profit attributable to Ordinary Shareholders equals profit attributable to shareholders of £1,676 million (2000 - £1,778 million) less preference dividends of £37 million (2000 - £37 million). The weighted average number of actual and potential Ordinary Shares in issue is detailed below.

	2001	2000
	Number	Number
	million	million
Actual weighted average number of shares in issue	3,536	3,488
Adjustment for weighted average number of shares on which options have been granted but not yet exercised	32	17
Potential weighted average number of shares in issue	3,568	3,505

The calculation of the underlying basic earnings per 25p Ordinary Share, noted below, has been included to enable shareholders to assess the underlying trading performance.

	2001	2000
	pence	pence
Basic earnings per share	46.4	49.9
Exceptional items		
Exceptional merger costs, administrative expenses and income	5.1	2.7
Exceptional charge in respect of Lex Vehicle Leasing		1.0
Exceptional tax credit		(1.1)
Intelligent Finance	3.0	1.8
Goodwill amortisation	2.1	1.3
Underlying earnings per share	56.6	55.6

14 Treasury Bills and Other Eligible Bills

	Group			
	2001		2000	
	Book Value	Market Value	Book Value	Market Value
	£ million	£ million	£ million	£ million
Investment securities				
Treasury bills and similar securities	2,602	2,600	1,158	1,161
Other eligible bills	448	451	2,038	2,038
	3,050	3,051	3,196	3,199
Other securities				
Treasury bills and similar securities	57	57		
Other eligible bills	964	964		
	1,021	1,021		
	4,071	4,072	3,196	3,199

The movement on treasury bills and other eligible bills held for investment purposes was as follows:

	£ million
At 1 January 2001	3,196
Exchange translation	(22)
Additions	14,800
Disposals	(14,928)
Amortisation	4
At 31 December 2001	3,050
Aggregate unamortised discounts net of premiums at 31 December 2001	16

15 Loans and Advances to Banks

	Group	
	2001	2000
	£ million	£ million
Repayable on demand	1,625	2,400
Other loans and advances repayable		
in 3 months or less	9,191	10,099
between 3 months and 1 year	1,741	4,826
between 1 year and 5 years	185	642
after 5 years	187	150
	12,929	18,117

16 Loans and Advances to Customers

	Group	
	2001	2000
	£ million	£ million
Repayable on demand or at short notice	16,679	11,468
Other loans and advances repayable		
in 3 months or less	18,296	17,260
between 3 months and 1 year	10,057	8,961
between 1 year and 5 years	27,582	24,810
after 5 years	127,171	109,063
Gross loans and advances to customers	199,785	171,562
Provisions for bad and doubtful debts (Note 18)	(1,769)	(1,578)
Interest in suspense	(123)	(96)
Loans and advances to customers	197,893	169,888

At 31 December 2001, there were gross loans and advances to customers of £3,280 million (2000 - £2,080 million) outstanding from associated undertakings and joint ventures.

Loans and advances to customers include finance lease receivables of £3,900 million (2000 - £3,692 million). Assets acquired in the year for letting under finance leases amounted to £1,005 million (2000 - £1,662 million).

The Group's gross lending exposure is analysed below.

	2001	2000
	£ million	£ million
Agriculture, forestry and fishing	1,038	974
Energy	1,598	1,610
Manufacturing industry	5,654	5,426
Construction and property	15,053	10,051
Hotels, restaurants and wholesale and retail trade	5,930	5,126
Transport, storage and communication	4,736	2,925
Financial	6,716	7,225
Other services	9,850	9,900
Individuals		
Home mortgages	127,636	110,412
Other personal lending	13,874	11,421
Overseas residents	7,700	6,492
Gross loans and advances to customers	199,785	171,562

Loans and advances to customers which have been securitised are shown below. These meet the criteria set out in FRS 5 "Reporting the Substance of Transactions", for a linked presentation format.

		At 31 December 2001	At 31 December 2000		
	Assets securitised	Gross assets securitised	Non-returnable finance	Gross assets securitised	Non-returnable finance
	£ million	£ million	£ million	£ million	£ million
SWAN Trust	Mortgages	204	204	337	337
Mound Financing (No 1) PLC	Mortgages	750	748	750	748
Mound Financing (No 2) PLC	Mortgages	750	748		
Melrose Financing No 1 plc	Corporate Loans	1,500	1,441		
Birmingham Midshires Mortgage Asset No 1 Ltd	Mortgages			37	36
		3,204	3,141	1,124	1,121

These special purpose companies, all of which are ultimately beneficially owned by charitable trusts, have been funded primarily through the issue of floating rate notes. Neither the Company nor its subsidiary undertakings will support any losses that may be suffered by the noteholders in accordance with the terms of the notes. When all liabilities to the noteholders have been discharged any remaining surpluses in the securitisation companies accrue to the Company or its subsidiary undertakings.

Neither the Company nor its subsidiary undertakings have the right or obligation to repurchase any securitised advance unless it has been in breach of warranty.

The HBOS Group undertakings and third parties have entered into a number of interest rate swaps with the securitisation undertakings, the intention of which is to swap all or part of the interest flows from customers into variable rate interest flows to match the variable rate interest payable to the noteholders.

In February 2001, £750 million of mortgages and £1,500 million of corporate loans were securitised through Mound Financing (No 2) PLC and Melrose Financing No 1 plc respectively.

In aggregate the securitisation undertakings had net interest income of £3.7 million (2000 - £1.6 million); operating expenses of £1.5 million (2000 - £0.2 million); provisions for bad and doubtful debts of £0.2 million (2000 - £0.2 million); resulting in a profit for the period of £2.0 million (2000 - £1.2 million).

17 Non-performing Assets

The aggregate gross non-performing loans and advances is £4,072 million (2000 - £3,666 million) including £1,125 million (2000 - £903 million) of advances on which interest is being held in suspense. Net of provisions and interest in suspense, non-performing loans and advances amount to £2,180 million (2000 - £1,992 million).

18 Provisions for Bad and Doubtful Debts

	Group		
	Specific £ million	General £ million	Total £ million
At 1 January 2001	971	607	1,578
Exchange translation	(2)	(3)	(5)
Acquisitions	16	11	27
New provisions less releases	595	52	647
Amounts written off	(478)		(478)
Cumulative provisions as at 31 December 2001	1,102	667	1,769
New provisions less releases	595	52	647
Recoveries of amounts previously written off	(39)		(39)
Net charge to profit and loss account	556	52	608

19 Operating Lease Assets

Assets leased to customers include the following amounts in respect of operating leased assets:

	Group
	£ million
Cost	
At 1 January 2001	1,956
Additions	1,305
Disposals	(775)
At 31 December 2001	2,486
Aggregate depreciation	(444)
Net Book Value at 31 December 2001	2,042
Net Book Value at 31 December 2000	1,519

20 Debt Securities

	2001				2000			
	Issued by Public Bodies £ million	Issued by Others £ million	Total £ million	Market Value £ million	Issued by Public Bodies £ million	Issued by Other £ million	Total £ million	Market Value £ million
Group								
Investment securities								
Listed								
British Government Securities	378		378	384	2,313		2,313	2,337
Others	2,096	10,992	13,088	13,144	1,739	9,393	11,132	11,154
Unlisted								
Certificates of deposit issued by banks and building societies		5,138	5,138	5,152		8,902	8,902	8,920
Others	1,221	9,395	10,616	10,623	1,238	5,431	6,669	6,693
Total investment securities	3,695	25,525	29,220	29,303	5,290	23,726	29,016	29,104
Other securities								
Listed	1,454	397	1,851	1,851	3		3	3
Unlisted	229	11,149	11,378	11,378	142	382	524	524
	5,378	37,071	42,449	42,532	5,435	24,108	29,543	29,631
of which:								
maturing within 1 year			22,189				12,919	
in more than 1 year			20,260				16,624	
			42,449				29,543	

The movement on debt securities held as investment securities is as follows:

	Group		
	Amortised Cost £ million	Aggregate amount written off £ million	Book Value £ million
At 1 January 2001	29,026	(10)	29,016
Exchange translation	189		189
Acquisitions	212		212
Additions	64,094		64,094
Amortisation	(51)		(51)
Disposals	(64,227)	2	(64,225)
Amount written off		(15)	(15)
At 31 December 2001	29,243	(23)	29,220
Aggregate unamortised premium at 31 December 2001	(45)		(45)

Debt securities include securities with a market value of £1,077 million (2000 - £1,058 million) for the Group sold subject to agreement to repurchase.

Debt securities include asset backed securities of £7,670 million (2000 - £1,332 million) which have been sold by the Company's subsidiary, Halifax plc, to bankruptcy remote special purpose vehicles funded by the issue of commercial paper on terms whereby the rewards and some of the risks of the portfolio have been retained by Halifax plc. The securitisation does not qualify for linked presentation under FRS 5 and the asset backed securities have therefore been retained on the Group balance sheet with commercial paper being included within debt securities in issue (Note 32).

21 Equity Shares

	Listed				Unlisted		Total Book Value £ million
	Cost £ million	Aggregate amount written off £ million	Book Value £ million	Cost £ million	Aggregate amount written off £ million	Book Value £ million	
Group							
At 1 January 2001	19		19	135	(7)	128	147
Exchange translation				1		1	1
Acquisitions	25		25	35		35	60
Additions	23		23	52		52	75
Disposals	(3)		(3)	(52)	2	(50)	(53)
Amounts written off					(6)	(6)	(6)
At 31 December 2001	64		64	171	(11)	160	224

The total value of investments as at 31 December 2001 for the Group was £285 million (2000 - £301 million) including £114 million (2000 - £156 million) in respect of listed equity shares.

22 Interests in Joint Ventures and Associated Undertakings

(i) Joint Ventures

	Group				
	Acquired Book Value £ million	Equity Adjustments £ million	Share of Net Tangible Assets £ million	Goodwill £ million	Book Value £ million
At 1 January 2001	112	(44)	68	116	184
Acquisitions and subscriptions of capital	39		39		39
Disposals		(1)	(1)		(1)
Equity accounting adjustments				(6)	(6)
At 31 December 2001	151	(45)	106	110	216

(ii) Associated Undertakings

	Group				
	Acquired Book Value £ million	Equity Adjustments £ million	Share of Net Tangible Assets £ million	Goodwill £ million	Book Value £ million
At 1 January 2001	115	9	124	(1)	123
Acquisitions and subscriptions of capital	30		30		30
Disposals	(18)	(13)	(31)	1	(30)
Equity accounting adjustments		11	11		11
At 31 December 2001	127	7	134		134

All the investments are unlisted.

The main joint ventures and associated undertakings are listed in Note 54 on page 106 of the audited consolidated accounts of HBOS for the financial year ended 31 December 2001.

23 Shares in Group Undertakings

	Banks £ million	Others £ million	Total £ million
Acquisitions and subscriptions of capital	734	567	1,301
At cost at 31 December 2001	734	567	1,301

The main subsidiary undertakings of the Group are listed in Note 55 on page 107 of the audited consolidated accounts of HBOS for the financial year ended 31 December 2001.

On 10 September 2001, the merger of Bank of Scotland Group and Halifax Group by way of Schemes of Arrangement under Section 425 of the Companies Act 1985 was completed. HBOS plc became established as the parent company of Bank of Scotland and Halifax Group plc. On 7 September 2001 the Company acquired 100% of the Ordinary Stock and Preference Stock of Bank of Scotland. On 10 September 2001, the Company acquired 100% of the Ordinary Share capital of Halifax Group plc.

24 Intangible Fixed Assets

	Goodwill £ million
<hr/>	
Cost	
At 1 January 2001	1,106
Exchange translation	(2)
Fair value adjustments (Note 50)	27
Additions (Note 50)	241
At 31 December 2001	1,372
<hr/>	
Amortisation and provisions for impairment	
At 1 January 2001	59
Amortisation charged in year	68
At 31 December 2001	127
<hr/>	
Net Book Value	
At 31 December 2001	1,245
At 31 December 2000	1,047
<hr/>	

Goodwill on acquisitions is capitalised and amortised by equal instalments over its estimated useful life, normally 20 years.

25 Tangible Fixed Assets

			Group
	Cost £ million	Depreciation £ million	Book Value £ million
Property			
At 1 January 2001	1,274	(387)	887
Exchange translation	(2)		(2)
Additions and transfers	76	1	77
Disposals	(45)	15	(30)
Depreciation for year		(47)	(47)
At 31 December 2001	1,303	(418)	885
of which:			
Freehold			700
Long leasehold			85
Short leasehold			100
			<u>885</u>
Occupied for own activities			<u>745</u>
Equipment			
At 1 January 2001	1,521	(832)	689
Exchange translation	(4)	3	(1)
Additions and transfers	313		313
Acquisitions	20	(4)	16
Disposals	(124)	62	(62)
Depreciation for year		(213)	(213)
At 31 December 2001	1,726	(984)	742
Total tangible fixed assets 2001	3,029	(1,402)	1,627
Total tangible fixed assets 2000	2,795	(1,219)	1,576
Equipment includes amounts acquired under finance leases	32	(28)	4

Included within Group tangible fixed assets are assets in the course of construction amounting to £89 million (2000 - £89 million) which are not depreciated until the assets are brought into use.

26 Other Assets

	Group	
	2001	2000
	£ million	£ million
Own shares (Note 27)	5	6
Positive market values of trading derivative contracts	2,813	1,195
Other assets	1,387	1,502
	4,205	2,703

27 Own Shares

Included in other assets are own shares held as follows:

(a) No. 1 Employee Share Ownership Trust (formerly Halifax Group plc Employee Share Ownership Plan)

The No. 1 Employee Share Ownership Trust administers shares conditionally granted to Halifax Executive Directors and other Executives under the Halifax Group plc Short Term Executive Bonus Scheme and the Halifax Group plc Long Term Executive Bonus Scheme, and shares which have been conditionally granted to employees under the Halifax Group plc Annual Bonus Plan.

Interest free loans have been provided by Halifax Group plc to the trust to allow shares to be purchased in the market to satisfy these share grants. The cost of the shares conditionally awarded is being charged to the profit and loss account on a straight line basis over the performance period.

On 10 September 2001, HBOS plc replaced Halifax Group plc as the principal company, the name of the trust was amended, and the Halifax Group plc shares held in the trust were replaced by HBOS plc shares on a one-for-one basis.

As a consequence of the merger, 0.6 million shares conditionally awarded under the Halifax Group plc Short Term Executive Scheme were released early from the trust.

At 31 December 2001, 2.1 million HBOS plc ordinary shares (2000 - 2.0 million Halifax Group plc ordinary shares) were held by the trustee and included in the balance sheet of HBOS plc. The shares, with a nominal value of 25p each, had a total market value at that date of £17 million (2000 - £13 million). Under the terms of the trust, dividends on these shares are waived. At 31 December 2001 all these shares had been conditionally granted.

(b) Halifax plc Qualifying Employee Share Ownership Trust (the "QUEST")

A QUEST has been operated by the Company's subsidiary, Halifax plc, in conjunction with an employee saving-related share option scheme (Halifax plc Sharesave Scheme 1997).

Contributions to the QUEST prior to the merger were used to subscribe for ordinary shares in Halifax plc at market value. These Halifax plc shares were exchanged for Halifax Group plc shares under a scheme of arrangement in June 1999, and these shares have been exchanged subsequently for HBOS plc shares under the terms of the scheme of arrangement effecting the merger in September 2001. The ordinary shares held by the QUEST are included within own shares in the balance sheet at nil value.

At 31 December 2001, the QUEST held 14.6 million HBOS plc ordinary shares (2000 - 14.6 million Halifax Group plc ordinary shares) with a market value of £116 million (2000 - £97 million).

Under the terms of the trust deed, dividends are required to be waived on the shares held by the QUEST.

Participants in the Halifax plc Sharesave Scheme 1997 and Halifax Group plc Sharesave Scheme 1999 have been given the opportunity to exchange their existing rights over Halifax Group plc ordinary shares for new rights over HBOS plc ordinary shares, on a one-for-one basis. The new rights are identical to the existing rights, including the option price, and will continue to be governed by the existing rules of the Sharesave Scheme.

28 Capital and Other Commitments

	Group	
	2001	2000
	£ million	£ million
There are commitments in respect of capital expenditure on fixed assets, authorised but not provided for in the accounts for which contracts have been entered into	25	49
Included in deposits by banks and in customer accounts are net obligations under finance leases payable as follows:		
within 1 year	8	9
between 2 and 5 years	14	21

Commitments for which contracts have been placed in relation to operating lease assets were £251 million (2000 - £22 million).

29 Long-Term Assurance Business

The value of long-term assurance business is actuarially assessed and comprises the surplus attributable to the Group, including minority interests, together with the net present value of in-force business. This method of calculating the net worth of the business to the Group is known as the embedded value approach. The principal economic assumptions behind the embedded value calculation are reviewed regularly and are as follows:

	2001	2000
	%	%
Risk discount rate (net of tax) for traditional with profits business	8.5	8.5
Risk discount rate (net of tax) for other business	9.5	10.0
Return on equities (net of tax credits)	7.5	7.0
Return on Gilts (gross of tax)	5.0	5.0
Expense inflation	3.0	3.0

In-force business is defined as all live policies where the first premium has been paid. The Group's entitlement is equivalent to one ninth of the value of traditional with profits business bonuses declared in any particular year. The level of assumed future bonuses is calculated by projecting the portfolio of with profits business forward and applying reversionary and terminal bonus rates at such a level as to exhaust the projected surplus of assets attributable to with profit policyholders over liabilities. For all other business the entire surplus is attributable to the Group.

The income from long-term assurance business which is included within other operating income in the consolidated profit and loss account is calculated as follows:

	2001	2000
	£ million	£ million
Closing value of Group's interest in long-term assurance business including minority interests	3,265	2,400
Opening value of Group's interest in long-term assurance business including minority interests	(2,400)	(1,762)
Increase in value of long-term assurance business	865	638
Transfer to long-term assurance business	(254)	(81)
Transfer of long-term assurance business of The Equitable (Note 50(b))	(277)	
Transfer of long-term assurance business of St. James's Place Capital plc (Note 50(c))	21	(336)
Income after tax from long-term assurance business	355	221
Taxation relating to long-term assurance business (Note 10)	115	67
Income before tax from long-term assurance business (Note 1)	470	288

The assets and liabilities attributable to policyholders are presented separately from those arising from other Group activities to reflect the different nature of the policyholders' interest.

The long-term assurance assets attributable to policyholders comprise:

	2001	2000
	£ million	£ million
Investments	37,591	31,464
Value of in-force policies	2,993	2,107
Net current assets/(liabilities)	282	(113)
	40,866	33,458
Long-term assurance business attributable to shareholders	(3,265)	(2,400)
Long-term assurance assets attributable to policyholders	37,601	31,058
Long-term assurance liabilities attributable to policyholders	37,601	31,058

Derivatives (options and futures) are used for efficient portfolio management of the long-term assurance business and to match obligations to policyholders. These derivatives are included in investments at market value.

30 Deposits by Banks

	Group	
	2001	2000
	£ million	£ million
Repayable on demand	8,440	6,653
Repayable		
in 3 months or less	16,267	15,793
between 3 months and 1 year	5,632	2,877
between 1 and 5 years	44	5
after 5 years	66	
	30,449	25,328
Amounts above include:		
Associated undertakings	444	386

31 Customer Accounts

	Group	
	2001	2000
	£ million	£ million
Repayable on demand	116,715	103,603
Repayable		
in 3 months or less	18,961	18,679
between 3 months and 1 year	3,917	3,345
between 1 and 5 years	876	1,282
after 5 years	47	103
	140,516	127,012
Amounts above include:		
Associated undertakings	9	13
Joint ventures	29	3

32 Debt Securities in Issue

	Group	
	2001	2000
	£ million	£ million
Bonds and Medium Term Notes		
Repayable		
within 1 year	8,668	3,628
between 1 and 2 years	3,552	6,088
between 2 and 5 years	3,699	4,526
after 5 years	2,546	2,437
	18,465	16,679
Other Debt Securities		
Repayable		
in 3 months or less	38,584	30,126
between 3 months and 1 year	12,202	6,600
between 1 and 2 years	206	98
between 2 and 5 years	67	171
after 5 years	4	4
	51,063	36,999
Total Debt Securities in Issue	69,528	53,678

Bonds and Medium Term Notes includes £320 million (2000 - £336 million) secured on advances to customers and certain other assets of the Group.

Other Debt Securities includes £7,711 million (2000 - £1,341 million) in respect of commercial paper issued to fund the purchase of asset backed securities by special purpose vehicles (Note 20).

33 Other Liabilities

	Group	
	2001	2000
	£ million	£ million
Negative market values of trading derivative contracts	2,580	1,046
Unclaimed shares	286	
Short positions in government debt securities	615	
Other liabilities	1,672	1,791
	5,153	2,837

Unclaimed shares comprises the net sale proceeds of certain Halifax Group plc ordinary shares which, following the Halifax Group restructuring which took effect on 1 June 1999, represented

Halifax plc ordinary shares. These shares were issued to meet claims for Halifax plc ordinary shares from qualifying members of Halifax Building Society and others following the transfer of business from Halifax Building Society to Halifax plc in 1997. This liability also includes the related unclaimed dividends up to the date of sale and the unclaimed capital payments arising from the Halifax Group restructuring in 1999. These amounts are being held on behalf of the persons who would have been entitled to claim the shares before they were sold.

34 Provisions for Liabilities and Charges

		Group			
		2001			
(i) Deferred Taxation		£ million			
At 1 January 2001		497			
Charge in year (Note 10)		121			
Other movements		10			
At 31 December 2001		628			
		2001		2000	
		Provided for in Accounts £ million	Full Potential Liability £ million	Provided for in Accounts £ million	Full Potential Liability £ million
Deferred taxation comprises:					
Group					
Capital allowances:					
on assets leased to customers	574	574	446	446	
on other assets	37	37	36	36	
Other timing differences	17	(103)	15	(106)	
	628	508	497	376	

	Group				
(ii) Other Provisions	Pensions Review Provision £ million	Pensions and Other similar Obligations £ million	HBOS Integration Provision £ million	Other Provisions £ million	Total £ million
At 1 January 2001	37	109		17	163
Exchange translation				(1)	(1)
Arising on acquisition				12	12
Charge for year	(5)	42	132	2	171
Utilised in year	(9)	(13)	(67)	(4)	(93)
At 31 December 2001	23	138	65	26	252

The pensions review provision has been established to cover estimated administrative costs and compensation payable in connection with Phases 1 and 2 of the Pensions Review and the FSAVC Review. A further provision of £41 million (2000 - £51 million) to cover direct and indirect costs arising from the pensions review is included in the long-term assurance business liabilities attributable to policyholders.

Of the provision for pensions and similar obligations, £33 million relates to post-retirement benefits (2000 - £31 million).

Other provisions include property related costs on surplus leased space.

35 Subordinated Liabilities

	Group	
	2001 £ million	2000 £ million
Dated Loan Capital		
DFL7 million 9.72% Registered Loans 2000/2001		2
€51.1 million 8.30% Notes 2002	31	
US\$300 million 8.80% Notes 2004	207	201
£400 million 8.75% Subordinated Notes 2006	400	400
US\$150 million 8.85% Notes 2006	103	100
£75 million 9.125% Subordinated Notes 2006	75	75
£60 million 9.00% Instruments 2006	60	60
A\$100 million Callable Notes 2007	35	37
€650 million 4.75% Subordinated bonds 2009	397	405
US\$500 million Floating rate subordinated step-up callable notes 2009	345	335

	Group	
	2001	2000
	£ million	£ million
€500 million 5.50% Instruments 2009	305	311
£75 million Floating rate subordinated notes 2009	75	75
US\$500 million Notes 2010	344	335
£75 million Floating Rate Instruments 2010	75	75
US\$150 million Notes 2011	103	100
€7 million Floating Rate Notes 2011	4	
£200 million Floating rate step-up callable subordinated notes 2012	200	200
€12.8 million 6.25% Instruments 2012	8	
€1,000 million Subordinated callable fixed/floating rate instruments 2013	611	
€325 million 6.125% Notes 2013	198	
£250 million 11% Subordinated bonds 2014	250	250
£150 million 10.5% Subordinated bonds 2018	150	150
£250 million 6.375% Instruments 2019	250	250
£500 million 9.375% Subordinated bonds 2021	500	500
€400 million 6.45% Eurodated Floating subordinated guaranteed bonds 2023	251	
Unamortised Premiums, Discounts and Issue Costs	(11)	(7)
	4,966	3,854
Repayable:		
within 1 year	31	2
between 2 and 5 years	845	201
after 5 years	4,090	3,651
	4,966	3,854

No repayment, for whatever reason, of dated subordinated debt prior to its stated maturity and no purchase by the relevant subsidiary undertaking of its subordinated debt may be made without the consent of the Financial Services Authority. On a winding up of the relevant company, the claims of the holders of dated subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of that company other than creditors whose claims are expressed to rank *pari passu* with or junior to the claims of the holders of the dated subordinated debt.

Interest on the floating rate subordinated US dollar step-up callable note 2009 is payable three months in arrear at US dollar LIBOR plus a margin of 0.35% per annum for years 1 to 5 and 0.85% per annum thereafter.

Interest on the £200 million floating rate step-up callable note dated 2012 is payable three months in arrear at LIBOR plus a margin of 0.25% per annum for years 1 to 10 and 1.25% per annum thereafter.

The €1,000 million Instruments bear interest at a fixed rate of 5.125% until 5 December 2008 at which time the interest rate becomes 3 month €EUR-EURIBOR-Telerate plus 1.00% until maturity. These instruments may, at the option of the Bank of Scotland, be redeemed at par on 5 December 2008, or any interest payment date thereafter.

	Group	Company
	2001	2001
	£ million	£ million
Undated Loan Capital		
£600 million Fixed to Floating Rate Undated Subordinated Notes		600
€500 million Fixed to Floating Rate Undated Subordinated Notes	305	305
£300 million 7.5% Subordinated Step-Up Notes	300	300
US\$300 million Reset Notes	207	201
£200 million Perpetual Notes	200	200
£200 million 7.375% Subordinated Guaranteed Bonds	200	200
€300 million Floating Rate Subordinated Step-up Notes	183	187
US\$250 million Floating Rate Primary Capital Notes	172	167
£150 million Instruments	150	150
£150 million Instruments	150	150
JPY 17 billion Instruments	110	107
£100 million Instruments	100	100
£100 million 12% Perpetual Subordinated Bonds	100	100
£100 million 8.75% Perpetual Subordinated Bonds	100	100
£75 million 13.625% Perpetual Subordinated Bonds	75	75
JPY 9 billion Instruments	47	53
£50 million 9.375% Perpetual Subordinated Bonds	50	50
JPY 42.5 billion 3.50% Subordinated Yen Step-Up Notes	223	
Unamortised Premiums, Discounts and Issue Costs	(12)	(3)
	2,660	2,131
		902

No exercise of any redemption option or purchase by the relevant company of any of its undated subordinated debt may be made without the consent of the Financial Services Authority. On a winding up of the Company or subsidiary undertaking the claims of the holders of perpetual subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of the Company or subsidiary undertaking other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the perpetual subordinated bonds. The perpetual subordinated bonds are junior in point of subordination to the dated subordinated debt referred to above.

The £600 million Fixed to Floating Rate Undated Subordinated Notes were issued to HBOS Capital Funding LP by the Company. HBOS Capital Funding LP has issued preferred securities of equivalent amount. These are included in minority and other interests (non-equity) in the Consolidated Balance Sheet (Note 37).

On 23 November 2001 HBOS plc issued €500 million Fixed to Floating Rate Undated Subordinated Notes at an issue price of 99.67% of their principal amount. The Notes will bear interest at 6.05% per annum payable annually in arrears to 23 November 2011 and thereafter at 3 month EUR-EURIBOR-Telerate plus 2.25% per annum paid quarterly in arrears.

The undated loan capital has no final date of maturity. All or some of the Capital Notes may be redeemed at the option of the relevant company at par on any interest payment date. The £200 million Perpetual Notes may, at the option of Bank of Scotland on 4 November 2013, be redeemed at par or exchanged for new notes. The new notes (and any further new notes issued) may be similarly redeemed or exchanged for further new notes at the option of Bank of Scotland on the fifth anniversary of their respective date(s) of issue.

The Instruments may, at the option of the relevant subsidiary undertaking on giving 30 days notice, be redeemed at par or exchanged for new Instruments on 10 August 2015 (£100 million); 9 February 2016 (JPY 17 billion); 30 May 2016 (JPY 9 billion); 30 October 2006 (£150 million) and 10 February 2023 (£150 million). The new Instruments (and any further new Instruments issued) may be similarly redeemed or exchanged for further new notes at the option of Bank of Scotland on the fifth anniversary of their respective date(s) of issue. The JPY 17 billion Instruments have been converted into an obligation of US\$160 million, bearing interest at US\$ LIBOR plus 1.01% by means of swap arrangements. The Reset Notes may be redeemed at the option of Bank of Scotland at par on 20 November 2007, at which time the interest rate becomes US\$ LIBOR plus 1.625%, or any interest payment date thereafter.

Halifax Group plc has the option, in the case of the 12% Perpetual Subordinated Bonds, at any time after 30 January 2022 and, in the case of the 8.75% Perpetual Subordinated Bonds, 14 September 2023, to redeem some or all of the Bonds at their principal value plus any accrued and unpaid interest. The 13.625% Perpetual Subordinated Bonds and the 9.375% Perpetual Subordinated Bonds carry no optional redemption clauses.

Interest on the undated Sterling 7.5% Subordinated Step-Up Notes is payable annually in arrears on 26 May from 26 May 2001 to 26 May 2016 at the rate of 7.5% per annum and, for each period of five years thereafter, annually in arrears on 26 May at the rate per annum equal to the sum of the five year benchmark Gilt rate plus 3.45%. Halifax Group plc has the option to redeem these Notes on 26 May 2016 and on each fifth anniversary thereafter.

Interest on the undated Euro Floating Rate Subordinated Step-Up Notes is payable on 26 May, 26 August, 26 November and 26 February each year until 26 August 2010 at the rate of 3 month EURIBOR plus a margin of 1.20% per annum and from and including 26 August 2010 at the rate of

3 month EURIBOR plus a margin of 2.30% per annum. Halifax Group plc has the option to redeem these notes on 26 August 2010 and on each interest payment date thereafter.

On 28 February 2001 Halifax Group plc issued 3.50% undated Subordinated Yen Step-Up Notes at an issue price of 100% of their principal amount. Interest on the 3.50% undated Subordinated Yen Step-Up Notes is payable half yearly in arrears on 28 February and 28 August until 28 February 2031 at the rate of 3.50% per annum and from and including 28 August 2031 at the rate of 6 month JPY LIBOR plus a margin of 2.09% per annum. Halifax Group plc has the option to redeem these notes on 28 February 2011, on 28 February 2031 and on each coupon payment date thereafter.

36 Share Capital

	Ordinary Shares £ million	9¼% Non- Cumulative Irredeemable Preference Shares £ million	9¾% Non- Cumulative Irredeemable Preference Shares £ million	Other Preference Shares	
				Sterling £ million	Euro € million
Authorised					
Created in year	1,185	375	125	1,204	1,500
At 31 December 2001	1,185	375	125	1,204	1,500
Allotted, called up and fully paid					
Issued to former shareholders of:					
Bank of Scotland - Preference shares £1		300	100		
Bank of Scotland - Ordinary shares 25p	317				
Halifax Group plc - Ordinary shares 20p	449				
Merger adjustment	112				
At 1 January 2001	878	300	100		
Issued under employee Stock Schemes, in lieu of dividends and acquisitions	14				
At 31 December 2001	892	300	100		

The merger adjustment represents the difference between the nominal value of 25 pence of the shares issued to former Halifax Group plc shareholders and the nominal value of 20 pence of the Halifax Group plc shares acquired.

Other sterling preference shares include £200 million 6.125 per cent. Non-Cumulative Redeemable Preference Shares, £1,000 million Sterling Preference Shares, £2.5 million 8.117 per cent. Non-Cumulative Perpetual Preference Shares Class A and £1.5 million 7.754 per cent. Non-Cumulative Perpetual Preference Shares Class B.

Euro preference shares include €1,500 million Euro preference shares.

The initial authorised share capital was £50,000 divided into 50,000 shares of £1 each. At an Extraordinary General Meeting on 12 June 2001, the shares were sub-divided into 200,000 ordinary shares of 25p each. On 7 September 2001, upon the Bank of Scotland Scheme of Arrangement becoming effective the authorised share capital of HBOS plc increased to £904,000,000 by the creation of a further 1,599,800,000 Ordinary Shares, 375,000,000 9¼ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each, 125,000,000 9¾ per cent. Non-Cumulative

Irredeemable Preference Shares of £1 each, 250,000 HBOS Class A Perpetual Preference Shares of £10 each and 150,000 HBOS Class B Perpetual Preference Shares of £10 each.

On 10 September 2001, upon the Halifax Scheme of Arrangement becoming effective the authorised share capital increased to £2,889,000,000 and €1,500,000,000 by the creation of a further 3,140,000,000 Ordinary Shares, 200,000,000 6.125 per cent. Non-Cumulative Redeemable Preference Shares of £1 each, 1,000,000,000 Sterling Preference Shares of £1 each and 1,500,000,000 Euro Preference Shares.

On 7 September 2001, the Company issued 1,311,553,989 Ordinary Shares, 300,000,000 9¼ per cent. Non-Cumulative Irredeemable Preference Shares and 100,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares as consideration for the acquisition of Bank of Scotland pursuant to the Bank of Scotland Scheme of Arrangement. On 10 September 2001, the Company issued 2,250,439,819 Ordinary Shares as consideration for the acquisition of Halifax Group plc pursuant to the Halifax Group Scheme of Arrangement.

On 12 September 2001, the Company issued 18,526 Ordinary Shares under the terms of the Halifax Group plc Share Ownership Plans.

The Group operates a number of share option schemes for executives and savings-related share option schemes for employees. In connection with the merger, the rules of the executive share option schemes and savings-related share option schemes required that participants either exercise their existing options under the previous schemes or exchange their rights existing under the previous schemes at the date of the merger for new rights over HBOS plc ordinary shares, on a one-for-one basis. Rights which are neither exercised nor exchanged will lapse by 10 March 2002.

At 31 December 2001, options to acquire 7.9 million ordinary shares were outstanding under the former Bank of Scotland executive stock option schemes. These options are exercisable at a range of prices from £1.10 to £7.13 at various dates up to 16 October 2010. Of these, options in respect of 0.6 million shares were outstanding where the scheme participants have not yet elected to either exchange their rights under these schemes for rights over HBOS plc ordinary shares or exercise their options under these former schemes.

At 31 December 2001, options to acquire 52.6 million ordinary shares were outstanding under savings-related share option schemes. These options are exercisable at a range of prices from £1.64 to £5.79 at various dates up to 31 December 2009. Of these, options in respect of 20.3 million shares were outstanding where the scheme participants have not yet elected to exchange their rights under these schemes for rights over HBOS plc ordinary shares or exercise their options under these former schemes.

The Group also operates a number of other Inland Revenue approved and unapproved employee share option schemes. At 31 December 2001, options to acquire 16.3 million ordinary shares were outstanding. These options are exercisable at a range of prices between £6.68 and £6.80 and at various dates up to 21 February 2006.

During the year, a total of 12 million shares were issued on the exercise of options for a consideration of £48 million.

37 Minority and Other Interests (Non-equity)

The principal minority and other interests (non-equity) are set out below.

	2001 £ million	2000 £ million
£600 million preferred securities [∅]	600	
£300 million Perpetual Regulatory tier One securities [^]	300	
£250 million preferred securities [†]	250	250
£150 million preferred securities [†]	150	150
£245 million preferred securities*	245	245
€415 million preferred securities*	257	257
£198 million non-cumulative preference shares**	198	198
	2,000	1,100
Less: unamortised issue costs	(13)	(3)
At 31 December	1,987	1,097

[∅] On 28 November 2001, £600 million Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A were issued through HBOS Capital Funding LP (£594 million net of expenses). These qualify as Tier 1 regulatory capital. These are perpetual securities and are not subject to any mandatory redemption provisions. They are redeemable in 2018, or each fifth anniversary thereafter, at the option of the general partner. The securities have a fixed coupon of 6.461% to 2018. Thereafter, if not redeemed, the coupon will be reset.

[^] On 28 February 2001, £300 million Perpetual Regulatory tier One securities were issued through Bank of Scotland (£297 million net of expenses). These qualify as Tier 1 regulatory capital. A £150 million Series A Issue has a fixed coupon of 7.286% to 2016 and a Series B Issue of £150 million has a fixed coupon of 7.281% to 2026. Thereafter, if not redeemed on their respective dates, for each Issue the coupon will be reset and will be further reset at five yearly intervals. There is an option to settle the coupon payment through the issue of Ordinary Shares. Coupon payments may be deferred but the Bank of Scotland may not declare or pay dividends on any of its Ordinary Shares whilst any coupon payments are deferred.

[†] During 2000, the £250 million and £150 million preferred securities were issued by a subsidiary undertaking of the Bank of Scotland.

^{*} During 1999, the £245 million and €415 million guaranteed non-voting non-cumulative preferred securities were issued by subsidiary undertakings of the Halifax Group.

^{**} During 1999, non-cumulative preference shares were issued by a subsidiary undertaking, Halifax plc, as part of the consideration to acquire the business of the Birmingham Midshires Building Society.

38 Reserves

	Share Premium £ million	Other Reserves £ million	Profit and Loss Account £ million
Group			
At 1 January 2001		209	9,051
Reserve arising on sale of unallocated shares		21	2
Premium arising on the issue of new shares prior to the merger		268	
Premium arising on the issue of new shares	13		
Dividends retained on account of stock dividends			24
Exchange translation		(6)	
Contribution to Employee Share Trust prior to the merger			(20)
Contribution to Employee Share Trust	14		(10)
Cost of employee options granted under company share ownership plans			(36)
Retained profit			646
At 31 December 2001	27	492	9,657
Company			
Premium arising on the issue of new shares	13		
Contribution to Employee Share Trust	14		(10)
Retained profit			43
At 31 December 2001	27		33

Other reserves arising on the sale of unallocated shares of £21 million represent the proceeds received during the year on the sale of certain Halifax Group plc ordinary shares. The £2 million adjustment to the profit and loss account reserve represents a revision to reserves created on the Halifax Group plc reconstruction in 1999. These shares, which, following the Halifax Group restructuring that took effect on 1 June 1999, represented Halifax plc ordinary shares issued to meet claims for Halifax plc ordinary shares from qualifying members of Halifax Building Society and others following the transfer of business from Halifax Building Society to Halifax plc in 1997, and which were no longer considered necessary to meet such claims.

The Group profit and loss account reserve at 31 December 2001 includes £756 million (2000 - £362 million) not presently available for distribution. This represents the excess of retained profits on an embedded value basis over those available for distribution.

The cumulative amount of positive goodwill on acquisitions of subsidiary undertakings written off in the Group reserves is £574 million (2000 - £574 million) and in respect of joint ventures and associated undertakings £nil (2000 - £1 million).

The Ordinary Dividend Stock Alternative Scheme, which was offered as an alternative to the cash dividend to Bank of Scotland stockholders, resulted in £24 million relating to the February 2001 final dividend (2000 - £70 million) being retained by Bank of Scotland and added to reserves.

39 Reconciliation of Shareholders' Funds

	2001	Group	Company
	£ million	2000	2001
		£ million	£ million
Profit attributable to shareholders	1,676	1,778	1,073
Dividends	(1,030)	(826)	(1,030)
Other recognised gains and losses	(6)	(7)	
Dividends retained on account of stock dividends	24	70	
Contribution to Employee Share Trust	(30)	(21)	(10)
Cost of employee options granted under company share ownership plans	(36)		
Ordinary capital subscribed	309	53	919
Preference capital subscribed			400
Reserve arising on sale of unallocated shares	23		
	930	1,047	1,352
Shareholders' Funds at 1 January	10,538	9,491	
Shareholders' Funds at 31 December	11,468	10,538	1,352
of which:			
Attributable to non-equity interests	400	400	400
Attributable to equity interests	11,068	10,138	952
	11,468	10,538	1,352

40 Memorandum Items

The contract amounts noted below indicate the volume of business outstanding at the balance sheet date in respect of contingent liabilities and commitments undertaken for customers. They do not reflect the underlying credit and other risks, which are significantly lower.

	2001	2000
	Contract	Contract
	Amount	Amount
	£ million	£ million
<hr/>		
Group		
Contingent Liabilities		
Acceptances and endorsements	202	160
Guarantees and assets pledged as collateral security		
Guarantees and irrevocable letters of credit	2,133	1,713
	<hr/> 2,335	<hr/> 1,873
Commitments		
Other commitments		
Short-term trade related transactions	202	104
Undrawn formal standby facilities, credit lines and other commitments to lend up to and including 1 year	26,298	19,229
over 1 year	10,772	8,199
	<hr/> 37,272	<hr/> 27,532
	<hr/>	

41 Derivatives

The Group uses interest rate swaps, forward foreign exchange contracts and other derivative instruments to hedge and reduce the interest rate and currency exposures that are inherent in any banking business. Trading transactions are either customer driven and generally matched or are carried out for proprietary trading purposes within limits approved by the Board.

The Group has entered into derivative contracts as noted below. The notional principal amounts and fair values of these derivatives (excluding internal trades) are analysed between non-trading and trading activity. "Fair value" is the amount at which instruments could be exchanged in an arm's length transaction.

	2001			2000		
	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Fair Value Liability £ million	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Fair Value Liability £ million
Group						
Non-Trading						
Exchange Rate Related Contracts						
Forward foreign exchange	1,653	24	12	16,888	114	503
Cross currency swaps	13,264	450	513	10,723	430	538
	14,917	474	525	27,611	544	1,041
Interest Rate Related Contracts						
Interest rate swaps	62,447	1,076	987	77,148	1,263	834
Forward rate agreements	734		1	3,119	10	7
Options	183	6	3	2		
Futures	2,838		4	13,017		
	66,202	1,082	995	93,286	1,273	841
Equity and Commodity Related Contracts						
Options and swaps	520	21	14	614	88	66
Total Non-Trading Derivatives	81,639	1,577	1,534	121,511	1,905	1,948

	2001			2000		
	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Year End Fair Value Liability £ million	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Year End Fair Value Liability £ million
Trading						
Exchange Rate Related Contracts						
Forward foreign exchange	49,887	327	441	14,393	247	278
Cross currency swaps	78	1	1	49		2
Options	483	3	3	285	7	4
	50,448	331	445	14,727	254	284
Interest Rate Related Contracts						
Interest rate swaps	184,125	1,415	1,508	110,950	675	607
Forward rate agreements	6,323	3	3	4,911	6	5
Options	31,364	89	61	14,252	88	5
Futures	80,591	22	60	32,019	5	2
	302,403	1,529	1,632	162,132	774	619
Equity and Commodity Related Contracts						
Options and swaps	323	11	5	349	11	12
Total Trading Derivatives	353,174	1,871	2,082	177,208	1,039	915
Total Group Derivatives	434,813	3,448	3,616	298,719	2,944	2,863

The residual maturity of 'over the counter' (OTC) and non-margined exchange traded contracts was as follows:

	2001		2000	
	Notional Principal Amount £ million	Replacement Cost £ million	Notional Principal Amount £ million	Replacement Cost £ million
Group				
Contracts maturing				
within 1 year	223,122	1,724	150,419	1,243
between 1 and 5 years	91,187	782	83,988	1,028
after 5 years	37,075	920	19,276	668
	351,384	3,426	253,683	2,939

Credit Risk Analyses

Counterparties of the Group's derivative transactions are primarily financial institutions. An institutional and geographical analysis of replacement cost, based on the location of the office writing the business, is shown below:

	Group	
	2001 £ million	2000 £ million
Institutional		
Financial Institutions	3,094	2,598
Non-financial Institutions	332	341
	3,426	2,939
Geographical		
UK	3,190	2,698
Rest of World	236	241
	3,426	2,939

The Group's objectives and policies in managing the risks that arise in connection with the use of financial instruments are set out on pages 41 to 43 of the Financial Review and Risk Management.

42 Fair Value of Financial Assets and Financial Liabilities

Fair values of financial assets and financial liabilities are based on market prices where available, or are estimated using other valuation techniques. Where they are short-term in nature or reprice frequently fair value approximates to carrying value.

Derivatives held for trading purposes as disclosed in Note 41 are carried at fair values. Derivatives held for non-trading purposes are accounted for in the same way as the underlying transaction being hedged. Fair values are based on market prices where available, or are estimated using other valuation techniques.

The following table shows the carrying amount and the fair value of financial assets and liabilities analysed between trading and non-trading:

	2001				2000			
	Assets		Liabilities		Assets		Liabilities	
	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million
Group								
Non-Trading								
Treasury bills and other eligible bills	3,050	3,051			3,196	3,199		
Debt securities	29,220	29,303			29,016	29,104		
Equity shares	224	285			147	301		
Debt securities in issue			69,162	66,961			53,507	53,528
Dated loan capital			4,966	5,709			3,854	4,243
Undated loan capital			2,660	2,705			2,131	2,194
Preference stocks			400	577			400	522
Minority and other interests (non-equity)			1,987	2,224			1,097	1,129
Derivatives	1,298	1,577	979	1,534	1,651	1,905	1,309	1,948
Total Non-Trading	33,792	34,216	80,154	79,710	34,010	34,509	62,298	63,564
Trading								
Treasury bills and other eligible bills	1,021	1,021						
Loans and advances to banks	463	463			282	282		
Loans and advances to customers	480	480			8	8		
Debt securities	13,229	13,229			527	527		

	2001				2000			
	Assets		Liabilities		Assets		Liabilities	
	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million
Other assets	165	165						
Debt securities in issue			366	366			171	171
Deposits by banks			6,649	6,649			173	173
Customer accounts			1,991	1,991			50	50
Other liabilities			946	946				
Derivatives	1,871	1,871	2,082	2,082	1,039	1,039	915	915
Total Trading	17,229	17,229	12,034	12,034	1,856	1,856	1,309	1,309

Fair values in respect of non-trading financial assets and liabilities are disclosed only where there is a liquid and active market.

Fair value information is not provided for items that do not meet the definition of a financial instrument or for certain other financial instruments, including short-term debtors and creditors. The fair value information presented does not therefore represent the fair value of the Group as a going concern at 31 December 2001.

43 Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	2001		
	Gains £ million	Losses £ million	Total Net Gains/ (Losses) £ million
Group			
Unrecognised gains and losses on hedges at 1 January 2001	877	1,262	(385)
Gains and losses arising in previous years that were recognised in the year ended 31 December 2001	421	771	(350)
Gains and losses arising before 1 January 2001 that were not recognised in the year ended 31 December 2001	456	491	(35)
Gains and losses arising in the year ended 31 December 2001 that were not recognised in that year	369	610	(241)

			2001
Unrecognised gains and losses on hedges at 31 December 2001	825	1,101	(276)
of which:			
Gains and losses expected to be recognised in the year ended 31 December 2002	233	663	(430)
Gains and losses expected to be recognised after 31 December 2002	592	438	154
			2000
	Gains £ million	Losses £ million	Total Net Gains/ (Losses) £ million
Group			
Unrecognised gains and losses on hedges at 1 January 2000	735	542	193
Gains and losses arising in previous years that were recognised in the year ended 31 December 2000	313	367	(54)
Gains and losses arising before 1 January 2000 that were not recognised in the year ended 31 December 2000	422	175	247
Gains and losses arising in the year ended 31 December 2000 that were not recognised in that year	455	1,087	(632)
Unrecognised gains and losses on hedges at 31 December 2000	877	1,262	(385)
of which:			
Gains and losses expected to be recognised in the year ended 31 December 2001	381	784	(403)
Gains and losses expected to be recognised after 31 December 2001	496	478	18

44 Interest Rate Sensitivity Gap

The tables below summarise the repricing profiles of the Group's assets and liabilities.

As at 31 December 2001

	Not more than 3 months £ million	Over 3 months but not over 6 months £ million	Over 6 months but not over 1 year £ million	Over 1 year but not over 5 years £ million	Over 5 years £ million	Non- interest bearing £ million	Trading £ million	Total £ million
Assets								
Treasury bills and other eligible bills	2,001	948	9	92			1,021	4,071
Loans and advances to banks	9,772	1,542	462	169	26	495	463	12,929
Loans and advances to customers	150,282	5,732	4,110	27,040	9,893	356	480	197,893
Debt securities and equity shares	19,550	5,023	1,589	2,102	729	451	13,229	42,673
Other assets	224	221	215	589	684	12,197	2,978	17,108
	181,829	13,466	6,385	29,992	11,332	13,499	18,171	274,674
Liabilities								
Deposits by banks	19,943	1,951	1,196	27	18	665	6,649	30,449
Customer accounts	127,404	2,465	2,840	3,779	150	1,887	1,991	140,516
Debt securities in issue	52,011	9,435	4,317	1,441	1,952	6	366	69,528
Other liabilities			1	20		9,138	3,526	12,685
Subordinated liabilities	1,268	203		785	5,370			7,626
Minority interests and shareholders' funds						13,870		13,870
Internal funding of trading business	(5,639)						5,639	
	194,987	14,054	8,354	6,052	7,490	25,566	18,171	274,674
On-balance sheet gap	(13,158)	(588)	(1,969)	23,940	3,842	(12,067)		
Non-trading derivatives	6,598	(746)	(1,372)	(9,305)	4,825			
Net interest rate repricing gap 2001	(6,560)	(1,334)	(3,341)	14,635	8,667	(12,067)		
Cumulative gap 2001	(6,560)	(7,894)	(11,235)	3,400	12,067			

As at 31 December 2000

	Not more than 3 months £ million	Over 3 months but not over 6 months £ million	Over 6 months but not over 1 year £ million	Over 1 year but not over 5 years £ million	Over 5 years £ million	Non- interest bearing £ million	Trading £ million	Total £ million
Assets								
Treasury bills and other eligible bills	2,919	185	19	73				3,196
Loans and advances to banks	14,493	2,253	618	87	24	360	282	18,117
Loans and advances to customers	118,657	5,241	3,499	29,737	12,211	535	8	169,888
Debt securities and equity shares	18,888	2,504	3,355	3,237	652	527	527	29,690
Other assets	5			1,277	247	11,470	1,195	14,194
	154,962	10,183	7,491	34,411	13,134	12,892	2,012	235,085
Liabilities								
Deposits by banks	21,664	1,820	1,256	4		411	173	25,328
Customer accounts	115,015	2,433	3,341	4,322	48	1,803	50	127,012
Debt securities in issue	40,334	4,253	3,526	3,398	1,996		171	53,678
Other liabilities				24	3	9,997	1,046	11,070
Subordinated liabilities	904	167		201	4,713			5,985
Minority interests and shareholders' funds						12,012		12,012
Internal funding of trading business	(572)						572	
	177,345	8,673	8,123	7,949	6,760	24,223	2,012	235,085
On-balance sheet gap	(22,383)	1,510	(632)	26,462	6,374	(11,331)		
Non-trading derivatives	14,501	(8,775)	(1,144)	(8,331)	3,749			
Net interest rate repricing gap 2000	(7,882)	(7,265)	(1,776)	18,131	10,123	(11,331)		
Cumulative gap 2000	(7,882)	(15,147)	(16,923)	1,208	11,331			

All derivative instruments which alter the interest bases of the non-trading portfolio of assets and liabilities are reflected in the above tables.

45 Trading Value at Risk

The Group's Value at Risk (VaR) methodology of estimating potential losses arising from the Group's exposure to market risk is explained on page 43 of the Financial Review and Risk Management. The Group's trading market risk exposure for the year ended 31 December 2001 is analysed below.

	Exposure							
			Average		Highest		Lowest	
	As at 31 December 2001 £ million	As at 31 December 2000 £ million	2001 £ million	2000 £ million	2001 £ million	2000 £ million	2001 £ million	2000 £ million
Total Value at Risk	13.8	3.1	8.0	1.7	21.4	4.5	0.8	0.2

For all significant exposures VaR has been calculated on a daily basis.

46 Non-trading Currency Exposure

Structural currency exposures arise from the Group's investments in overseas subsidiaries, branches and other investments and are noted in the table below.

	2001			2000		
	Net investments in overseas operations £ million	Borrowing taken out to hedge the net investments £ million	Remaining structural currency exposure £ million	Net investments in overseas operations £ million	Borrowing taken out to hedge the net investments £ million	Remaining structural currency exposure £ million
US Dollar	114	85	29	36	12	24
Euro	212	56	156	65	55	10
Australian Dollar	307	281	26	267	232	35
Other	2	2		2	2	
Total	635	424	211	370	301	69

As at 31 December 2001 and 31 December 2000 there are no material net currency exposures in the non-trading book relating to transactional (or non-structural) positions that would give rise to net currency gains or losses for the reason set out on page 43 of the Financial Review and Risk Management.

47 Assets and Liabilities in Foreign Currencies

	Group	
	2001	2000
	£ million	£ million
The aggregate amounts of assets and liabilities denominated in currencies other than sterling were:		
Assets	59,932	49,361
Liabilities	82,912	59,388

The above figures do not reflect the Group exposure to foreign exchange, which is significantly lower as it is hedged by off-balance sheet instruments.

48 Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2001	2000
	£ million	£ million
Group operating profit	2,670	2,683
Decrease/(increase) in accrued income and prepayments	395	(642)
(Decrease)/increase in accruals and deferred income	(840)	1,561
Provision for bad and doubtful debts	608	471
Depreciation and goodwill amortisation	538	490
Amortisation of debt securities	51	21
Increase in the income from long-term assurance business	(470)	(288)
Interest on subordinated loans	467	422
Profits on sale of investment securities	(92)	(116)
Profits on sale of fixed assets	(7)	(19)
Provisions for liabilities and charges	171	17
Provisions utilised	(93)	(19)
Provision against debt securities and equity shares	21	9
Exchange differences	(194)	(102)
Other non-cash movements	14	
Net cash inflow from trading activities	3,239	4,488
Net increase in notes in circulation	84	108
Net (increase)/decrease in items in course of collection	(229)	121
Net (increase)/decrease in treasury and other eligible bills	(875)	255
Net increase in loans and advances to banks and customers	(21,979)	(21,286)

	2001 £ million	2000 £ million
Net increase in deposits by banks and customer accounts	16,370	15,441
Net increase in debt securities in issue	15,850	5,960
Net increase in other assets	(1,320)	(1,117)
Net increase in other liabilities	2,233	678
Net (increase)/decrease in debt securities	(12,702)	133
Net cash inflow from operating activities	671	4,781

49 Gross Cash Flows

	Notes	2001 £ million	2000 £ million
(i) Returns on investments and servicing of finance			
Interest paid on loan capital		(456)	(395)
Preference dividends paid		(37)	(37)
Dividends paid to minority shareholders in subsidiary undertakings		(145)	(102)
		(638)	(534)
(ii) Capital expenditure and financial investment			
Transfers to long-term assurance business		(254)	(81)
Purchase of investment securities		(64,169)	(72,709)
Sale and maturity of investment securities		64,370	72,282
Purchase of property and equipment		(390)	(452)
Sale of property and equipment		99	130
Movement in own shares		1	6
Purchase of operating lease assets		(1,305)	(1,328)
Sale of operating lease assets		572	598
		(1,076)	(1,554)
(iii) Acquisitions and disposals			
Investment in subsidiary undertakings		(700)	(932)
Investment in associated undertakings, joint ventures and business interests		(69)	(54)
Disposal of associated undertakings, joint ventures and business interests		31	
Minority interest acquired		4	
Minority interest disposed		(5)	
		(739)	(986)

(iv) Financing

Issue of ordinary stock	52	275	53
Issue of subordinated loan capital	52	1,595	935
Issue of Perpetual Regulatory tier One securities		297	
Issue of preferred securities		594	400
Repayments of subordinated loan capital	52	(33)	(185)
Contribution to Employee Share Trust		(30)	(21)
Cost of employee options granted under company share ownership plans		(36)	
Other movements	52		2
		2,662	1,184

50 Acquisitions and Disposals**(a) ICC Bank plc**

On 16 February 2001, Bank of Scotland acquired 99.99% of the share capital of ICC Bank plc, which is based in Ireland. The remaining equity has been acquired during the year. The consideration of £227 million inclusive of fees and expenses was satisfied partly in cash raised from the proceeds of a placing of Bank of Scotland stock and partly by stock issued.

The summarised profit and loss account for ICC Bank plc included in the results of the Group from 16 February 2001 to 31 December 2001 is as follows:

	2001
	£ million
Interest receivable	128
Interest payable	(78)
Net interest income	50
Fees and commissions receivable	9
Fees and commissions payable	(1)
Other operating income	7
Net operating income	65
Administrative expenses	(19)
Depreciation	(1)
Operating expenses	(20)
Provisions for bad and doubtful debts	(4)
Operating profit	41

The net assets at the date of acquisition are shown in the table below.

	Acquired book value £ million	Revaluation adjustments £ million	Accounting policy adjustments £ million	Total fair value adjustments £ million	Fair value to the Group £ million
Loans and advances to banks and customers	2,239	(4)		(4)	2,235
Debt securities and equity shares	233	39		39	272
Other assets, prepayments and accrued income	41		(1)	(1)	40
Total assets	2,513	35	(1)	34	2,547
Deposits by banks, customer accounts and debt securities in issue	2,255				2,255
Other liabilities, accruals and deferred income and other provisions	48				48
Subordinated liabilities	78	1		1	79
Minority interests	2				2
Total liabilities	2,383	1		1	2,384
Net assets	130	34	(1)	33	163
Goodwill					64
Consideration					227
Satisfied by:					
Cash					193
Shares issued at fair value					34
					227

In accordance with FRS 7 "Fair Values in Acquisition Accounting", the principal fair value adjustment reflects the revaluation of debt securities and equity shares to market value. The other accounting policy and revaluation adjustments are not individually material.

(b) Equitable Life Assurance Society ("The Equitable")

On 1 March 2001, the Halifax Group acquired the operating assets, salesforce and unit linked and non-profit business of The Equitable for £507 million (including costs of acquisition). Net assets with a fair value of £341 million were acquired, creating a balance of goodwill on the acquisition of £166 million.

The acquisition method of accounting has been adopted and the results of the acquired operation have been consolidated in full from that date.

On 11 January 2002, The Equitable's guaranteed annuity rate and non-guaranteed annuity rate policyholders voted in favour of a scheme of arrangement to compromise their respective claims against the with-profits fund. The scheme became effective on 8 February 2002.

As a result of this, in accordance with the terms of the acquisition, in addition to the consideration paid of £507 million, Halifax plc (a subsidiary undertaking of HBOS plc) agreed to pay a further £250 million which it has done by unconditionally waiving the repayment of £250 million of loans advanced by it to The Equitable under a fully collateralised loan facility of £251 million, which was granted in 2001.

This waiver will be dealt with as an adjustment to goodwill, although this has not been recognised in the balance sheet as at 31 December 2001 as the scheme only became effective after the balance sheet date.

In addition, Halifax Group is obliged to pay up to a further £250 million depending on the extent to which certain new business sales and profitability targets are achieved in 2003 and 2004 by the distribution channel acquired from The Equitable. Any amounts to be paid will only be ascertained in 2005. Under the terms of the acquisition, any obligation arising was to have been met by Halifax plc advancing a further loan of £250 million under the £251 million fully collateralised loan facility and waiving its repayment to the extent The Equitable became entitled to a further payment. It has now been agreed that in the event that a further amount becomes payable to The Equitable, a cash payment will be made by Halifax Group plc. This will be dealt with, in the accounts of Halifax Group plc, as an adjustment to the value of goodwill arising on the acquisition of The Equitable's business.

The following table summarises the effects of this acquisition:

	Acquired book value £ million	Revaluation adjustments £ million	Accounting policy adjustments £ million	Total fair value adjustments £ million	Fair value to the Group £ million
Long-term assurance business attributable to shareholders			277	277	277
Long-term assurance assets attributable to policyholders	4,106				4,106
Other assets	149		10	10	159
Total assets	4,255		287	287	4,542
Long-term assurance liabilities attributable to policyholders	4,106				4,106
Other liabilities	84	12	(1)	11	95
Total liabilities	4,190	12	(1)	11	4,201
Net assets	65	(12)	288	276	341
Goodwill					166
Consideration					507
Satisfied by:					
Cash					500
Acquisition costs					7
					507

In accordance with FRS 7, preliminary fair value adjustments have been made. The principal adjustment required reflects the fact that as a mutual life assurance society, The Equitable did not prepare accounts on an embedded value basis. A fair value adjustment for £277 million has therefore been made, being an estimate of the value of acquired in-force business. The other accounting policy and revaluation adjustments are not individually material.

The goodwill arising on the acquisition is being amortised over a period of 20 years to reflect the strategic rationale of the acquisition and the period over which the economic benefits associated with the goodwill are expected to arise.

The summarised profit and loss account for The Equitable's acquired operating business included in the results of the Group from 1 March 2001 to 31 December 2001 is as follows:

	£ million
Fees and commissions receivable	62
Other operating income	
Income from long-term assurance business	46
Total income	108
Administrative expenses	(42)
Depreciation	(1)
Operating profit	65

In addition, exceptional integration costs of £42 million have been incurred in respect of this acquisition.

It has not been practicable to disclose the turnover, operating profit or profit after taxation for the acquired operating assets, salesforce and unit-linked and non-profit business for the periods prior to the acquisition as they were integrated within The Equitable's operations and thus did not form a separately identifiable business.

(c) St. James's Place Capital plc (SJPC)

On 1 June 2000, the Halifax Group acquired 60% of the issued share capital of SJPC for a total cost of £810 million.

The preliminary fair value adjustments applied as at 31 December 2000 have been reviewed, resulting in a £12 million increase in the value of goodwill acquired net of minority interests of £9 million. The revaluation adjustments relate to SJPC's participating interest in LAHC. LAHC has changed its accounting to reflect the latest ABI guidance (in particular the way DSS payments are accounted for) resulting in a reduction to the embedded value of £43 million. This is offset by the renegotiation of various agreements relating to certain indemnities which amounted to £22 million post tax. As a result net assets with a fair value of £437 million were acquired which, after deduction of the minority interest of £187 million, creates goodwill on acquisition of £560 million.

(d) During the year a further £26 million of goodwill arose from the acquisition of minorities and from fair value adjustments to previous acquisitions. During 2000, £24 million of goodwill arose from the combination of an acquisition of a portfolio of motor finance receivables and motor dealer funding, acquisitions of minorities and from fair value adjustments to previous acquisitions.

(e) UK credit card operation of Bank One Corporation (“Bank One International”)

On 21 June 2000, the Group’s subsidiary, Halifax plc, acquired Bank One International for a total consideration of £228 million. Net assets with a fair value of £207 million were acquired creating goodwill on acquisition of £21 million.

(f) There were no material disposals in the year to 31 December 2001.

51 Analysis of the Balances of Cash as shown in the Balance sheet

	As at 1 January 2001 £ million	Cashflow £ million	As at 31 December 2001 £ million	As at 1 January 2000 £ million	Cashflow £ million	As at 31 December 2000 £ million
Cash and balances at central banks	1,252	(102)	1,150	944	308	1,252
Loans and advances to other banks repayable on demand	2,400	(775)	1,625	1,261	1,139	2,400
	3,652	(877)	2,775	2,205	1,447	3,652

The Group maintains balances with the Bank of England which, at 31 December 2001, amounted to £732 million (2000 - £636 million).

52 Analysis of the Changes in Financing During the Year

	2001		2000	
	Share Capital (including Premium) £ million	Loan Capital £ million	Share Capital (including Premium) £ million	Loan Capital £ million
At 1 January	1,278	5,985	1,270	5,133
Effect of foreign exchange differences				100
Acquisitions		79		
Shares issued as part payment for the acquisition of ICC Bank plc	34			
Proceeds of capital issues (including premium) - ordinary shares	275		53	
Issue of subordinated loan capital		1,595		935
Repayments of loan capital		(33)		(185)
Non-cash movement				
Transfer of share premium to other reserves	(268)		(45)	
Other movements				2
At 31 December	1,319	7,626	1,278	5,985

53 Related Party Transactions

In the year ended 31 December 2001, Bank of Scotland Group provided both administration and processing services to Sainsbury's Bank plc. The amounts in respect of administration and processing services payable to Bank of Scotland Group during the year were £19 million (2000 - £20 million), of which £6 million was outstanding at the year end (2000 - £5 million).

During the year, IBM United Kingdom (Systems Operations) Limited, a non-consolidated subsidiary, provided to Bank of Scotland Group systems operations services. The amounts in respect of these services payable from Bank of Scotland Group during the year were £116 million (2000 - £36 million), of which £11 million was outstanding at the year end (2000 - £2 million).

54 Main Joint Ventures and Associated Undertakings

	Nature of Business		Issued Share and Loan Capital	Group's Interest	Accounts Made up to	Principal Area of Operations
Incorporated in the UK						
Joint Ventures:						
Centrica Personal Finance Limited	Finance	ordinary	£3,000,000	50.0%	December 2001	UK
		loan	£4,500,000	50.0%		
RFS Limited	Finance	ordinary	£6,000,006	50.0%	December 2001	UK
Lex Vehicle Leasing (Holdings) Ltd and its subsidiaries	Vehicle Leasing	ordinary	£66,300,000	50.0%	December 2001	UK
Halifax Cetelem Credit Ltd	Consumer Credit	ordinary	£12,000,000	50.0%	December 2001	UK
esure Holdings Ltd and its subsidiaries	Insurance	ordinary	£3,330,000	70.0%	December 2001	UK
Associated Undertaking:						
Sainsbury's Bank plc	Banking	ordinary	£130,000,000	45.0%	February 2001	UK

All the above are held by subsidiary undertakings.

The Group also holds 100% of the preference shares issued by esure Holdings Ltd.

55 Main Subsidiary Undertakings

	Company's Interest in Ordinary Share Capital and Voting Rights	Principal Business	Incorporated
The Governor and Company of Bank of Scotland and subsidiaries, including	100%†	Banking, financial and related services	UK
Bank of Scotland Treasury Services PLC	100%	Banking	UK
Bank of Western Australia Ltd	56.3%	Retail and commercial banking	Australia
CAPITAL BANK plc	100%*	Banking and personal finance	UK
Halifax Group plc	100%	Retail financial services	UK
and subsidiaries, including			
Halifax plc	100% [∅]	Banking	UK
Halifax General Insurance Services Ltd	100%	General insurance brokerage	UK
Halifax Share Dealing Ltd	100%	Execution only stockbroking	UK
Clerical Medical Investment Group Ltd	100%	Life assurance	UK
Halifax Financial Services Ltd	100%	Financial services	UK
Halifax Unit Trust Management Ltd	100%	Unit trust management	UK
St. James's Place Capital plc	60%	Financial services	UK

† HBOS plc holds 100% of the issued preference share capital.

* Bank of Scotland also holds 100% of the issued preference share capital.

[∅] Halifax Group plc also holds 75% of the issued preference share capital.

56 Transactions with Directors, Officers and Connected Persons

The aggregate amounts outstanding at 31 December 2001 in respect of loans and credit cards which were made available by the Group for persons who are, or were during the year, Directors and officers of HBOS plc and their connected persons were:

	Number	Aggregate amount outstanding £000
Loans	7	1,248
Credit card accounts	12	33

57 Segmental Analysis

Business Sector

The Group reports through five divisions: Retail, Business, Corporate, Treasury, Insurance & Investment, plus BankWest and Group Items.

	Profit before Tax £ million	Exceptional items and Finance £ million	2001 Total £ million	Profit before Tax £ million	Exceptional items and Finance £ million	2000 Total £ million
Retail	1,403	(179)	1,224	1,567	(141)	1,426
Business	308	(9)	299	290	(62)	228
Corporate	515	(1)	514	376	(2)	374
Treasury	169	(2)	167	210		210
Insurance & Investment	772	(22)	750	593	(7)	586
BankWest	80		80	73		73
Group Items	(240)	(164)	(404)	(184)	(45)	(229)
	3,007	(377)	2,630	2,925	(257)	2,668

	Net Assets		Total Assets	
	2001 £ million	2000 £ million	2001 £ million	2000 £ million
Retail	3,953	3,886	139,499	121,230
Business	1,046	1,153	21,954	18,448
Corporate	2,100	1,790	38,211	29,007
Treasury	643	870	61,866	55,277
Insurance & Investment	3,352	2,487	42,963	34,969
BankWest	374	352	7,782	7,212
	11,468	10,538	312,275	266,143

Geographical

The table below analyses the Group results and assets by the geographical area in which the business is generated. The geographical analysis is prepared in accordance with the location of the relevant company or branch.

	2001			2000		
	UK £ million	Rest of World £ million	Group Total £ million	UK £ million	Rest of World £ million	Group Total £ million
Interest receivable	14,961	1,154	16,115	14,154	957	15,111
Fees and commissions receivable	1,789	132	1,921	1,575	136	1,711
Dealing profits	77	5	82	61	5	66
Other operating income	974	239	1,213	815	28	843
Gross income	17,801	1,530	19,331	16,605	1,126	17,731
Operating profit before exceptional items and Intelligent Finance	2,663	308	2,971	2,720	175	2,895
Share of operating profits of joint ventures	25	(5)	20	10		10
Share of operating profits of associated undertakings	13	3	16	18	2	20
Exceptional items and Intelligent Finance	(377)		(377)	(245)	(12)	(257)
Group profit before taxation	2,324	306	2,630	2,503	165	2,668
Total assets	289,423	22,502	311,925	248,932	16,904	265,836
Joint ventures			216			184

	2001			2000		
Associated undertakings	<u>134</u>			<u>123</u>		
Group total assets	<u>312,275</u>			<u>266,143</u>		
Net assets (excluding minority interests)	10,370	1,098	11,468	9,871	667	10,538

58 Business Merger

The merger of the Bank of Scotland Group and Halifax Group was completed on 10 September 2001. The book value of net assets at the time of the merger together with adjustments arising from the alignment of accounting policies were:

£ million

Bank of Scotland Group

Book value of net assets at time of merger	3,925
Accounting adjustments relating to merger alignment (Note 59)	(53)
Restated net assets at time of merger	<u>3,872</u>

Halifax Group

Book value of net assets at time of merger	7,587
Accounting adjustments relating to merger alignment (Note 59)	(7)
Restated net assets at time of merger	<u>7,580</u>

An analysis of contribution to the profit attributable to shareholders made by the combining groups in the period prior to the merger date of 10 September 2001, together with the contribution from the combined Group in the period subsequent to the merger, is as follows:

Profit & Loss Account	Bank of Scotland Group Pre merger £ million	Halifax Group Pre merger £ million	Combined Post merger £ million	Total £ million
Net interest income	1,426	1,491	1,256	4,173
Non-interest income	623	964	1,112	2,699
Net operating income	2,049	2,455	2,368	6,872
Administrative expenses	(872)	(1,038)	(1,057)	(2,967)
Depreciation and goodwill amortisation	(59)	(146)	(333)	(538)

Profit & Loss Account	Bank of Scotland Group Pre merger £ million	Halifax Group Pre merger £ million	Combined Post merger £ million	Total £ million
Provisions for bad and doubtful debts	(328)	(87)	(193)	(608)
General insurance claims	(12)	(34)	(22)	(68)
Amounts written off fixed asset investments	(4)		(17)	(21)
Operating profit	774	1,150	746	2,670
Before exceptional items and Intelligent Finance	774	1,269	928	2,971
Exceptional items		(9)	(138)	(147)
Intelligent Finance		(110)	(44)	(154)
Share of operating profits/(losses) of joint ventures and associated undertakings	30	(2)	8	36
Merger costs - exceptional	(40)	(36)		(76)
Profit on ordinary activities before taxation	764	1,112	754	2,630
Before exceptional items and Intelligent Finance	804	1,267	936	3,007
Exceptional items	(40)	(45)	(138)	(223)
Intelligent Finance		(110)	(44)	(154)
Taxation	(272)	(331)	(162)	(765)
Profit on ordinary activities after taxation	492	781	592	1,865
Before exceptional items and Intelligent Finance	532	901	722	2,155
Exceptional items	(40)	(43)	(99)	(182)
Intelligent Finance		(77)	(31)	(108)
Minority interests	(59)	(76)	(54)	(189)
Profit for the period attributable to shareholders	433	705	538	1,676

Pre merger results are adjusted for the effect of alignments of accounting policies and practices, which are not material.

The equivalent analysis for the year ended 31 December 2000 is as follows:

Profit & Loss Account	Bank of Scotland Group Pre merger £ million	Halifax Group Pre merger £ million	Total £ million
Net interest income	1,645	2,386	4,031
Non-interest income	1,151	1,062	2,213
Net operating income	2,796	3,448	6,244
Administrative expenses	(1,174)	(1,406)	(2,580)
Depreciation and goodwill amortisation	(299)	(191)	(490)
Provisions for bad and doubtful debts	(381)	(90)	(471)
General insurance claims	(11)		(11)
Amounts written off fixed asset investments	(9)		(9)
Operating profit	922	1,761	2,683
Before exceptional items and Intelligent Finance	1,002	1,893	2,895
Exceptional items	(80)	(44)	(124)
Intelligent Finance		(88)	(88)
Share of operating profits/(losses) of joint ventures and associated undertakings	41	(56)	(15)
Profit on ordinary activities before taxation	963	1,705	2,668
Before exceptional items and Intelligent Finance	1,043	1,882	2,925
Exceptional items	(80)	(89)	(169)
Intelligent Finance		(88)	(88)
Taxation	(286)	(471)	(757)
Profit on ordinary activities after taxation	677	1,234	1,911
Before exceptional items and Intelligent Finance	739	1,323	2,062
Exceptional items	(62)	(27)	(89)
Intelligent Finance		(62)	(62)

Profit & Loss Account	Bank of Scotland Group Pre merger £ million	Halifax Group Pre merger £ million	Total £ million
Minority interests	(60)	(73)	(133)
Profit for the year attributable to shareholders	617	1,161	1,778

Pre merger results are adjusted for the effect of alignments of accounting policies and practices, which are not material.

59 Accounting Policy Alignment

The Group's accounting policies are set out on pages 65 and 66. These harmonise the policies used within Bank of Scotland Group and Halifax Group prior to the merger of the two groups on 10 September 2001.

The Group has adopted a consistent approach to the transitional implementation arrangements of FRS 15 "Tangible Fixed Assets". This has resulted in Bank of Scotland Group restating the carrying value of its tangible fixed assets to a historical cost basis. The effect of this merger adjustment at 31 December 2000 was to decrease the Group's tangible fixed assets by £47 million, with a corresponding decrease to the Group's profit and loss account reserves. The impact of this merger adjustment on profit on ordinary activities before taxation in 2001 and 2000 is not material to the Group.

General provision policy has been standardised based on an expected loss methodology. The loan loss estimate makes use of, *inter alia*, historical loan loss experience and economic and other business climate conditions. Specific loan loss provision methodology has also been standardised within all Divisions of HBOS. The impact on 2001 results of aligning general and specific provisioning policy methodologies is not significant.

While a number of accounting policies and practices have now been aligned across the Group, none of these are material to the Group.

60 Post Balance Sheet Events

As described in Note 50, on 1 March 2001, the Halifax Group acquired the operating assets, sales force and unit linked and non-profit business of The Equitable. On 11 January 2002, The Equitable's guaranteed annuity rate and non-guaranteed annuity rate policyholders voted in favour of a scheme of arrangement to compromise their respective claims against the with-profits fund. The scheme became effective on 8 February 2002. As a result of this, in accordance with the terms of the acquisition, in addition to the consideration paid of £507 million, Halifax plc (a subsidiary of HBOS plc) agreed to pay a further £250 million which it has done by unconditionally waiving the repayment of £250 million of loans advanced by it to The Equitable under a fully collateralised loan facility of £251 million, which was granted in 2001. The accounting implications arising from this are set out in Note 50.

Capitalisation and Indebtedness of HBOS

The following table and the notes thereto set out the audited capitalisation and indebtedness of HBOS as at 31 December 2001 which has been extracted without material adjustment from HBOS's Annual Report and Accounts 2001:

	As at 31 December 2001
	<i>(£ millions)</i>
Authorised Capital	
9¼% Non-Cumulative Irredeemable Preference Shares (of £1 each)	375
9¾% Non-Cumulative Irredeemable Preference Shares (of £1 each)	125
6.125% Non-Cumulative Redeemable Preference Shares (of £1 each)	200
Sterling Preference Shares (of £1 each)	1,000
8.117% Non-Cumulative Perpetual Preference Shares Class A (of £10 each)	3
7.754% Non-Cumulative Perpetual Preference Shares Class B (of £10 each)	1
Ordinary Shares (of 25p each)	1,185
	2,889
	2,889
	<i>(€ millions)</i>
Euro Preference Shares.....	1,500
	1,500
	1,500
	<i>(£ millions)</i>
Issued Capital	
9¼% Non-Cumulative Irredeemable Preference Shares (of £1 each, fully paid)...	300
9¾% Non-Cumulative Irredeemable Preference Shares (of £1 each, fully paid)	100
Ordinary Shares (of 25p each, fully paid)	892
Reserves	10,176
Shareholders' Funds (including non-equity interests)	11,468
	11,468
Minority Interests - Equity	415
Minority and other Interests - Non Equity ⁽¹⁾	1,987
	2,402

	As at 31 December 2001
Subordinated loan capital⁽²⁾	
Undated ⁽³⁾	2,660
Dated ⁽⁴⁾	4,966
Total Capital Resources	21,496
Other Borrowings⁽⁵⁾	
Deposits by banks	30,449
Customer accounts	140,516
Debt securities in issue	69,528
Total Indebtedness	240,493
Total Capitalisation and Indebtedness ⁽⁶⁾	261,989

Notes:

- (1) Halifax Group provides a subordinated guarantee in respect of each of the issues of £245,000,000 7.881 per cent. Guaranteed Non-voting Non-cumulative Preferred Securities issued by Halifax Group Sterling Finance (Jersey) L.P. and €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities issued by Halifax Group Euro Finance (Jersey) L.P. It is proposed that these subordinated guarantees be cancelled and replaced with subordinated guarantees provided by HBOS. Bank of Scotland has provided a subordinated guarantee in respect of each of the issues of £250,000,000 8.117 per cent. Non-cumulative Perpetual Preferred Securities Class A and £150,000,000 7.754 per cent. Non-cumulative Perpetual Preferred Securities Class B by Bank of Scotland Capital Funding L.P. HBOS provides a subordinated guarantee in respect of the issue of £600,000,000 6.461 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A issued by HBOS Capital Funding L.P. All other non-equity minority interests are unguaranteed.
- (2) All loan capital issued by Bank of Scotland and Halifax Group, as detailed in the tables below, has been issued on an unsecured basis. Unless otherwise stated, issues of loan capital are unguaranteed.
- (3) The Subordinated Undated Loan Capital was comprised as follows:

	As at 31 December 2001
	<i>(£ millions)</i>
€500 million Fixed to Floating Rate Undated Subordinated Notes.....	305
£300 million 7.5% Subordinated Step-Up Notes	300
US\$300 million Reset Notes	207
£200 million Perpetual Notes	200
£200 million 7.375% Subordinated Guaranteed Bonds*	200
€300 million Floating Rate Subordinated Step-Up Bonds	183
US\$250 million Floating Rate Primary Capital Notes	172
£150 million Instruments	150

	As at 31 December 2001
	<i>(£ millions)</i>
£150 million Instruments	150
JPY 17 billion Instruments	110
£100 million Instruments	100
£100 million 12% Sterling Perpetual Subordinated Bonds	100
£100 million 8.75% Sterling Perpetual Subordinated Bonds	100
£75 million 13.625% Sterling Perpetual Subordinated Bonds	75
JPY 9 billion Instruments	47
£50 million 9.375% Sterling Perpetual Subordinated Bonds	50
JPY 42.5 billion 3.50% Subordinated Yen Step-Up Notes	223
Unamortised Premiums, Discounts and Issue Costs	(12)
	2,660

* Clerical Medical Investment Group Limited ("CMIG") (a wholly owned subsidiary of Halifax Group) has provided a subordinated guarantee to Clerical Medical Finance plc ("CMF") (a wholly owned subsidiary of CMIG) in relation to the issue by CMF of 7.375 per cent. Undated Subordinated Guaranteed Bonds.

(4) The Subordinated Dated Loan Capital was comprised as follows:

	As at 31 December 2001
	<i>(£ millions)</i>
€51.1 million 8.30% Notes 2002	31
US\$300 million 8.80% Notes 2004*	207
£400 million 8.75% Subordinated notes 2006	400
US\$150 million 8.85% Notes 2006*	103
£75 million 9.125% Subordinated notes 2006	75
£60 million 9.00% Instruments 2006	60
A\$100 million Callable Notes 2007	35
€650 million 4.75% Subordinated bonds 2009	397
US\$500 million Floating rate subordinated step-up callable notes 2009	345
€500 million 5.50% Instruments 2009	305
£75 million Floating rate subordinated notes 2009	75
US\$500 million Notes 2010*	344

	As at 31 December 2001
	<i>(£ millions)</i>
€51.1 million 8.30% Notes 2002	31
£75 million Floating Rate Instruments 2010	75
US\$150 million Notes 2011*	103
€7 million Floating Rate Notes 2011	4
£200 million Floating rate step-up callable subordinated notes 2012	200
€12.8 million 6.25% Instruments 2012	8
€1,000 Subordinated callable fixed/floating rate instruments 2013	611
€325 million 6.125% Notes 2013	198
£250 million 11% Subordinated bonds 2014	250
£150 million 10.5% Subordinated bonds 2018	150
£250 million 6.375% Instruments 2019	250
£500 million 9.375% Subordinated bonds 2021	500
€400 million 6.45% Eurodated Floating subordinated guaranteed bonds 2023**	251
Unamortised premiums, discounts and issue costs	(11)
	4,966

* These notes, the proceeds of which are on-lent to Bank of Scotland, are liabilities of wholly-owned subsidiaries of Bank of Scotland and are guaranteed unconditionally by Bank of Scotland on a subordinated basis.

** CMIG has provided a subordinated guarantee to CMF in relation to the issue by CMF of 6.45% Eurodated Floating subordinated guaranteed bonds 2023.

- (5) Save for £320 million of the HBOS Group's debt securities in issue which are unguaranteed but secured on advances to customers and certain other assets of the HBOS Group, and £7,711 million of the HBOS Group's debt securities in issue which are unguaranteed but secured on asset backed securities of the HBOS Group, none of the other borrowings listed are secured or guaranteed. As at 31 December 2001, the HBOS Group had contingent liabilities (including guarantees) of £2,335 million. No account has been taken of intra group guarantees.
- (6) There has been no material change in the capitalisation, indebtedness and contingent liabilities (including guarantees) of HBOS Group since 31 December 2001 save for the placing of 172.5 million ordinary shares on 27 February 2002 (such placing being settled with respect to 150 million ordinary shares on 5 March 2002 and with respect to 22.5 million ordinary shares on 7 March 2002) the proceeds of which totalled £1,258 million, net of expenses.

Taxation

General

Holders should inform themselves as to the tax consequences of the Proposals within the countries of their residency and domicile and the jurisdiction in which they have any branch or representative through which they may hold Halifax Preferred Securities. The comments below are of a general nature based on law and published practice as at the date hereof in each jurisdiction referred to and do not constitute tax or legal advice. They relate only to the position of persons who are the beneficial owners of their Halifax Preferred Securities and hold their Halifax Preferred Securities as an investment (unless otherwise specified). Any Holders who are in doubt as to their personal tax position should consult their professional advisers. In assessing their tax position investors should note that the Issuer is a Jersey limited partnership and not a legal entity separate from its partners. The comments below under “*United Kingdom Taxation*” in relation to the UK tax treatment of the Halifax Preferred Securities apply only to persons who are resident in the United Kingdom for taxation purposes.

Jersey Taxation

The implementation of the Proposals alone should have no effect on the Jersey tax position of Holders (other than residents of Jersey receiving any additional income as a result thereof). Holders of Halifax Preferred Securities or Preferred Securities (other than residents of Jersey) are not subject to any tax in Jersey in respect of the holding, exchange, sale or other disposal of the Halifax Preferred Securities or the Preferred Securities. Distribution payments may be made by the Issuer without withholding or deduction for, or on account of, and without, any payment of Jersey income tax.

No stamp duties are payable in Jersey on the acquisition, ownership, exchange, sale or other disposal of Halifax Preferred Securities or the Preferred Securities. Probate or Letters of Administration may be required to be obtained in Jersey on the death of an individual with an estate in Jersey, which includes a holding of Halifax Preferred Securities or Preferred Securities. Stamp duty is payable in Jersey on the registration of such Probate or such Letters of Administration on the value of the deceased's estate in Jersey.

United Kingdom Taxation

Classification of the Issuer

Halifax Group has been advised that the Issuer should be classified as a partnership for UK tax purposes. Accordingly, Holders who are resident in the United Kingdom for tax purposes should, broadly, be taxed as if they hold their proportionate share of the Issuer's assets. It is possible, however, that the Inland Revenue may seek to treat UK tax resident Holders as holding interests in a “unit trust scheme” and/or apply the “offshore fund” rules in which case the anticipated tax consequences for such Holders may be different to that which is summarised below. The following paragraphs summarise the anticipated tax consequences for certain categories of UK tax resident Holders on the basis that the Issuer is a partnership for UK tax purposes. UK tax resident Holders who are in any doubt as to their tax position in respect of the Proposals are strongly recommended to take independent professional advice.

UK Corporate Holders

The tax position of UK tax resident corporate Holders should be computed under the Inland Revenue Statement of Practice SP4/98. In practice, since the Issuer's only or main asset is expected to be the Notes (or the Amended Notes), the Holders within charge to UK corporation tax should be subject to tax as income under the "loan relationship" rules in respect of profits and gains arising from, and in certain circumstances, fluctuations in the value of, Halifax Preferred Securities. The implementation of the Proposals of itself should have no effect on the tax position of Holders falling within the loan relationship rules.

UK Individuals

The Inland Revenue may treat the implementation of the Proposals as giving rise to a disposal of the Halifax Preferred Securities for UK taxation of chargeable gains purposes. On the basis that the Issuer is classified as a partnership, such a disposal would, in practice, be treated as a disposal by the Holders of their underlying share of the Notes. Accordingly, individual Holders who are UK tax resident may be subject to UK taxation of chargeable gains in respect of the implementation of the Proposals. Such individuals, depending on their circumstances, may also be subject to tax as income, under the "accrued income scheme" in respect of any accrued interest on the Halifax Preferred Securities at the time of the implementation of the Proposals.

Stamp Duty and Stamp Duty Reserve Tax ("SDRT")

No stamp duty or SDRT should arise in respect of the Proposals.

Proposed EU Directive on the Taxation of Savings Income

On 13 December 2001, the European Commission published a draft Directive to ensure effective taxation of savings income in the form of interest payments within the European Community. Subject to a number of important conditions being met, it is proposed that Member States will be required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State, subject to the right of certain Member States to opt instead for a withholding system for a transitional period in relation to such payments. As a consequence of the substitution of HBOS in place of Halifax Group as issuer of the Notes, the Notes may fall within the scope of such a withholding system (if so adopted). The United Kingdom does not currently propose to adopt a withholding system.

Certifications and Transfer Restrictions

Each Holder who is located in the United States or is a U.S. person (as those terms are defined in Regulation S) wishing to consent to the Proposals will be required to certify, represent, warrant, and agree as follows:

1. it understands and acknowledges that the Preferred Securities and the Guarantee are not and will not be registered under the Securities Act and that the Preferred Securities are “restricted securities” within the meaning of Rule 144 under the Securities Act, and it represents that it will be holding the Preferred Securities for its own account for investment and not with a view to any distribution or resale, directly or indirectly, in the United States or otherwise in violation of the securities laws of the United States
2. it (a) is an entity having such knowledge and experience in financial and business matters, that it is capable of evaluating the merits and risks of consenting to the Proposals described herein or holding or investing in the Preferred Securities and (b) has had the opportunity to review the Explanatory Memorandum and has where it considers necessary reviewed the Explanatory Memorandum and understands and accepts the risks associated with holding or investing in the Preferred Securities and the replacement of the Halifax Guarantee with the Guarantee
3. it agrees that if, for so long as the Preferred Securities are “restricted securities” as defined in Rule 144(a)(3) under the Securities Act, it should decide to transfer any Preferred Securities, such Preferred Securities may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believes is a QIB purchasing for its own account or for the account of a QIB, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, (c) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available) or (d) pursuant to effective registration statement, in each case in accordance with any applicable securities laws of any State of the United States and
4. it acknowledges and agrees that the Issuer will not recognise any proposed offer, sale, pledge or other transfer of the Preferred Securities if the offer, sale, pledge or transfer is made other than in compliance with the above-stated restrictions.

Consent Notice

Set out below is the text of the consent (which may be given electronically) in respect of the Proposals that is sought to substitute the guarantor of the Halifax Preferred Securities through the cancellation of the Halifax Guarantee and its replacement with the Guarantee and to amend the terms of the Halifax Preferred Securities, the Limited Partnership Agreement and the ancillary documents relating thereto. The consent in writing (which may be given electronically) of the Holders of at least two-thirds of the outstanding Halifax Preferred Securities is required to give effect to the Proposals and accordingly any Holder who wishes to approve the Proposals must take the necessary action in response to the instructions from Euroclear or Clearstream, Luxembourg, as the case may be, as described in the section headed "Action to be taken" above. Any consent given (which may be given electronically) will be deemed to be given on the basis of the text of the consent set out below.

Form of Written Consent to the Proposals

"We, being a Holder of Halifax Preferred Securities hereby, both upon submission of this consent and at the Closing Time:

1. represent, warrant and undertake to the Issuer, Halifax Group, HBOS, the General Partner and the Initial Limited Partner, that:
 - (a) we are the holder of €_____ [*insert total amount in liquidation preference of Halifax Preferred Securities held*] in liquidation preference of the €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities of the Issuer; and
 - (b) we have irrevocably instructed the blocking of the relevant securities accounts relating to such Halifax Preferred Securities in accordance with the relevant clearing system's procedures; and
 - (c) we have full power and authority to consent to the Proposals.
2. for the purposes of paragraph 8.3 of the terms of the Halifax Preferred Securities (as set out in Schedule 3 to the Limited Partnership Agreement) and Clauses 5.1 and 5.2 of the Halifax Guarantee, irrevocably agree and consent to the Proposals as defined and set out in an Explanatory Memorandum dated 16 April 2002 (the "Explanatory Memorandum"), and their implementation on and subject to the conditions set out therein, including:
 - (a) the substitution of HBOS for Halifax Group as guarantor of the Halifax Preferred Securities by way of the cancellation, discharge and replacement of the Halifax Guarantee and execution and delivery by HBOS of the Guarantee on the terms set out in the Explanatory Memorandum;
 - (b) the amendment of the Limited Partnership Agreement and the Halifax Preferred Securities by way of execution of a Supplemental Limited Partnership Agreement as set out in the Explanatory Memorandum; and

irrevocably agree, consent, authorise and instruct HSBC Issuer Services Common Depository Nominee (UK) Limited, in its capacity as the registered holder of the Halifax Preferred

Securities pursuant to the Limited Partnership Agreement, to execute the Supplemental Limited Partnership Agreement on behalf of Holders, to implement the amendments set out in paragraph 2(b) above and to execute all such deeds and instruments and do all such other acts and things as may be necessary or desirable to carry out and give effect to this written consent and the Proposals.

Yes

No

(mark the appropriate box)

3. certify, represent, warrant and undertake to the Issuer, Halifax Group, HBOS, the General Partner and the Initial Limited Partner, that:

either

- (a) we are not a U.S. person and we are located outside the United States (as those terms are defined in Regulation S of the Securities Act);

Yes

No

(mark the appropriate box)

or

- (b) we are a U.S. person (as defined in Regulation S of the Securities Act) and (i) are a qualified institutional buyer within the meaning of Rule 144A under the Securities Act or (ii) are an “accredited investor” as defined in Rule 501(a)(1), (2), (3) or (7) of Regulation D under the Securities Act; and

- (i) we understand and acknowledge that the Preferred Securities and the Guarantee are not and will not be registered under the Securities Act and that the Preferred Securities are “restricted securities” within the meaning of Rule 144 under the Securities Act, and we represent that we will be holding the Preferred Securities for our own account for investment and not with a view to any distribution or resale, directly or indirectly, in the United States or otherwise in violation of the securities laws of the United States;

- (ii) we (a) are an entity having such knowledge and experience in financial and business matters that we are capable of evaluating the merits and risks of holding or investing in the Preferred Securities and (b) have had the opportunity to review the Explanatory Memorandum and, where considered necessary have reviewed the Explanatory Memorandum and understand and accept the risks associated with holding or investing in the Preferred Securities and the replacement of the Halifax Guarantee with the Guarantee;

- (iii) we agree that if, for so long as the Preferred Securities are “restricted securities” as defined in Rule 144(a)(3) under the Securities Act, we should decide to transfer any Preferred Securities, such Preferred Securities may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A

to a person that we and any person acting on our behalf reasonably believes is a qualified institutional buyer (“QIB”) as such term is defined in Rule 144A purchasing for its own account or for the account of a QIB, (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, (c) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available) or (d) pursuant to an effective registration statement, in each case in accordance with any applicable securities laws of any State of the United States; and

- (iv) we acknowledge and agree that the Issuer will not recognise any proposed offer, sale, pledge or other transfer of the Preferred Securities if the offer, sale, pledge or transfer is made other than in compliance with the above-stated restrictions.

Yes

No

(mark the appropriate box)

Capitalised terms used in this form of written consent shall have the respective meanings assigned thereto in the Explanatory Memorandum unless the context otherwise requires.”

General Information

1 Listing

If the Proposals are approved and implemented, the Preferred Securities will continue to be listed on the Luxembourg Stock Exchange. If the Proposals are not approved and implemented, the Preferred Securities will also continue to be listed on the Luxembourg Stock Exchange.

2 Legal Notice

The legal notice relating to the modification of the terms of the Halifax Preferred Securities, if approved by Holders and implemented, together with the Memorandum and Articles of Association of HBOS and the Limited Partnership Agreement constituting the Issuer, as amended, will be lodged with the Registrar of the District Court in Luxembourg (*Greffier en Chef du Tribunal d'Arrondissement de et Luxembourg*) where such documents will be available for inspection and where copies thereof will be obtainable upon request.

3 Clearing

If the Proposals are approved and implemented, the Preferred Securities will continue to be accepted for clearance through Euroclear and Clearstream, Luxembourg, with the same Common Code as the Halifax Preferred Securities of 10509742. The International Securities Identification Number for the Preferred Securities will continue to be GB0058322420 which is the same as for the Halifax Preferred Securities.

4 No Material Change

Save as described or incorporated by reference herein, there has been no significant change in the financial or trading position of HBOS, the HBOS Group or the Issuer since 31 December 2001 and no material adverse change in the financial position or prospects of HBOS, the HBOS Group or the Issuer since 31 December 2001.

5 Auditors

The auditors of HBOS are KPMG Audit Plc, Chartered Accountants and Registered Auditors. The financial information set out in this Explanatory Memorandum does not constitute statutory accounts within the meaning of section 240(5) of the Companies Act 1985. The audited consolidated accounts of HBOS for the year ended 31 December 2001 and of Halifax Group for the years ended 31 December 1999 and 31 December 2000 and the audited consolidated accounts of Bank of Scotland for the years ended 29 February 2000 and 28 February 2001 were audited by KPMG Audit Plc, Chartered Accountants and Registered Auditors. KPMG Audit Plc made reports under Section 235 of the Companies Act 1985 on the accounts of HBOS for the year ended 31 December 2001, on the accounts of Halifax Group for the years ended 31 December 1999 and 31 December 2000 and on the accounts of Bank of Scotland for the years ended 29 February 2000 and 28 February 2001, which were unqualified and did not include a statement under Section 237(2) or (3) of the Companies Act 1985 and which accounts were, in the case of Halifax Group, delivered to the Registrar of Companies in England and Wales and, in the case of HBOS, delivered to the Registrar of Companies in Scotland.

6 Availability of Information

Holders of the Halifax Preferred Securities may at any time during normal business hours on any day (bank holidays, Saturdays, Sundays and other public holidays excepted) obtain (free of charge) copies of the following documents at the office of Dexia Banque Internationale à Luxembourg S.A., 69, route d'Esch L-2953 Luxembourg and at the office of HBOS at 33 Old Broad Street, London EC2N 1HZ:

- The Memorandum and Articles of Association of HBOS and Halifax Group
- Limited Partnership Agreement dated 8 December 1999
- Halifax Guarantee dated 9 December 1999
- Halifax Preferred Securities Offering Circular dated 8 December 1999
- Following implementation of the Proposals, the terms and conditions of the Amended Notes, and prior to implementation of the Proposals, a draft (subject to modification) of the terms and conditions of the Amended Notes
- Following implementation of the Proposals, the Supplemental Limited Partnership Agreement and prior to implementation of the Proposals, a draft (subject to modification) of the Supplemental Limited Partnership Agreement
- Following implementation of the Proposals, the Guarantee, and prior to implementation of the Proposals, a draft (subject to modification) of the Guarantee
- Audited consolidated accounts of Bank of Scotland for the two financial years ended 28 February 2001
- Audited consolidated accounts of Halifax Group for the two financial years ended 31 December 2000 and
- Audited consolidated accounts of HBOS for the financial year ended 31 December 2001.

For so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, the most recently published consolidated audited annual financial statements and consolidated unaudited semi-annual interim financial statements of HBOS, and the most recently published non-consolidated audited annual accounts of the Issuer, will be available (free of charge) at the specified office of the Paying and Transfer Agent in Luxembourg and the specified office of HBOS referred to above. HBOS does not intend to publish non-consolidated annual financial statements or non-consolidated interim financial statements. The Issuer does not intend to publish annual consolidated financial statements or interim financial statements.

7 Articles of Association - Additional Preference Shares

The Articles of Association of HBOS restrict the circumstances in which HBOS can issue preference shares ("Additional Preference Shares") which rank *pari passu* with the HBOS Preference Shares and other Priority Preference Shares (as defined herein under the section headed "*Certain consequences in connection with the Proposals - If the Proposals are approved and implemented*"). Article 4.7 provides that no such Additional Preference Shares may be issued unless (i) at the time of such proposed issue the Auditors have reported that immediately following such issue the aggregate nominal amount of the Additional Preference Shares to be issued, when added to the

aggregate nominal amount of the Priority Preference Shares for the time being in issue, will not exceed an amount equal to 25 per cent. of the Adjusted Capital and Reserves; and (ii) the average of the profit after taxation and before extraordinary items and dividends on an annualised basis for the most recent three accounting reference periods of HBOS to have ended prior to the date of such issue for each such period exceeds four and one half times the aggregate annual amount of the dividends (exclusive of any imputed tax credit available to shareholders) payable in the then current accounting reference period on the whole of the issued share capital of HBOS which has priority to or ranks equally with the Priority Preference Shares (including any share capital then being issued). For these purposes, the "Adjusted Capital and Reserves" means the aggregate from time to time of the amount paid up or credited as paid up on the issued share capital of HBOS and the amount standing to the credit of reserve accounts, including any share premium account and revaluation reserve and any credit balance on the profit and loss account all as shown in the balance sheet from the then latest accounts but after: (i) deducting from the aggregate any debit balance on the profit and loss account subsisting at the date of the accounts; (ii) deducting any amount referable to goodwill (arising other than on consolidation) or any other intangible asset; (iii) deducting an amount equal to any distribution (other than distributions to any member of the HBOS Group) out of the profits accrued prior to the date of the accounts; (iv) excluding any sums set aside for future taxation; (v) excluding any amounts attributable to outside interests in subsidiaries; (vi) making such adjustments as may be appropriate to reflect any variation in the amount of the paid up share capital or share premium account since the date of the accounts; and (vii) making such adjustments as may be appropriate to reflect the issue of the Additional Preference Shares then to be issued.

Registered Office of the Issuer

22 Grenville Street
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HBOS

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