

OFFERING MEMORANDUM



**BANK OF SCOTLAND**

**The Governor and Company of the Bank of Scotland**

**£150,000,000 7.286% Series A Perpetual Regulatory tier One securities**

**£150,000,000 7.281% Series B Perpetual Regulatory tier One securities**

This Offering Memorandum relates to the issue by The Governor and Company of the Bank of Scotland (the "Issuer") of £150,000,000 7.286% Series A Perpetual Regulatory tier One securities, (the "Series A PROs<sup>SM</sup>") and £150,000,000 7.281% Series B Perpetual Regulatory tier One securities, (the "Series B PROs<sup>SM</sup>") and together with the Series A PROs, the "PROs<sup>SM</sup>"), respectively of the Issuer. The PROs will bear interest from (and including) 28 February 2001 to (but excluding) 31 May 2016 in the case of the Series A PROs, or 31 May 2026 in the case of the Series B PROs, at a rate of 7.286% per annum in the case of the Series A PROs, or 7.281% per annum in the case of the Series B PROs, payable semi-annually in arrear on 31 May and 30 November in each year (except that the first payment will be made on 30 November 2001 in respect of the period from the Issue Date (as defined herein) to 30 November 2001 and will amount to £55.05 per £1,000 nominal amount of Series A PROs and £55.01 per £1,000 nominal amount of Series B PROs). Thereafter, the PROs will bear interest at a rate, reset every five years, of 3.645% per annum in the case of the Series A PROs, or 4.095% per annum in the case of the Series B PROs, above the gross redemption yield on a specified United Kingdom government security, payable semi-annually in arrear on 31 May and 30 November in each year, all as more particularly described in "Terms and Conditions of the PROs — 5. Coupon Payments". Payments (which term, as defined herein, does not include principal) may be deferred as described in "Terms and Conditions of the PROs — 4. Deferrals", but the Issuer may not declare or pay dividends on any of its Ordinary Stock (as defined herein) and certain other capital securities whilst any Payments are deferred.

Each series of PROs is redeemable in whole but not in part at the option of the Issuer on 31 May 2016 in the case of the Series A PROs, or on 31 May 2026 in the case of the Series B PROs, or on any Coupon Payment Date (as defined herein) in each case thereafter. In addition, upon the occurrence of certain tax or regulatory events, each series of PROs may be exchanged or their terms varied so that they become Upper Tier 2 Securities (as defined herein) or redeemed at their Special Redemption Price (as defined herein), provided that if (following the Issuer giving notice to exchange or vary any PROs for or into Upper Tier 2 Securities) such tax or regulatory events do or would persist after such exchange or variation or certain other provisions apply, the relevant series of PROs may be redeemed at their principal amount, as more particularly described in "Terms and Conditions of the PROs — 7. Exchange, Variation or Redemption".

Under existing Financial Services Authority requirements, the Issuer may not redeem or purchase any PROs, or exchange or vary the terms of the PROs so that they become Upper Tier 2 Securities, unless the Financial Services Authority has given its prior consent.

The PROs will be unsecured securities of the Issuer and will be subordinated to the claims of Senior Creditors (as defined herein) in that no payment of principal or interest in respect of the PROs may be made unless the Issuer is solvent and is able to make such payment and remain solvent immediately thereafter. In the event of the winding-up of the Issuer, the PRO Holders (as defined herein) will, for the purpose only of calculating the amounts payable in respect of each PRO, be treated as if they were the holders of a notional class of preference stock ranking *pari passu* with the holders of the Existing Preference Stock (as defined herein) and the holders of Parity Securities (as defined herein) (if any) from time to time issued by the Issuer as regards a preferential right to participate in a return of assets in the winding-up over and so ranking senior to the holders of all other classes of the Issuer's issued stock (other than Existing Preference Stock and any stock qualifying as Parity Securities) on the day immediately prior to the commencement of the winding-up. See "Terms and Conditions of the PROs — 3. Winding-up".

For a description of certain matters that prospective investors should consider, see "Investment Considerations".

Application has been made to list each series of PROs on the Luxembourg Stock Exchange.

The PROs have been assigned an A- rating by Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. and an aa3 rating by Moody's Investors Service, Inc. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

**Offering Price: 100% of £1,000 per Perpetual Regulatory tier One security**

It is expected that the PROs will be ready for delivery in book-entry form only through the facilities of the Euroclear Bank S.A./N.V. and Clearstream Banking, *société anonyme*, on or about 28 February 2001. See "Summary of Provisions Relating to the PROs while in Global Form."

**Schroder Salomon Smith Barney**  
**Barclays Capital**

26 February 2001

"PROs" is a service mark of Salomon Smith Barney Inc.

The Issuer accepts responsibility for the information contained in this Offering Memorandum. To the best of the knowledge and belief of the Issuer (which has taken all reasonable care to ensure that such is the case) the information contained in this Offering Memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

In connection with the issue and sale of the PROs, no person is authorised to give any information or to make any representation not contained in this document and if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the Managers (as defined in "Subscription and Sale" below) or The Bank of New York.

This Offering Memorandum is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer or the Managers that any recipient of this Offering Memorandum should purchase any of the PROs. Each investor contemplating purchasing PROs should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. This Offering Memorandum does not constitute an offer to sell or the solicitation of an offer to buy any securities.

The distribution of this document and the offering or sale of the PROs in certain jurisdictions may be restricted by law. The Issuer and the Managers do not represent that this document may be lawfully distributed, or that the PROs may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer or the Managers which would permit a public offering of the PROs or distribution of this document in any jurisdiction where action for that purpose is required. Accordingly, no PROs may be offered or sold, directly or indirectly, and neither this Offering Memorandum nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Offering Memorandum or the PROs may come must inform themselves about, and observe, any such restrictions. See "Subscription and Sale" below for a description, *inter alia*, of certain restrictions on offers, sales and deliveries of the PROs in the United States or to US persons. Neither the delivery of this Offering Memorandum nor any sale hereunder shall create, under any circumstances, any implication that there has been no change in the affairs of the Issuer since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

In connection with this issue, Salomon Brothers International Limited may over-allot or effect transactions which stabilise or maintain the market price of the PROs at a level which might not otherwise prevail. Such stabilising, if commenced, may be discontinued at any time.

The PROs have not been, and will not be, registered under the United States Securities Act of 1933 (the "Securities Act"), and comprise PROs in bearer form that are subject to United States tax law requirements. Subject to certain exceptions, the PROs may not be sold or delivered, directly or indirectly, within the United States or to or for the account or benefit of, U.S. persons as defined in Regulation S under the Securities Act ("Regulation S").

In this document all references to "£" are to pounds sterling.

Terms which are defined in "Terms and Conditions of the PROs" have (save where the context otherwise requires) the same meaning when used throughout this Offering Memorandum.

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## SUMMARY

*The following summary refers to certain provisions of the Terms and Conditions of the PROs and the Trust Deed and insofar as it refers to the Terms and Conditions of the PROs is qualified by the more detailed information contained elsewhere in this document. Terms which are defined in "Terms and Conditions of the PROs" have the same meaning when used herein.*

<b>Issuer</b> .....	The Governor and Company of the Bank of Scotland
<b>Trustee</b> .....	The Bank of New York
<b>Issue size</b> .....	£150,000,000 Series A PROs and £150,000,000 Series B PROs
<b>Redemption</b> .....	The PROs are perpetual securities and have no maturity date. The Series A PROs and the Series B PROs are each, however, redeemable in whole but not in part at the option of the Issuer, subject to the prior approval of the Financial Services Authority and to the Solvency Condition having been met within the previous six months, at their principal amount together with any Payments which are Outstanding on 31 May 2016 in the case of the Series A PROs, or on 31 May 2026 in the case of the Series B PROs, or on any Coupon Payment Date in each case thereafter.
<b>Interest</b> .....	The Series A PROs bear interest at a rate of 7.286% per annum to (but excluding) 31 May 2016 and thereafter at 3.645% per annum above the gross redemption yield on a specified United Kingdom government Gilt, reset every five years. The Series B PROs bear interest at a rate of 7.281% per annum to (but excluding) 31 May 2026 and thereafter at 4.095% per annum above the gross redemption yield on a specified United Kingdom government Gilt, reset every five years.
<b>Coupon Payment Dates</b> .....	Subject as described below, Coupon Payments will be payable on 31 May and 30 November in each year, beginning on 30 November 2001.
<b>Subordination</b> .....	The rights and claims of the PRO Holders and the Couponholders are subordinated to the claims of Senior Creditors. Upon any winding-up of the Issuer, the PRO Holders will, as regards a preferential right to participate in a return of assets, rank <i>pari passu</i> (for the purposes only of calculating the amounts payable in respect of each PRO) with the holders of the Existing Preference Stock and the Parity Securities (if any) of the Issuer then in issue and in priority to all holders of other classes of issued stock for the time being (other than the Existing Preference Stock and any stock qualifying as Parity Securities) but will rank junior to any notional class of preference stock in the capital of the Issuer by reference to which the amount payable in respect of any Junior Subordinated Debt in a winding-up of the Issuer is determined.
<b>Exceptional deferral of Payments</b> .....	If the Issuer determines, on the 20th business day prior to the date on which any Payment (such term does not include principal) would, in the absence of deferral in accordance with Condition 4, be due and payable that it is, or payment of the relevant Payment will result in the Issuer being, in non-compliance with applicable Capital Regulations, the Issuer may, subject to the dividend restriction described below, elect to defer such Payment. Such exceptionally deferred Payment must, unless the Issuer elects to defer such Payment pursuant to its general right to defer referred to below, be satisfied on the Coupon Payment Date next following the 19th business day after the Issuer determines that it no longer is, and payment of such Payment will not result in it being, in non-compliance with such applicable Capital Regulations. No interest will accrue on an Exceptionally Deferred Coupon Payment.

<b>General deferral of Payments . . .</b>	Subject to the dividend restriction described below, the Issuer may elect to defer any Payment (which term does not include principal) on the PROs for any period of time. However, the deferred Payment will bear interest at 2% per annum above the then current rate of interest on the PROs.
<b>Dividend restriction during period of deferral . . . . .</b>	<p>If the Issuer defers a Payment for any reason as described above then, while any Payment is so deferred, it may not declare or pay a dividend or other distribution on any of its Ordinary Stock, Parity Securities or any other stock or securities of the Issuer (if any) ranking junior to the PROs on a return of assets on a winding-up or in respect of distribution of dividends and/or income (other than in certain limited circumstances) nor may the Issuer or any member of the Group redeem, purchase or otherwise acquire any Ordinary Stock, Existing Preference Stock, Parity Securities or any other stock or securities ranking junior to the PROs on a return of assets on a winding-up or in respect of a distribution of dividends and/or income (other than in certain limited circumstances).</p> <p>If the Issuer makes a payment of a dividend or other distribution in respect of the Ordinary Stock, the Existing Preference Stock, any Parity Securities or any other stock or securities ranking junior to the PROs (on a return of assets on a winding-up or on a distribution of dividends and/or income) then the Issuer may not defer any Payment on the PROs on the same or the next Coupon Payment Date. In addition, if no dividend is paid on the Existing Preference Stock then the Issuer must defer Payments under the PROs due on the same date.</p>
<b>Alternative coupon satisfaction mechanism . . . . .</b>	Investors will always receive payments made in respect of PROs in cash. However, if the Issuer defers a Payment it must, or if and to the extent the Issuer so elects at any time it may, satisfy its obligation to make any Payment (which term does not include principal) to PRO Holders by issuing its Ordinary Stock to the Trustee or its agent which, when sold, will provide a cash amount which the Paying Agents, on behalf of the Trustee, will pay to the PRO Holders in respect of the relevant Payment. The Calculation Agent will calculate in advance the amount of Ordinary Stock to be issued in order to enable the Trustee or its agent to raise the full amount of money due on the relevant payment date to PRO Holders.
<b>Insufficiency and availability of Ordinary Stock . . . . .</b>	The Issuer currently has no authorised but unissued Ordinary Stock to allot and issue to satisfy a Coupon Payment under the alternative coupon satisfaction mechanism. The Issuer will undertake to the Trustee to propose a resolution at the time of its next annual general meeting to create (if required) and authorise the issue of not less than such amount of Ordinary Stock as the Issuer reasonably considers may be required to satisfy the next two Coupon Payments using the alternative coupon satisfaction mechanism described above.
<b>Market Disruption Event . . . . .</b>	If, in the opinion of the Issuer, a Market Disruption Event exists on or after the 15th business day preceding any date upon which the Issuer is due to satisfy a Payment using the alternative coupon satisfaction mechanism, the Payment to PRO Holders may be deferred until the Market Disruption Event no longer exists.
<b>Suspension . . . . .</b>	If, following any take-over offer or any reorganisation, restructuring or scheme of arrangement, the Issuer (unless there is a New Owner) or any New Owner ceases to be the ultimate holding company of the Group, any changes to the documentation relating to the PROs determined by an independent investment bank to be appropriate in order to preserve substantially the economic effect for the PRO Holders of a holding of

the PROs prior to the Suspension will be made by the Issuer and the Trustee and pending such changes the Issuer will be unable to satisfy Payments using the alternative coupon satisfaction mechanism. If the investment bank is unable to determine appropriate amendments, as notified to the Issuer and the Trustee, the PROs will (subject to the prior consent of the Financial Services Authority) be redeemed at the Special Redemption Price.

<b>Additional amounts</b> .....	The Issuer will pay additional amounts to PRO Holders to gross up Payments upon the imposition of UK withholding tax, subject to customary exceptions.
<b>Exchange, variation or redemption for taxation reasons</b> .....	Upon the occurrence of certain changes in the treatment of the PROs for taxation purposes, the Issuer may, subject to the prior consent of the Financial Services Authority, exchange the Series A PROs and/or the Series B PROs for, or vary the terms of the relevant PROs so that they become, Upper Tier 2 Securities or redeem such PROs at the Special Redemption Price, as described in Condition 7(c). If following the Issuer giving notice to vary or exchange any PROs for or into Upper Tier 2 Securities, such PROs cannot be exchanged or varied or such change in tax treatment also affects or would affect the Upper Tier 2 Securities or certain other provisions apply and provided that the Solvency Condition has been met within the previous six months, the Issuer may redeem all, but not some only, of such PROs or any such Upper Tier 2 Securities for or into which they have been exchanged or varied at their principal amount together with accrued interest and any other amounts outstanding thereon.
<b>Exchange, variation or redemption for regulatory reasons</b> .....	The PROs will qualify as Tier 1 Capital for the purposes of the Financial Services Authority's capital adequacy regulations. If at any time the Series A PROs and/or the Series B PROs cease to qualify as Tier 1 Capital, the Issuer may, subject to the prior consent of the Financial Services Authority, exchange the relevant PROs for, or vary the terms of such PROs so that they become, Upper Tier 2 Securities or redeem such PROs at the Special Redemption Price, as described in Condition 7(d). If following the Issuer giving notice to vary or exchange any PROs for or into Upper Tier 2 Securities, such PROs cannot be exchanged or varied for or into Upper Tier 2 Securities or certain other provisions apply and provided that the Solvency Condition has been met within the previous six months, the Issuer may redeem all, but not some only, of such PROs or any such Upper Tier 2 Securities for or into which they have been exchanged or varied at their principal amount together with accrued interest and all other amounts outstanding thereon.
<b>Remedy for non-payment</b> .....	The sole remedy against the Issuer available to the Trustee or any PRO Holder for recovery of amounts owing in respect of any Payment or principal in respect of the PROs will be the institution of proceedings for the winding-up of the Issuer and/or proving in such winding-up.
<b>Form</b> .....	Bearer. Each series of PROs will be represented initially by a Temporary Global PRO, which will be deposited outside the United States with a common depositary for Clearstream, Luxembourg and Euroclear on or about 28 February 2001. The Temporary Global PROs will be exchangeable for interests in the Permanent Global PROs on or after a date which is expected to be 10 April 2001 upon certification as to non-US beneficial ownership as required by US Treasury regulations and as described in the Temporary Global PROs. Save in limited circumstances, PROs in definitive bearer form with coupons and a talon

attached on issue will not be issued in exchange for interests in the Permanent Global PROs.

**Listing** ..... Luxembourg.

**Governing law** ..... English.

**Rating** ..... The PROs have been assigned an A- rating by Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. and an aa3 rating by Moody's Investors Service, Inc. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

## INVESTMENT CONSIDERATIONS

*Prospective investors should carefully consider the following information in conjunction with the other information contained in this document. Terms which are defined in “Terms and Conditions of the PROs” have the same meaning when used herein.*

### **Deferral**

The Issuer may elect to defer any Payment (such term does not include principal) on the PROs for any period of time, as more particularly described in “Terms and Conditions of the PROs — 4. Deferrals”. Any such deferred Payment will, unless it is an exceptional deferral as described under “— 4(a) Exceptional Deferral of Payments —” bear interest at 2% above the rate applicable to the PROs and during the period of such deferral the Issuer may not declare or pay a dividend on any of its Ordinary Stock, Parity Securities or any other stock or securities of the Issuer (other than the Jersey Preferred Securities and the Perpetual Preference Stock) (if any) ranking junior to the PROs on a return of assets on a winding-up or in respect of distribution of dividends and/or income nor may the Issuer or any member of the Group redeem, purchase or otherwise acquire any Ordinary Stock, Existing Preference Stock, Parity Securities or any other stock or securities ranking junior to the PROs on a return of assets on a winding-up or in respect of distribution of dividends and/or income (including the Jersey Preferred Securities and the Perpetual Preference Stock) (save where those securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of securities of the same aggregate principal amount and which do not rank senior (on a return of assets on a winding-up or in respect of a distribution of dividends and/or income) to those securities being redeemed, purchased or acquired).

### **Perpetual securities**

The Issuer is under no obligation to redeem the PROs at any time (save in the particular circumstances referred to in “Terms and Conditions of the PROs — 8. Payments — (d) Suspension”) and the PRO Holders have no right to call for their redemption.

### **Conversion to Upper Tier 2 Securities and redemption risk**

Upon the occurrence of certain specified tax and regulatory events, the Series A PROs and/or the Series B PROs may be exchanged or their terms varied so that they become Upper Tier 2 Securities or the Issuer may elect to redeem the relevant PROs at the Special Redemption Price together with any Payments which are Outstanding. If following the Issuer giving notice to vary or exchange the PROs into Upper Tier 2 Securities, such specified tax and regulatory event applies or would apply to the Upper Tier 2 Securities or certain other provisions apply, such PROs or any such Upper Tier 2 Securities for or into which they have been exchanged or varied may, subject as provided in “Terms and Conditions of the PROs — 7. Exchange, Variation or Redemption — (c) Exchange, Variation or Redemption due to Taxation and — (d) Exchange, Variation or Redemption for Regulatory Purposes”, be redeemed at their principal amount together with any Payments which are Outstanding.

### **No limitation on issuing debt and *pari passu* securities**

There is no restriction within the terms of the PROs on the amount of debt (which will not be treated as Tier 1 Capital for regulatory purposes by the Financial Services Authority) which the Issuer may issue which ranks senior on a return of assets on a winding-up or in respect of distribution of dividends and/or income to the PROs. Similarly, there is no restriction within the terms of the PROs on the amount of preference stock or other securities (which will be treated as Tier 1 Capital for regulatory purposes by the Financial Services Authority) which the Issuer may issue which rank *pari passu* with the PROs as regards a return of assets on a winding-up or in respect of a distribution of dividends and/or income. In addition, the Issuer may issue preference stock or other securities (which will be treated as Tier 1 Capital for regulatory purposes by the Financial Services Authority) that are senior to the PROs provided that the rights attaching to the PROs are changed to give PRO Holders substantially equivalent rights of priority to such newly issued senior stock or other securities. The issue of any such debt or securities may reduce the amount recoverable by PRO Holders on a winding-up of the Issuer or may increase the likelihood of a deferral of payments under the PROs.



### **Proposed Exchange Offer for Jersey Preferred Securities**

The Issuer intends to effect an offer to exchange (i) the 8.117% Non-cumulative Perpetual Preferred Securities Class A and (ii) the 7.754% Non-cumulative Perpetual Preferred Securities Class B, of Bank of Scotland Capital Funding LP, for two series of perpetual regulatory tier one securities. Such an offer will be subject to the Issuer obtaining the requisite approvals and clearances. There can, therefore, be no assurance that such an exchange offer will take place.

### **No Voting Rights**

PRO Holders have no voting rights at any general meeting of the Issuer.

### **Insufficiency and availability of Ordinary Stock**

The Issuer currently has no authorised but unissued Ordinary Stock to allot and issue to satisfy a Coupon Payment under the alternative coupon satisfaction mechanism. The Issuer will undertake to the Trustee to propose a resolution at the time of its next annual general meeting expected to be held on 15 June 2001 to create (if required) and authorise the issue of not less than such amount of Ordinary Stock as the Issuer reasonably considers may be required to satisfy the next two Coupon Payments using the alternative coupon satisfaction mechanism. If the Issuer is to make a Payment using the alternative coupon payment mechanism and insufficient Ordinary Stock is available, then the Issuer's payment obligation shall be suspended to the extent of such insufficiency and, except in the case of Exceptionally Deferred Coupon Payments, shall bear interest at 2% above the rate applicable to the PROs, until such time as sufficient Ordinary Stock is available to satisfy all or part of the suspended payment obligation, as more particularly described in "Terms and Conditions of the PROs — 6. Alternative Coupon Satisfaction Mechanism — (d) Insufficiency".

### **Market Disruption Event**

If, following a decision by the Issuer to satisfy a Payment using the alternative coupon payment mechanism, a Market Disruption Event exists in the opinion of the Issuer, the Payment to PRO Holders may be deferred until the cessation of such market disruption, as more particularly described in — "Terms and Conditions of the PROs — 6. Alternative Coupon Satisfaction Mechanism — (e) Market Disruption". Any such deferred Payments shall bear interest at the rate applicable to the PROs if the Market Disruption Event continues for 14 days or more.

### **Restricted remedy for non-payment**

In accordance with Financial Services Authority requirements for subordinated capital, the sole remedy against the Issuer available to the Trustee or any PRO Holder for recovery of amounts owing in respect of any Payment or principal in respect of the PROs will be the institution of proceedings for the winding-up of the Issuer and/or proving in such winding-up.

### **Absence of prior public market**

The PROs constitute a new issue of securities by the Issuer. Prior to this issue, there has been no public market for the PROs. Although application has been made for the PROs to be listed on the Luxembourg Stock Exchange, there can be no assurance that an active public market for the PROs will develop and, if such a market were to develop, the Managers are under no obligation to maintain such a market. The liquidity and the market prices for the PROs can be expected to vary with changes in market and economic conditions, the financial condition and prospects of the Issuer and other factors that generally influence the market prices of securities.

## TERMS AND CONDITIONS OF THE PROs

### Terms and Conditions of the Series A PROs

*The following, subject to alteration, are the terms and conditions of the Series A PROs which will be endorsed on each Series A PRO in definitive form (if issued). These terms and conditions as amended by the provisions under "Terms and Conditions of the Series B PROs" on page 30 will, subject to alteration, apply to the Series B PROs and will be endorsed on each Series B PRO in definitive form (if issued). For the purposes of these terms and conditions as contained on pages 10 to 29, the term "PROs" will be relevant to the Series A PROs alone or the Series B PROs alone, as the case may be. Notes in italics do not form part of the terms and conditions of the PROs.*

The PROs are constituted by the Trust Deed. The issue of the PROs was authorised pursuant to resolutions of a duly appointed committee of the Board passed on 20 February 2001. The statements in these Conditions include summaries of, and are subject to, the detailed provisions of the Trust Deed. Copies of the Trust Deed, the Agency Agreement and the Calculation Agency Agreement are available for inspection during normal business hours by the PRO Holders and the Couponholders at the principal office of the Trustee, being at 101 Barclay Street, New York, NY 10286, and at the specified office of each of the Paying Agents. The PRO Holders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed, the Agency Agreement and the Calculation Agency Agreement applicable to them.

### 1 Form, Denomination and Title

#### (a) *Form and Denomination*

The PROs are serially numbered and in bearer form in the Authorised Denominations each with Coupons and one Talon attached on issue.

#### (b) *Title*

Title to the PROs, Coupons and Talons will pass by delivery. The bearer of any PRO will (except as otherwise required by law or as ordered by a court of competent jurisdiction) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest in it or its theft or loss or anything written on it) and no person will be liable for so treating the PRO Holder.

### 2 Status and Subordination

#### (a) *Status*

The PROs constitute direct, unsecured, subordinated securities of the Issuer and rank *pari passu* without any preference among themselves.

#### (b) *Subordination*

- (i) *Condition of Payment:* The rights and claims of the PRO Holders and the Couponholders are subordinated to the claims of Senior Creditors, in that payments in respect of the PROs (including the issue of Ordinary Stock in accordance with Condition 6) are conditional upon the Issuer being solvent at the time of payment (or at the time of the issue of such Ordinary Stock) by the Issuer and in that no principal or Payments shall be due and payable in respect of the PROs (including the issue of Ordinary Stock in accordance with Condition 6) except to the extent that the Issuer could make such payment (or make such issue of Ordinary Stock) and still be solvent immediately thereafter. In these Conditions the Issuer shall be considered to be solvent if (i) it is able to pay its debts to Senior Creditors as they fall due and (ii) the Auditors have reported to the Trustee within the previous six months that the Solvency Condition has been satisfied.
- (ii) *Winding-Up Claims:* Amounts representing any payments of principal or interest on the PROs in respect of which the conditions referred to in Condition 2(b)(i) are not satisfied on the date upon which the same would otherwise be due and payable ("Winding-Up Claims") will be payable by the Issuer in a winding-up of the Issuer as provided in Condition 3 and on any redemption pursuant to Condition 7(b), 7(c), 7(d) or 8(d). A Winding-Up Claim shall not bear interest.

- (iii) *Senior Tier 1 Securities:* So long as any of the PROs remains outstanding, the Issuer agrees that it will not issue any preference stock or other securities which are Tier 1 Capital which would rank (as regards distributions on a return of assets on a winding-up or in respect of distribution of dividends and/or income) senior to the PROs unless the Trust Deed and the PROs are amended to ensure that the Trustee and the PRO Holders obtain such of those rights and entitlements as are contained in or attached to such preference stock or other securities as are required so as to ensure that the PROs rank *pari passu* with, and contain substantially equivalent rights of priority as to payment as, such preference stock or other securities as the Trustee in its absolute discretion shall determine to be not materially less beneficial to the interests of the PRO Holders or as shall be approved by an Extraordinary Resolution (as defined in the Trust Deed).
- (iv) *Set-off:* Subject to applicable law, no PRO Holder or Couponholder may exercise, claim or plead any right of set-off, compensation or retention in respect of any amount owed to it by the Issuer arising under or in connection with the PROs or the Coupons and each PRO Holder and Couponholder shall, by virtue of his holding of any PRO or Coupon, be deemed to have waived all such rights of set-off, compensation or retention.

For the avoidance of doubt, if the Issuer would otherwise not be solvent for the purposes of the above Condition 2(b), any sums which would otherwise be payable in respect of the PROs will be available to meet the losses of the Issuer.

*On a return of assets on a winding-up of the Issuer, the PROs are expressed to rank pari passu with the Issuer's Existing Preference Stock and Parity Securities. Condition 2(b)(iii) contains a covenant that states that the Issuer will not issue any securities that would rank senior to the PROs on a return of assets on a winding-up or in respect of distribution of dividends and/or income. Dividends under the Existing Preference Stock are only payable if the Issuer has sufficient distributable profits and distributable reserves and provided that payment on such Existing Preference Stock would not breach the Financial Services Authority's prevailing capital adequacy requirements. If dividends are not paid on the Existing Preference Stock then those dividends do not cumulate, although there is a mechanism whereby additional Existing Preference Stock may be issued in lieu. Payments of interest on the PROs may, or in some cases shall, be deferred on any Coupon Payment Date but any deferred Payment will cumulate and be due to holders of PROs on a return of assets on a winding-up of the Issuer (if not paid prior to that event).*

*Condition 4(c) provides that, if any dividend payment is made on the Existing Preference Stock, the Issuer shall not be entitled to defer a Payment on the PROs under Condition 4(a) and (b) and that, if a dividend payment is deferred on the Existing Preference Stock, then Payment must be deferred on the PROs, all as provided in Condition 4(c). Accordingly, the effect of Condition 4(c) is substantially the same as if the Existing Preference Stock and the PROs rank pari passu as regards the payment of dividends. As at the date of this Offering Memorandum, no Parity Securities are in issue.*

### 3 Winding-up

If at any time an order is made, or an effective resolution is passed, for the winding-up of the Issuer (except in any such case a solvent winding-up solely for the purpose of a reconstruction or amalgamation or the substitution in place of the Issuer of a successor in business of the Issuer (as defined in the Trust Deed), the terms of which reconstruction, amalgamation or substitution have previously been approved in writing by the Trustee or by an Extraordinary Resolution), there shall be payable by the Issuer in respect of each PRO (in lieu of any other payment by the Issuer) such amount, subject as provided in Condition 2(b), if any, as would have been payable to such PRO Holder if, on the day prior to the commencement of the winding-up and thereafter, such PRO Holder were the holder of one of a notional class of preference stock in the capital of the Issuer (the "**Notional Stock**") ranking *pari passu* with the holders of the Existing Preference Stock and the Parity Securities (if any) from time to time issued by the Issuer as regards a preferential right to participate in a return of assets in the winding-up over and so ranking senior to the holders of all other classes of issued stock for the time being in the capital of the Issuer (other than the Existing Preference Stock and any stock qualifying as Parity Securities), but ranking junior to the claims of Senior Creditors and junior to any other notional class of preference stock in the capital of the Issuer by reference to which the amount payable in respect of any Junior Subordinated Debt in a winding-up of the Issuer is determined, on the assumption that the amount that such PRO Holder was entitled to receive in respect of such Notional Stock (on a return of assets in such winding-up) was an amount equal to the principal amount or the Special Redemption

Price, if applicable, of the relevant PRO and any other Payments which are Outstanding together with, to the extent not otherwise included within the foregoing, the *pro rata* share of any Winding-Up Claims attributable to the PRO.

#### **4 Deferrals**

The Issuer must make each Coupon Payment on the relevant Coupon Payment Date subject to and in accordance with these Conditions. However, the Issuer may defer a Coupon Payment and any other Payment in the following circumstances:

##### **(a) *Exceptional Deferral of Payments***

- (i) If on the 20th business day preceding the date on which any Payment would, in the absence of deferral in accordance with this Condition 4, be due and payable, the Exceptional Deferral Condition is satisfied, any such Payment may be deferred (subject to Condition 4(c), and, if not so deferred, must be satisfied through the issue of Ordinary Stock pursuant to Condition 6 unless the prior consent of the Financial Services Authority is obtained for the making of such Payment in cash) by the Issuer giving notice to the Trustee, the PRO Holders, the Principal Paying Agent and the Calculation Agent not less than 16 business days prior to such date. If following the deferral of a Payment by the Issuer under this Condition 4(a)(i) the Exceptional Deferral Condition ceases to be satisfied on the 20th business day preceding a Coupon Payment Date, then the Issuer shall satisfy such Payment on the Relevant Deferred Coupon Payment Date having given, not less than 16 business days prior to the Relevant Deferred Coupon Payment Date, notice to the Trustee, the PRO Holders, the Principal Paying Agent and the Calculation Agent that it will satisfy such Payment on such date unless (i) it has previously elected to satisfy such Payment earlier (provided that, at the time of satisfying such Payment, the Exceptional Deferral Condition is not satisfied) by delivering a notice to the Trustee, the PRO Holders, the Principal Paying Agent and the Calculation Agent not less than 16 business days prior to the relevant Exceptionally Deferred Coupon Payment Date or (ii) it elects to defer such Payment under Condition 4(b).
- (ii) If any Payment is deferred pursuant to this Condition 4(a) then: (1) the Issuer may not declare or pay a dividend on any Ordinary Stock, Parity Securities or any other stock or securities of the Issuer (other than the Jersey Preferred Securities and the Perpetual Preference Stock) (if any) ranking junior to the PROs on a return of assets on a winding-up or in respect of distribution of dividends and/or income nor may the Issuer or any member of the Group redeem, purchase or otherwise acquire any Ordinary Stock, Existing Preference Stock, Parity Securities or any other stock or securities ranking junior to the PROs on a return of assets on a winding-up or in respect of a distribution of dividends and/or income (save where those securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of securities of the same aggregate principal amount and which do not rank senior (on a return of assets on a winding-up or in respect of a distribution of dividends and/or income) to those securities being redeemed, purchased or acquired) from the date of the first-mentioned notice in Condition 4(a)(i) until such time as that Exceptionally Deferred Coupon Payment is satisfied; and (2) no amount will be payable by way of interest on any such deferred Payment, save as provided in Condition 6(e). Any such deferred Payment shall be capable of satisfaction only by the issue of Payment Ordinary Stock in accordance with Condition 6.

##### **(b) *Election to defer Payment***

- (i) The Issuer may (subject to Condition 4(c)), in respect of any Payment which would, in the absence of deferral in accordance with this Condition 4, be due and payable, defer such Payment by giving notice to the Trustee, the Principal Paying Agent, the Calculation Agent and the PRO Holders not less than 16 business days prior to the relevant due date. The Issuer may then satisfy any such Payment at any time only by the issue of Payment Ordinary Stock pursuant to Condition 6, upon delivery of notice to the Trustee, the PRO Holders, the Principal Paying Agent and the Calculation Agent not less than 16 business days prior to the relevant Coupon Satisfaction Date.

- (ii) If the Issuer has given the notice first-mentioned in (i) above then: (1) the Issuer may not declare or pay a dividend on any Ordinary Stock, Parity Securities or any other stock or securities of the Issuer (other than the Jersey Preferred Securities and the Perpetual Preference Stock) (if any) ranking junior to the PROs on a return of assets on a winding-up or in respect of distribution of dividends and/or income nor may the Issuer or any member of the Group redeem, purchase or otherwise acquire any Ordinary Stock, Existing Preference Stock, Parity Securities or any other stock or securities ranking junior to the PROs on a return of assets on a winding-up or in respect of a distribution of dividends and/or income (save where those securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of securities of the same aggregate principal amount and which do not rank senior (on a return of assets on a winding-up or in respect of a distribution of dividends and/or income) to those securities being redeemed, purchased or acquired) from the date of such notice until such time as that Deferred Coupon Payment (and any other Deferred Coupon Payment or Accrued Coupon Payment) is satisfied; and (2) each Payment which the Issuer defers pursuant to the giving of such a notice shall bear interest at a rate equal to the aggregate of the rate determined in accordance with Condition 5(b) and 2% per annum from (and including) the date of deferral of such Payment pursuant to this Condition 4(b) to (but excluding) the relevant Coupon Satisfaction Date.

**(c) *Limitations on Issuer's ability to defer payments***

- (i) If a dividend or other distribution is declared or made either in full or in part in respect of the Existing Preference Stock, any Parity Securities, the Ordinary Stock or any other stock or securities of the Issuer ranking junior to the PROs on a return of assets on a winding up or in respect of distribution of dividends and/or income, then (subject to Condition 2(b)(i) and paragraph (ii) below) the Issuer shall not be entitled to defer (pursuant to Condition 4(a) or (b)) the Coupon Payment or any other Payment which would, in the absence of any such deferral, be due and payable on (x) the same date as such dividend or other distribution is declared or made or (y) if the Coupon Payment or other Payment would have been due on any subsequent date, on the next following Coupon Payment Date, provided however that if the Exceptional Deferral Condition is satisfied the relevant Coupon Payment or other Payment must be satisfied through the issue of Ordinary Stock in accordance with and subject to Condition 6 unless the prior consent of the Financial Services Authority is obtained for the making of such Payment in cash.
- (ii) Payments of any Coupon Payment or any other Payment which would, in the absence of any deferral, be due and payable on any Coupon Payment Date must be deferred in full under Condition 4(a) or (b) if no dividend is paid on such date on the Existing Preference Stock.
- (iii) Any inability to defer Payments as provided in paragraph (i) above, and any deferral provided in paragraph (ii) above, is without prejudice to the ability of the Issuer to exercise its election to satisfy any Payment through the issue of Ordinary Stock as provided in Condition 6.
- (iv) For the avoidance of doubt, any issue of bonus or other scrip stock or securities by way of satisfaction of any dividend or other distribution shall be treated as a payment of the relevant dividend or distribution for the purposes of paragraphs (i) and (ii) above.

**5 Coupon Payments**

**(a) *Coupon Payment Dates***

The PROs bear interest at the Coupon Rate from (and including) the Issue Date and such interest will (subject to Conditions 2(b)(i), 4(a), 4(b), 4(c), 6(d), 6(e) and 8(d)) be payable on each Coupon Payment Date. Each PRO will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused. In such event, it shall continue to bear interest in accordance with this Condition (both before and after judgment) as provided in the Trust Deed.

**(b) *Coupon Rate***

- (i) The Coupon Rate in respect of the period from (and including) the Issue Date to (but excluding) the First Reset Date is 7.286% per annum.
- (ii) The Coupon Rate in respect of each Reset Period shall be the aggregate of 3.645% per annum and the Five Year Benchmark Gilt Rate in respect of such Reset Period (as determined by the Principal Paying Agent).

**(c) *Determination and Publication of Coupon Rate and Coupon Amounts***

The Principal Paying Agent will, upon the determination of each Coupon Rate pursuant to Condition 5(b)(ii), calculate the Coupon Amount in respect of each Authorised Denomination and cause the Coupon Rate and each Coupon Amount payable in respect of a Coupon Period to be notified to the Trustee, the Issuer and the Luxembourg Stock Exchange and to be notified to the PRO Holders as soon as possible after their determination but in no event later than the fourth business day thereafter.

The Coupon Amount with respect to the First Coupon Period is £55.05 per £1,000 nominal amount of PROs.

Each Coupon Amount in respect of any Coupon Period or other period in respect of which interest is required to be calculated shall be calculated by applying the Coupon Rate to the principal amount of the PRO of the relevant Authorised Denomination. Such Coupon Amount shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed.

**(d) *Determination or Calculation by Trustee***

If the Principal Paying Agent does not at any time for any reason so determine the Coupon Rate or calculate each Coupon Amount in accordance with Conditions 5(b)(ii) and 5(c), the Trustee or an agent on its behalf shall do so and such determination or calculation shall be deemed to have been made by the Principal Paying Agent. In doing so, the Trustee or such agent shall apply the foregoing provisions of this Condition, with any necessary consequential amendments, to the extent that, in its opinion, it or such agent can do so, and in all other respects it or such agent shall do so in such manner as it shall deem fair and reasonable in all the circumstances. All determinations or calculations made or obtained for the purposes of the provisions of this Condition 5(d) by the Trustee, shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Calculation Agent, the Paying Agents and all PRO Holders and Couponholders and (in the absence of wilful default or bad faith) no liability to the Issuer, the PRO Holders or the Couponholders shall attach to the Trustee in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

**6 Alternative Coupon Satisfaction Mechanism**

**(a) *Alternative Coupon Satisfaction Mechanism***

The Issuer may elect to satisfy any Payment in full or in part through the issue of Ordinary Stock to the Trustee in accordance with this Condition 6, in which case it shall notify the Trustee, the Principal Paying Agent and the Calculation Agent not less than 16 business days prior to the relevant Coupon Payment Date.

**(b) *Issue of stock***

If any Payment is to be satisfied in full or in part through the issue of Ordinary Stock to the Trustee then, subject to Conditions 6(d) and 6(e):

- (i) by close of business on or before the 7th business day prior to the relevant Coupon Payment Date, Coupon Satisfaction Date or Exceptionally Deferred Coupon Payment Date the Issuer will issue to the Trustee (or, if so agreed between the Issuer and the Trustee, to an agent of the Trustee) such amount of Ordinary Stock (the "**Payment Ordinary Stock**") as, in the determination of the Calculation Agent, has a market value of not less than the relevant Payment (including, for the avoidance of doubt, any Accrued Coupon Payment) to be satisfied in accordance with this Condition 6; and

- (ii) the Trustee will use reasonable endeavours to effect the transfer or instruct its agent to effect the transfer of such Payment Ordinary Stock to or to the order of the Calculation Agent (subject to any necessary consents being obtained) as soon as practicable and in any case not later than by close of business on the 6th business day prior to the date on which the relevant Payment is due and the Calculation Agent has agreed to use reasonable endeavours to procure purchasers for such Payment Ordinary Stock. If necessary, the Calculation Agent has further agreed to exchange, as agent of the Trustee, the proceeds of such sale into sterling at prevailing market exchange rates and deliver such exchanged proceeds to, or hold such exchanged proceeds to the order of, the Trustee who shall pay or procure that its agent pays such proceeds as it holds in respect of the relevant Payment on its due date to the Principal Paying Agent for application in accordance with Condition 6(c).

**(c) *Issue satisfies Payment***

Where the Issuer either elects or is required to make a Payment hereunder by issuing Ordinary Stock to the Trustee and in accordance with its obligations under the Trust Deed issues such stock, such issue shall (subject to Condition 6(e)) satisfy the relevant Payment and so discharge any obligation of the Issuer to make such Payment or, as the case may be, in the circumstances referred to in Condition 6(d) below, the relevant part of such Payment if made in accordance with this Condition 6. The proceeds of sale of Ordinary Stock issued in accordance with this Condition 6 shall be paid by the Principal Paying Agent to the PRO Holders in respect of the relevant Payment.

**(d) *Insufficiency***

If the Issuer is to satisfy all or part of a Payment in accordance with this Condition 6 and the Issuer does not, on the date when the amount of such Ordinary Stock required to be issued is determined in accordance with this Condition 6, have a sufficient amount of Ordinary Stock authorised for issue for such purpose, then any Ordinary Stock so authorised to be issued shall be applied by the Issuer in satisfaction of all or part of the relevant Payment. In such circumstances where the Issuer has no, or an insufficient amount of, Ordinary Stock authorised for issue for such purpose, the Issuer shall notify the Trustee, the Principal Paying Agent, the Calculation Agent and the PRO Holders that all or part, as the case may be, of the relevant Payment cannot be so satisfied due to the events described in this paragraph, in which case the same shall be satisfied following the date of the next annual general meeting or extraordinary general meeting of Proprietors at which a resolution is passed creating (if required) a sufficient amount of Ordinary Stock and authorising the Board to allot and issue the same to satisfy all or such part of the relevant Payment provided that if the amount of Ordinary Stock authorised to be issued at any such meeting is insufficient to satisfy all or such part of the relevant Payment then the Ordinary Stock so authorised to be issued shall be applied by the Issuer in part satisfaction of all or such part of the relevant Payment. Following the passage of any such resolution, the Issuer shall notify the Trustee, the Principal Paying Agent, the Calculation Agent and the PRO Holders of the date upon which the relevant Payment or, as the case may be, the part thereof is to be made in accordance herewith on not less than 16 business days' notice. The relevant Payment or, as the case may be, the part thereof which is not so satisfied shall, unless it is an Exceptionally Deferred Coupon Payment, continue to accrue interest at a rate determined in accordance with Condition 4(b)(ii) from (and including) the date on which Payment would otherwise have been due to (but excluding) the date on which such Payment or part thereof is satisfied. If, in the case of an insufficiency of Ordinary Stock, the Issuer does not hold an annual general meeting or extraordinary general meeting within 6 months of giving the above first-mentioned notice, at which a resolution is proposed to create (if required) and authorise the Board to allot and issue a sufficient amount of Ordinary Stock as is required for the foregoing purpose, the Trustee shall by notice require the Issuer to convene an extraordinary general meeting at which such a resolution shall be proposed on a date falling within 10 weeks of such notice from the Trustee. In the event that any such resolution proposed at any such annual general meeting or extraordinary general meeting is rejected, such resolution will then be proposed at the next following annual general meeting of the Issuer and, if at such annual general meeting such resolution is rejected again, from the date of such second rejection the Issuer shall not be entitled to declare or pay a dividend on any Ordinary Stock, Parity Securities or any other stock or securities of the Issuer (other than the Jersey Preferred Securities and the Perpetual Preference Stock) (if any) ranking junior to the PROs

on a return of assets on a winding-up or in respect of distribution of dividends and/or income nor may the Issuer or any member of the Group redeem, purchase or otherwise acquire any Ordinary Stock, Existing Preference Stock, Parity Securities or any other stock or securities ranking junior to the PROs on a return of assets on a winding-up or in respect of a distribution of dividends and/or income (save where those securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of securities of the same aggregate principal amount and which do not rank senior (on a return of assets on a winding-up or in respect of a distribution of dividends and/or income) to those securities being redeemed, purchased or acquired) until such time as such resolution has been passed by the Proprietors.

*The Issuer currently has no authorised but unissued Ordinary Stock which the Board is authorised to allot and issue to satisfy a Coupon Payment under the alternative coupon satisfaction mechanism referred to in Condition 6. The Issuer will undertake to the Trustee to propose a resolution at the time of its next annual general meeting expected to be held on 15 June 2001 to create (if required) and authorise the issue of not less than such amount of Ordinary Stock as the Issuer reasonably considers may be required to satisfy the next two Coupon Payments using the alternative coupon satisfaction mechanism described above.*

**(e) Market Disruption**

Notwithstanding the provisions of Condition 6(b) and Condition 4(c)(i), if there exists, in the opinion of the Issuer, a Market Disruption Event on or after the 15th business day preceding any date upon which the Issuer is due to satisfy a Payment in accordance with this Condition 6, then the Issuer may give a notice to the Trustee, the Principal Paying Agent, the Calculation Agent and the PRO Holders as soon as possible after the Market Disruption Event has arisen or occurred, whereupon the relevant Payment may be deferred until such time as the Market Disruption Event no longer exists.

Any such deferred Payment will be satisfied as soon as practicable following such time as the Market Disruption Event no longer exists. Interest shall not accrue on such deferred Payment unless, as a consequence of the existence of a Market Disruption Event, the Issuer does not make the relevant Payment for a period of 14 days or more after the date it is due to be satisfied, in which case interest shall accrue on such deferred Payment from (and including) the date on which the relevant Payment was due to be satisfied to (but excluding) the date on which such Payment is made. Any such interest shall accrue at the rate applicable to the PROs determined in accordance with Condition 5 and shall be satisfied only in accordance with Condition 6 and as soon as reasonably practicable after the relevant deferred Payment is made. No liability shall attach to the Trustee or its agents if, as a result of a Market Disruption Event or any other event outside the control of the Trustee or its agent, the Trustee or its agent is unable to comply with the provisions of Condition 6(b).

**7 Exchange, Variation or Redemption**

**(a) No Fixed Redemption Date**

The PROs are perpetual securities in respect of which there is no fixed redemption date and the Issuer shall (subject to the provisions of Conditions 2 and 3 and without prejudice to the provisions of Condition 12) only have the right to repay them in accordance with the following provisions of this Condition 7 or in the circumstances provided for in Condition 8(d).

Any redemption by the Issuer or purchase by the Issuer or any Subsidiary of the PROs is subject to the prior consent of the Financial Services Authority.

**(b) Issuer's Call Option**

Provided that the Solvency Condition has been met within the previous six months, the Issuer may, by giving not less than 30 nor more than 60 days' notice to the PRO Holders in accordance with Condition 16 and to the Principal Paying Agent and the Trustee, which notice shall be irrevocable, elect to redeem all, but not some only, of the PROs on the First Reset Date or any Coupon Payment Date thereafter at their principal amount together with any Payments which are Outstanding.



**(c) *Exchange, Variation or Redemption due to Taxation***

If the Issuer satisfies the Trustee immediately prior to the giving of the notice referred to below that, on the next due date for a Coupon Payment:

- (i) the Issuer would be unable to make such Payment without being required to pay additional amounts as provided in Condition 11 and such requirement or circumstance cannot be avoided by the Issuer taking reasonable measures available to it; or
- (ii) Payments of amounts in respect of interest on the PROs including, for the avoidance of doubt, the issue of Payment Ordinary Stock pursuant to Condition 6, may be treated as “distributions” within the meaning of Section 832(1) of the Income and Corporation Taxes Act 1988 (or such other Section and/or Act as may from time to time supersede or replace Section 832(1) of the Income and Corporation Taxes Act 1988 for the purposes of such definition) and such requirement or circumstance cannot be avoided by the Issuer taking reasonable measures available to it; or
- (iii) as a result of any change in or proposed change in, or amendment to or proposed amendment to, the laws of the United Kingdom or any political subdivision or authority thereof having power to tax, or any change in or proposed change in the application of official or generally published interpretation of such laws, or any interpretation or pronouncement by any relevant tax authority that provides for a position with respect to such law or regulations that differs from the previously generally accepted position in relation to similar transactions or which differs from any specific written confirmation given by a tax authority in respect of the PROs, which change or amendment becomes, or would become, effective, or in the case of a change or proposed change in law if such change is enacted (or, in the case of a proposed change, is expected to be enacted) by Act of Parliament or Act of the Scottish Parliament or made by Statutory Instrument or Scottish Statutory Instrument, on or after 26 February 2001, there is more than an insubstantial risk that the Issuer will not obtain substantially full relief for the purposes of United Kingdom corporation tax for the next following Payment of interest including, for the avoidance of doubt, where the Payment of interest is to be satisfied by the issue of Payment Ordinary Stock pursuant to Condition 6 or, as a result of the PROs being in issue, the Issuer may be unable to claim or surrender losses as group relief, and such requirement or circumstance cannot be avoided by the Issuer taking reasonable measures available to it,

then the Issuer may (subject to the prior consent of the Financial Services Authority but without any requirement for the consent or approval of the PRO Holders or, save as specified below, the Trustee), having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 16, the PRO Holders (which notice shall be irrevocable) either (x) exchange the PROs for, or vary the terms of the PROs so that they become, Upper Tier 2 Securities on terms which preserve any existing rights under these Conditions to Payments which are Outstanding or (y) (provided that the Solvency Condition has been met within the previous six months) redeem the PROs at the Special Redemption Price together with any Payments which are Outstanding.

If following the Issuer giving notice to effect such exchange or variation pursuant to (x) above:

(a) the consent of the Financial Services Authority is not given or, (b) the PROs cannot be exchanged or varied for or into Upper Tier 2 Securities (in which case the Issuer shall deliver to the Trustee an opinion of independent legal advisers of recognised standing stating that (in their opinion) the PROs cannot be exchanged or varied for or into Upper Tier 2 Securities and the Trustee shall accept such opinion as sufficient evidence thereof in which event it shall be conclusive and binding on the PRO Holders) or, (c) any of the conditions listed in paragraphs (i) to (iii) above apply or continue to apply to Upper Tier 2 Securities for or into which the PROs have been exchanged or varied or, (d) if the Issuer shows to the satisfaction of the Trustee that any of the conditions listed in paragraphs (i) to (iii) above would apply if such exchange or variation were to take place, the Issuer may, provided that the Solvency Condition has been met within the previous six months, having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 16, the PRO Holders (which notice shall be irrevocable), redeem, in accordance with these Conditions (and in particular subject to the consent of the Financial Services Authority to such redemption under Condition 7(a)), at any time all, but not some only, of the PROs or any such Upper Tier 2 Securities for or into which they

have been exchanged or varied at their principal amount together with any Payments which are Outstanding. The Trustee shall use its reasonable endeavours to assist the Issuer in the exchange or variation of the PROs for or into Upper Tier 2 Securities, provided that the Trustee shall not be obliged to participate or assist in any such exchange or variation if, in its opinion, the terms of the securities into which the PROs are to be exchanged or are to be varied impose, in the Trustee's opinion, more onerous obligations upon it. If the Trustee does not so participate or assist as provided above, the Issuer will use its reasonable endeavours to appoint a replacement trustee in accordance with the terms of the Trust Deed for such purpose. Failing which, the Issuer may, subject as provided above, redeem the PROs as provided above. Prior to the publication of any notice of exchange, variation or redemption pursuant to this Condition 7(c) the Issuer shall deliver to the Trustee a certificate signed by a Director of the Issuer stating that the relevant requirement or circumstance referred to in paragraphs (i), (ii) or (iii) above is satisfied or would be satisfied were such exchange or variation to take place and the Trustee shall accept such certificate as sufficient evidence of the satisfaction of the conditions precedent set out above in which event it shall be conclusive and binding on the PRO Holders. Upon expiry of such notice the Issuer shall either redeem, vary or exchange the PROs, as the case may be.

**(d) *Exchange, Variation or Redemption for Regulatory Purposes***

If the Issuer satisfies the Trustee immediately prior to the giving of the notice referred to below that the Financial Services Authority has determined that the PROs no longer qualify as Tier 1 Capital then the Issuer may (subject to the prior consent of the Financial Services Authority but without any requirement for the consent or approval of the PRO Holders or, save as specified below, the Trustee), having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 16, the PRO Holders (which notice shall be irrevocable) (x) exchange the PROs for, or vary the terms of the PROs so that they become, Upper Tier 2 Securities on terms which preserve any existing rights under these Conditions to Payments which are Outstanding or (y) (provided that the Solvency Condition has been met within the previous six months and only with respect to any determination as aforesaid by the Financial Services Authority after 1 August 2001) redeem the PROs at the Special Redemption Price together with any Payments which are Outstanding.

If following the Issuer giving notice to effect such exchange or variation pursuant to (x) above: (a) the consent of the Financial Services Authority is not given or (b) the PROs cannot be exchanged or varied for or into Upper Tier 2 Securities (in which case the Issuer shall deliver to the Trustee an opinion of independent legal advisers of recognised standing stating that (in their opinion) the PROs cannot be exchanged or varied for or into Upper Tier 2 Securities and the Trustee shall accept such opinion as sufficient evidence thereof in which event it shall be conclusive and binding on the PRO Holders) or (c) any of the conditions listed in Condition 7(c)(i), (ii) and (iii) above apply, or would apply, to such Upper Tier 2 Securities, the Issuer may, provided that the Solvency Condition has been met within the previous six months, having given not less than 30 nor more than 60 days' notice to the Trustee, the Principal Paying Agent and, in accordance with Condition 16, the PRO Holders (which notice shall be irrevocable), redeem, in accordance with these Conditions (and, in particular, subject to the consent of the Financial Services Authority to such redemption under Condition 7(a)), at any time all, but not some only, of the PROs or any such Upper Tier 2 Securities for or into which they have been exchanged or varied at their principal amount together with any Payments which are Outstanding. The Trustee shall use its reasonable endeavours to assist the Issuer in the exchange or variation of the PROs for or into Upper Tier 2 Securities, provided that the Trustee shall not be obliged to participate or assist in any such exchange or variation if, in its opinion, the terms of the securities into which the PROs are to be exchanged or are to be varied impose, in the Trustee's opinion, more onerous obligations upon it. If the Trustee does not so participate or assist as provided above, the Issuer will use its reasonable endeavours to appoint a replacement trustee in accordance with the terms of the Trust Deed for such purpose. Failing which, the Issuer may, subject as provided above, redeem the PROs as provided above. Upon the expiry of such notice the Issuer shall either redeem, vary or exchange the PROs, as the case may be.

**(e) Purchases**

The Issuer or any Subsidiary may (subject to the prior consent of the Financial Services Authority and provided the Auditors have reported to the Trustee within the previous six months that the Solvency Condition has been met) at any time purchase PROs in any manner and at any price. In each case purchases will be made together with all unmatured Coupons and Talons (if any) appertaining thereto.

**(f) Cancellation**

All PROs redeemed by the Issuer and any unmatured Coupons and Talons (if any) appertaining thereto will be cancelled and may not be reissued or resold. PROs purchased by the Issuer or any Subsidiary may be held, reissued, resold or, at the option of the Issuer, surrendered to any Paying Agent for cancellation. Following any such cancellation, the Issuer or the Principal Paying Agent will notify the Luxembourg Stock Exchange of the principal amount of the PROs so cancelled.

**8 Payments**

**(a) Method of Payment**

- (i) Payments of principal and Coupon Amounts will be made by or on behalf of the Issuer against presentation and surrender of PROs or the appropriate Coupons (as the case may be) at the specified office of any of the Paying Agents except that payments of Coupon Amounts in respect of any period not ending on a Coupon Payment Date will only be made upon surrender of the relative PRO. Such payments will be made, at the option of the payee by sterling cheque drawn on, or by transfer to a sterling account maintained by the payee with, a bank in London.
- (ii) Upon the due date for redemption of any PRO, any unexchanged Talon relating to such PRO (whether or not attached) shall become void and no Coupon shall be delivered in respect of such Talon and unmatured Coupons relating to such PRO (whether or not attached) shall also become void and no payment shall be made in respect of them. If any PRO is presented for redemption without all unmatured Coupons and any unexchanged Talon relating to it, redemption shall be made only against the provision of such indemnity as the Issuer may require.
- (iii) On or after the Coupon Payment Date for the final Coupon forming part of a Coupon sheet issued in respect of any PRO, the Talon forming part of such Coupon sheet may be surrendered at the specified office of any Paying Agent in exchange for a further Coupon sheet (and another Talon for a further Coupon sheet) (but excluding any Coupons that may have become void pursuant to Condition 12).
- (iv) The names of the initial Paying Agents and their initial specified offices are set out below. The Issuer reserves the right, subject to the prior written approval of the Trustee, such approval not to be unreasonably withheld, at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that it will at all times maintain (aa) a Paying Agent having a specified office outside the United Kingdom and (bb) for so long as the PROs are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, a Paying Agent having a specified office in Luxembourg. Notice of any such termination or appointment and of any change in the specified offices of the Paying Agents will be given to the PRO Holders in accordance with Condition 16.

**(b) Payments subject to Fiscal Laws**

Without prejudice to the terms of Condition 11, all payments made in accordance with these Conditions shall be made subject to any fiscal or other laws and regulations applicable in the place of payment. No commissions or expenses shall be charged to the PRO Holders in respect of such payments.

**(c) *Payments on Payment Business Days***

A PRO or a Coupon may only be presented for payment on a day which is a Payment Business Day. No further interest or other payment will be made as a consequence of the day on which the relevant PRO or Coupon may be presented for payment under this paragraph falling after the due date.

**(d) *Suspension***

If, following any take-over offer made under the City Code on Take-overs and Mergers or any reorganisation, restructuring or scheme of arrangement, the Issuer (unless there is a New Owner) or any New Owner ceases to be the ultimate holding company of the Group, then the Issuer shall as soon as practicable give notice to the Trustee, the Calculation Agent and the PRO Holders, whereupon the Issuer's right to satisfy a Payment by the method contemplated by Condition 6 shall be suspended (such event being a "**Suspension**"). In such event an independent investment bank appointed by the Issuer (at the Issuer's expense) and approved by the Trustee shall determine, subject to the requirements that (i) the Issuer shall not be obliged to reduce its net assets, (ii) no amendment may be proposed or made which would alter the regulatory capital treatment of the PROs for banking capital adequacy purposes without the prior consent of the Financial Services Authority, and (iii) no such amendment may be made which would, in the Trustee's opinion, impose more onerous obligations on it without its consent, what amendments (if any) to these Conditions, the Trust Deed and any other relevant documents are appropriate in order to preserve substantially the economic effect, for the PRO Holders, of a holding of the PROs prior to the Suspension. Upon any such determination being reached and notified to the Trustee and the Issuer by such investment bank, the Trustee and the Issuer shall, pursuant to the terms of the Trust Deed and without the consent of the PRO Holders or Couponholders, effect any necessary consequential changes to these Conditions and the Trust Deed and any other relevant documents, whereupon the Issuer's right to satisfy a Payment by the method contemplated in Condition 6 shall no longer be subject to the Suspension.

If, after using all reasonable endeavours, such investment bank is unable to formulate such amendments, it shall so notify the Issuer, the New Owner, the Trustee, the Principal Paying Agent and the Calculation Agent and each PRO shall (subject to the prior consent of the Financial Services Authority) be redeemed by the Issuer, following notice to the PRO Holders by the Issuer of such redemption as soon as practicable after receipt of the consent of the Financial Services Authority, at the Special Redemption Price, together with any Payments which are Outstanding, not later than the 60th business day following the giving of such notice by the Issuer to the PRO Holders. Such redemption will, unless otherwise agreed by the Issuer and the Trustee, be effected through the issue of Ordinary Stock, such Ordinary Stock to be transferred to the New Owner in consideration for which the New Owner issues and transfers its ordinary shares (or share capital of an equivalent class) in accordance, *mutatis mutandis*, with Condition 6(b), (c), (d) and (e) (with references to the Payment Ordinary Stock being construed as references to such ordinary shares or equivalent share capital of the New Owner which, when sold, provide a net cash amount (converted into sterling if necessary at the prevailing market rate in accordance with the Calculation Agency Agreement) of not less than the redemption amount so payable by the Issuer).

**(e) *Limitation on PRO Holders***

If at any time the Issuer becomes aware that a PRO Holder owns, directly or indirectly, 10% or more of the Ordinary Stock, the Issuer will have the right to suspend Payments in respect of such PRO Holder. A PRO Holder is required to provide written notice to the Issuer if at any time any such PRO Holder owns, directly or indirectly, 10% or more of the Ordinary Stock. Any amounts so suspended will be forfeited and may not be subsequently claimed.

**9 Pre-Emption**

The Issuer shall, from time to time, use reasonable endeavours to keep available for issue such amount of Ordinary Stock as it reasonably considers would be required to be issued in order to satisfy the requirement to issue Payment Ordinary Stock in accordance with Condition 6 in connection with the next two Coupon Payments and to ensure that the Board is authorised to issue the same.

In the event of breach by the Issuer of this Condition 9, without prejudice to Condition 6(d), the sole remedy shall be that the Trustee may require the Issuer to put before the next general meeting of the Proprietors a resolution to create and authorise for issue such amount of Ordinary Stock as the Issuer reasonably considers would be required to be issued in order to satisfy the requirement to issue Payment Ordinary Stock in accordance with Condition 6 in connection with the next two Coupon Payments.

The Trustee shall not be obliged to monitor compliance by the Issuer with this Condition and shall be entitled to assume, unless it has actual knowledge to the contrary, that the Issuer is complying with its obligations under this Condition.

*The Issuer currently has no authorised but unissued Ordinary Stock which the Board is authorised to allot and issue to satisfy a Coupon Payment under the alternative coupon satisfaction mechanism referred to in Condition 6. The Issuer will undertake to the Trustee to propose a resolution at the time of its next annual general meeting expected to be held on 15 June 2001 to create (if required) and authorise the issue of not less than such amount of Ordinary Stock as the Issuer reasonably considers may be required to satisfy the next two Coupon Payments using the alternative coupon satisfaction mechanism described above.*

## **10 Non-Payment When Due**

*Notwithstanding any of the provisions below in this Condition 10, the right to institute winding-up proceedings is limited to circumstances where payment has become due. Pursuant to Condition 2(b) no principal or Payment will be due if the Solvency Condition is not satisfied, or if the Issuer would not otherwise be solvent. Also, in the case of any Payment such Payment will not be due if the Issuer has elected to defer that Payment pursuant to Condition 4(a) or 4(b) (subject always to Condition 4(c)) or if the circumstances referred to in any of Conditions 6(d), 6(e) or 8(d) then apply. The Trust Deed contains provisions entitling the Trustee to claim from the Issuer, inter alia, the fees, expenses and liabilities incurred by it in carrying out its duties under the Trust Deed. The restrictions on commencing proceedings described below will not apply to any such claim.*

- (a) If the Issuer shall not make payment in respect of the PROs (in the case of payment of principal) for a period of 7 days or more after the due date for the same or (in the case of any Coupon Amount, Deferred Coupon Payment, Exceptionally Deferred Coupon Payment or Accrued Coupon Payment or any payment under Clause 2.6 of the Trust Deed in respect of a payment shortfall) shall not make payment for a period of 14 days or more after the date on which such payment is due, the Issuer shall be deemed to be in default under the Trust Deed, the PROs and the Coupons and the Trustee may, notwithstanding the provisions of paragraph (b) of this Condition 10, institute proceedings for the winding-up of the Issuer.
- (b) Subject as provided in Condition 9, the Trustee may at its discretion and without further notice institute such proceedings against the Issuer as it may think fit to enforce any term or condition binding on the Issuer under the Trust Deed, the PROs or the Coupons (other than for the payment of any principal or satisfaction of any Payments in respect of the PROs or the Coupons, including any payment under Clause 2.6 of the Trust Deed) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums, in cash or otherwise, sooner than the same would otherwise have been payable by it.
- (c) The Trustee shall not be bound to take any of the actions referred to in paragraph (a) or (b) above against the Issuer to enforce the terms of the Trust Deed, the PROs or the Coupons unless (i) it shall have been so requested by an Extraordinary Resolution or in writing by the holders of at least one-fifth in principal amount of the PROs then outstanding and (ii) it shall have been indemnified to its satisfaction.
- (d) No PRO Holder or Couponholder shall be entitled to proceed directly against the Issuer or to institute proceedings for the winding-up of the Issuer or to prove in such winding-up unless the Trustee, having become so bound to proceed or being able to prove in such winding-up, fails to do so within a reasonable period and such failure shall be continuing, in which case the PRO Holder or Couponholder shall have only such rights against the Issuer as those which the Trustee is entitled to exercise. No remedy against the Issuer shall be available to the Trustee or any PRO Holder or Couponholder (i) for the recovery of amounts owing in respect of the PROs or the Coupons (including any payment under Clause 2.6 of the Trust Deed), other than the institution of proceedings for the winding-up of the Issuer and/or proving in such winding-up and (ii) for the breach of any other term under the Trust Deed, the PROs or the Coupons, other than as provided in paragraph (b) above.

## **11 Taxation**

All payments by the Issuer of principal, Coupon Amounts, Deferred Coupon Payments, Exceptionally Deferred Coupon Payments, Accrued Coupon Payments and Winding-Up Claims in respect of the PROs will be made without withholding of or deduction for, or on any account of, any present or future taxes, duties, assessments or governmental charges of whatsoever nature imposed or levied by or on behalf of the United Kingdom or any political subdivision 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 the Issuer will pay such additional amounts as may be necessary in order that the net amounts receivable by PRO Holders or Couponholders after such withholding or deduction shall equal the respective amounts of principal and interest which would have been receivable in respect of the PROs or, as the case may be, Coupons in the absence of such withholding or deduction, except that no such additional amounts shall be payable in relation to any payment with respect to any PRO or Coupon presented for payment:

- (a) by or on behalf of a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such PRO or Coupon by reason of his having some connection with the United Kingdom other than the mere holding of such PRO or Coupon; or
- (b) unless it is proved to the satisfaction of the Paying Agent to whom the same is presented that the holder would not be able to avoid such withholding or deduction by satisfying any statutory requirements and/or by making a declaration of non-residence or other similar claim for exemption but, in either case, fails to do so; or
- (c) in the United Kingdom; or
- (d) more than 30 days after the Relevant Date except to the extent that the holder thereof would have been entitled to such additional amounts on presenting the same for payment on the last day of such period of 30 days; or
- (e) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (f) by or on behalf of a PRO Holder who would have been able to avoid such withholding or deduction by presenting the relevant PRO or Coupon to another Paying Agent in a Member State of the European Union.

References in these Conditions to principal, Coupon Amounts, Deferred Coupon Payments, Exceptionally Deferred Coupon Payments and/or Accrued Coupon Payments shall be deemed to include any additional amounts which may become payable pursuant to the foregoing provisions or any undertakings given in addition thereto or in substitution therefor pursuant to the Trust Deed.

In the event that any payment is settled through the issue of Ordinary Stock pursuant to Condition 6, then any additional amounts which are payable shall also be settled through the issue of Ordinary Stock.

## **12 Prescription**

PROs and Coupons (which for this purpose shall not include Talons) will become void unless presented for payment within a period of 10 years in the case of PROs and five years in the case of Coupons from the Relevant Date relating thereto. There shall be no prescription period for Talons but there shall not be included in any Coupon sheet issued in exchange for a Talon any Coupon the claim in respect of which would be void pursuant to this Condition or Condition 8(a)(ii) or any Talon which would be void pursuant to Condition 8(a)(ii).

## **13 Meetings of PRO Holders, Modification, Waiver and Substitution**

The Trust Deed contains provisions for convening meetings of PRO Holders to consider any matter affecting their interests including the modification by Extraordinary Resolution of these Conditions or other provisions of the Trust Deed.

The quorum at any such meeting for passing an Extraordinary Resolution will be one or more persons holding or representing a clear majority in principal amount of the PROs for the time being outstanding, or at any adjourned such meeting one or more persons being or representing PRO Holders whatever the

principal amount of the PROs so held or represented, except that at any meeting the business of which includes the modification of certain of these Conditions (including, *inter alia*, the provisions regarding subordination referred to in Conditions 2 and 3, the terms concerning currency and due dates for payment of principal or Coupon Payments in respect of the PROs and reducing or cancelling the principal amount of any PRO or the Coupon Rate) and certain other provisions of the Trust Deed the quorum will be one or more persons holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, in principal amount of the PROs for the time being outstanding.

An Extraordinary Resolution passed at any meeting of PRO Holders will be binding on all PRO Holders, whether or not they are present at the meeting, and on all Couponholders.

Notwithstanding any other provision of these Conditions, the Trustee may agree, without the consent of the PRO Holders or Couponholders, to any modification (subject to certain exceptions) of, or to any waiver or authorisation of any breach or proposed breach of, any of these Conditions or any other provisions of the Trust Deed which, in the opinion of the Trustee, is not materially prejudicial to the interests of the PRO Holders or to any modification which is of a formal, minor or technical nature or to correct a manifest error or to comply with the mandatory provisions of the law of the jurisdiction in which the Issuer is incorporated.

No modification to these Conditions or any other provisions of the Trust Deed shall become effective unless the prior consent thereto of the Financial Services Authority shall have been obtained.

Subject to the prior consent of the Financial Services Authority and as provided in the Trust Deed, the Trustee may agree with the Issuer, without the consent of the PRO Holders or Couponholders, to the substitution on a subordinated basis equivalent to that referred to in these Conditions of any holding company of the Issuer, any subsidiary of such holding company, any Subsidiary, any successor in business of the Issuer or any subsidiary of any successor in business of the Issuer (the “**Substituted Issuer**”) in place of the Issuer (or any previous Substituted Issuer under this Condition 13) as a new issuing party under the Trust Deed, the PROs and the Coupons. In connection with any proposed substitution as aforesaid and in connection with the exercise of its functions, the Trustee shall have regard to the interests of the PRO Holders as a class and the Trustee shall not have regard to the consequences of such substitution for individual PRO Holders or Couponholders resulting from in particular their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory.

In connection with any substitution or such exercise as aforesaid, no PRO Holder or Couponholder shall be entitled to claim, whether from the Issuer, the Substituted Issuer or the Trustee or any other person, any indemnification or payment in respect of any tax consequence of any such substitution or exercise upon any individual PRO Holders or Couponholders except to the extent already provided in Condition 11 and/or any undertaking given in addition thereto or in substitution therefor pursuant to the Trust Deed.

Any such modification, waiver, authorisation or substitution shall be binding on all PRO Holders and all Couponholders and, unless the Trustee agrees otherwise, any such modification or substitution shall be notified to the PRO Holders in accordance with Condition 16 as soon as practicable thereafter.

#### **14 Replacement of the PROs, Coupons and Talons**

Should any PRO, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Principal Paying Agent (or any other place of which notice shall have been given in accordance with Condition 16) upon payment by the claimant of the expenses incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced PROs, Coupons or Talons must be surrendered before any replacement PROs, Coupons or Talons will be issued.

#### **15 The Trustee**

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility including provisions relieving it from taking any action unless indemnified to its satisfaction. The Trustee is entitled to enter into business transactions with the Issuer or any Subsidiary without accounting for any profit resulting therefrom. The Trustee is entitled under the Trust Deed to rely on reports and certificates addressed and/or delivered to it by the Auditors whether or not the same

are subject to any limitation on the liability of the Auditors and whether by reference to a monetary cap or otherwise.

## 16 Notices

Notices to PRO Holders will be valid if published in a leading newspaper having general circulation in London (which is expected to be the *Financial Times*) and for so long as the PROs are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, in Luxembourg (which is expected to be the *Luxemburger Wort*). Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made. Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the PRO Holders in accordance with this Condition.

## 17 Further Issues

The Issuer shall be at liberty from time to time without the consent of the PRO Holders or the Couponholders to create and issue further PROs ranking *pari passu* in all respects (or in all respects save for the date from which interest thereon accrues and the amount of the first payment of interest on such further PROs) and so that the same shall be consolidated and form a single series with the outstanding PROs. Any such PROs shall be constituted by a deed supplemental to the Trust Deed.

## 18 Agents

The Issuer will procure that there shall at all times be a Calculation Agent and a Principal Paying Agent so long as any PRO is outstanding. If either the Calculation Agent or the Principal Paying Agent is unable or unwilling to act as such or if it fails to make a determination or calculation or otherwise fails to perform its duties under these Conditions or the Calculation Agency Agreement or the Agency Agreement, as appropriate, the Issuer shall appoint, on terms acceptable to the Trustee, an independent bank acceptable to the Trustee to act as such in its place. Neither the termination of the appointment of a Calculation Agent or the Principal Paying Agent nor the resignation of either will be effective without a successor having been appointed.

All calculations and determinations made by the Calculation Agent or the Principal Paying Agent in relation to the PROs shall (save in the case of manifest error) be final and binding on the Issuer, the Trustee, the Paying Agents, the PRO Holders and the Couponholders. None of the Issuer, the Trustee and the Paying Agents shall have any responsibility to any person for any errors or omissions in any calculation by the Calculation Agent.

## 19 Governing Law

- (a) The Trust Deed, the PROs, the Coupons and the Talons are governed by, and shall be construed in accordance with, the laws of England.
- (b) The Issuer has, in the Trust Deed, (i) agreed, for the benefit of the Trustee and the PRO Holders and the Couponholders, that the courts of England shall have jurisdiction to hear and determine any suit, action or proceedings, and to settle any disputes, which may arise out of or in connection with the Trust Deed or the PROs or Coupons (respectively, “**Proceedings**” and “**Disputes**”) and, for such purposes, irrevocably submitted to the jurisdiction of such courts, (ii) waived any objection which it might now or hereafter have to the courts of England being nominated as the forum to hear and determine any Proceedings and to settle any Disputes and (iii) agreed not to claim that any such court is not a convenient or appropriate forum. The Issuer has in the Trust Deed agreed that the process by which any Proceedings in England are begun may be served on it by being delivered to Bank of Scotland, 38 Threadneedle Street, London EC2P 2EH, Attention: Associate Director, Customer Services Sales. Nothing contained herein or in the Trust Deed shall affect the right to serve process in any other manner permitted by law. The submission to the jurisdiction of the courts of England shall not (and shall not be construed so as to) limit the right of the Trustee or the PRO Holders or the holders of Coupons, or any of them, to take Proceedings in any other court of competent jurisdiction nor shall the taking of Proceedings in any one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not) if and to the extent permitted by applicable law.



## 20 Contracts (Rights of Third Parties) Act 1999

No person shall have any right to enforce any term or condition of the PROs under the Contracts (Rights of Third Parties) Act 1999.

## 21 Definitions

In these Conditions:

**"Accrued Coupon Payment"** means, as at any time, where these Conditions provide that interest shall continue to accrue after a Coupon Payment Date in respect of a PRO, the amount of interest accrued thereon in accordance with Conditions 4(b), 5, 6(d) and 6(e);

**"Agency Agreement"** means the agency agreement dated 28 February 2001 between the Issuer, the Trustee and the Paying Agents, relating to the PROs under which each Paying Agent agrees to perform the duties required of it under these Conditions;

**"Assets"** means the unconsolidated gross assets of the Issuer, all as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingent assets and for subsequent events, all in such manner as the directors, the Auditors or the liquidator (as the case may be) may determine;

**"Auditors"** means KPMG Audit Plc as statutory auditors to the Issuer or such other auditor to the Issuer as may be appointed from time to time;

**"Authorised Denominations"** means £1,000, £10,000 and £100,000;

**"Benchmark Gilt"** means, in respect of a Reset Period, such United Kingdom government security having a maturity date on or about the last day of such Reset Period as the Principal Paying Agent, with the advice of the Reference Dealers, may determine to be appropriate;

**"Board"** means the board of directors of the Issuer from time to time;

**"business day"** means a day, other than a Saturday or Sunday, on which commercial banks and foreign exchange markets are open for general business in London;

**"Calculation Agency Agreement"** means the calculation agency agreement dated 28 February 2001 between the Issuer, the Trustee and the Calculation Agent, relating to the PROs under which the Calculation Agent agrees to perform the duties required of it under these Conditions;

**"Calculation Agent"** means Cazenove & Co., as calculation agent in relation to the PROs, or its successor or successors for the time being appointed under the Calculation Agency Agreement;

**"Capital Regulations"** means at any time the regulations, requirements, guidelines and policies relating to capital adequacy then in effect of the Financial Services Authority;

**"Conditions"** means these terms and conditions. Any reference to a particularly numbered Condition shall be construed accordingly;

**"Coupon"** means an interest coupon relating to a PRO and includes, where the context so permits, a Talon;

**"Coupon Amount"** means (i) in respect of a Coupon, the amount of interest payable on the presentation and surrender of such Coupon for the relevant Coupon Period or the First Coupon Period in accordance with Condition 5 and (ii) for the purposes of Conditions 7(c), 7(d) and 8(d) any interest accrued from and including the preceding Coupon Payment Date (or, if none, the Issue Date) to but excluding the due date for redemption if not a Coupon Payment Date;

**"Coupon Determination Date"** means, in relation to each Reset Date, the fifth business day prior to such Reset Date;

**"Coupon Payment"** means, in respect of a Coupon Payment Date, the aggregate Coupon Amounts for the Coupon Period ending on such Coupon Payment Date;

**"Coupon Payment Date"** means each 31 May and 30 November in each year, starting 30 November 2001;

**"Coupon Period"** means a period beginning on (and including) the first Coupon Payment Date and each successive period beginning on (and including) a Coupon Payment Date and ending on (but excluding) the next succeeding Coupon Payment Date;

**“Couponholder”** means the bearer of any Coupon;

**“Coupon Rate”** has the meaning given to it in Condition 5(b);

**“Coupon Satisfaction Date”** means the date on which the Issuer has resolved to satisfy a Deferred Coupon Payment, as notified by the Issuer to the Trustee, the PRO Holders, the Principal Paying Agent and the Calculation Agent in accordance with Condition 4(b);

**“dealing day”** means a day, other than a Saturday or Sunday, on which the London Stock Exchange (or such other stock exchange on which the Benchmark Gilt or the Reference Bond (as the case may be) is at the relevant time listed) is ordinarily open for the trading of securities;

**“Deferred Coupon Payment”** means any Payment, or part thereof, which, pursuant to Condition 4(b), the Issuer has elected to defer and which has not been satisfied;

the **“Exceptional Deferral Condition”** will be satisfied if, in the determination of the Issuer, on the relevant date, the Issuer is, or payment of the relevant Payment will result in the Issuer being, in non-compliance with the applicable Capital Regulations;

**“Exceptionally Deferred Coupon Payment”** means a Payment, or part thereof, which has been deferred in accordance with Condition 4(a) and not satisfied;

**“Exceptionally Deferred Coupon Payment Date”** means the date on which the Issuer has resolved to satisfy an Exceptionally Deferred Coupon Payment, as notified by the Issuer to the Trustee, the PRO Holders, the Principal Paying Agent and the Calculation Agent in accordance with Condition 4(a);

**“Existing Preference Stock”** means the 9¼% sterling non-cumulative irredeemable preference stock and the 9¾% sterling non-cumulative irredeemable preference stock of the Issuer and shall include any further preference stock required to be issued pursuant to the terms thereof;

**“Financial Services Authority”** means the Financial Services Authority of the United Kingdom and, if any successor governmental authority succeeds to the bank regulatory functions of the Financial Services Authority in the United Kingdom, such successor governmental authority; provided, however, that if the Issuer becomes domiciled in a jurisdiction other than the United Kingdom, then each reference herein to the Financial Services Authority shall be deemed to instead refer to the governmental authority having primary regulatory authority with respect to the Issuer’s capital adequacy in such other jurisdiction.

**“First Coupon Period”** means the period beginning on (and including) the Issue Date and ending on (but excluding) the first Coupon Payment Date;

**“First Reset Date”** means 31 May 2016;

**“Five Year Benchmark Gilt Rate”** means, in respect of a Reset Period, the gross redemption yield (as calculated by the Principal Paying Agent on the basis set out by the Joint Index and Classification Committee of the Institute and Faculty of Actuaries as reported in the Journal of the Institute of Actuaries Vol. 105, part 1, 1978, page 18 (as amended from time to time)) on a semi-annual compounding basis (converted to an annualised yield and rounded up (if necessary) to four decimal places) of the Benchmark Gilt, with the price of the Benchmark Gilt for this purpose being the arithmetic average of the bid and offered prices of such Benchmark Gilt quoted by the Reference Dealers at 3.00 p.m. (London time) on the relevant Coupon Determination Date on a dealing basis for settlement on the next following dealing day in London;

**“Group”** means The Governor and Company of the Bank of Scotland and its Subsidiaries or any New Owner and its subsidiaries;

**“holding company”** has the meaning ascribed to it under Section 736 of the Companies Act 1985;

**“interest”** shall, where appropriate, include Coupon Amounts, Deferred Coupon Payments, Exceptionally Deferred Coupon Payments and Accrued Coupon Payments;

**“Issue Date”** means 28 February 2001, being the date of initial issue of the PROs;

**“Issuer”** means The Governor and Company of the Bank of Scotland;

**“Jersey Preferred Securities”** means limited partnership interests held by limited partners (other than the Preferential Limited Partner, as defined in the partnership agreement) in Bank of Scotland Capital Funding L.P., a subsidiary undertaking of the Issuer established for unlimited duration as a limited partnership in Jersey and registered under the Limited Partnerships (Jersey) Law, 1994;

**“Junior Subordinated Debt”** means the Issuer’s outstanding Tier 2 Capital and any other obligations of the Issuer which are expressed to rank *pari passu* with the aforesaid obligations;

**“Liabilities”** means the unconsolidated gross liabilities of the Issuer, all as shown in the latest published audited balance sheet of the Issuer, but adjusted for contingent liabilities and for subsequent events, all in such manner as the directors, the Auditors or the liquidator (as the case may be) may determine;

**“London Stock Exchange”** means the London Stock Exchange plc;

**“Lower Tier 2 Capital”** has the meaning ascribed to it in the Financial Services Authority’s Guide to Banking Supervisory Policy or any successor publication replacing such guide;

**“Market Disruption Event”** means (i) the occurrence or existence of any suspension of or limitation imposed on trading (by reason of movements in price exceeding limits permitted by the London Stock Exchange or otherwise) or on settlement procedures for transactions in the Ordinary Stock on the London Stock Exchange if, in any such case, that suspension or limitation is, in the determination of the Calculation Agent, material in the context of the sale of the Ordinary Stock, or (ii) in the opinion of the Issuer, there has been a substantial deterioration in the price and/or value of the Ordinary Stock or circumstances are such as to prevent or to a material extent restrict the issue or delivery of the Payment Ordinary Stock, or (iii) where, pursuant to these Conditions, monies are required to be converted from one currency into another currency in respect of any Payment, the occurrence of any event that makes it impracticable to effect such conversion;

**“New Owner”** means any new ultimate holding company of the Group;

**“Notional Stock”** has the meaning ascribed to it in Condition 3;

**“Ordinary Stock”** means ordinary stock in the capital of the Issuer;

**“Outstanding”**, in relation to any Coupon Payment, Deferred Coupon Payment, Exceptionally Deferred Coupon Payment or Coupon Amount not falling within the definition of Coupon Payment, means that such payment (a) has either become due and payable or would have become due and payable except for the non-satisfaction on the relevant date of the conditions referred to in Condition 2(b)(i) or the deferral, postponement or suspension of such payment in accordance with any of Condition 4(a), 4(b), 6(d), 6(e) or 8(d); and (b) in any such case has not been satisfied, and in relation to any Accrued Coupon Payment means any amount thereof which has not been satisfied whether or not payment has become due;

**“Parity Securities”** means any stock (other than the Existing Preference Stock) or other securities which are Tier 1 Capital of the Issuer and which rank as regards a return of assets on a winding-up and in respect of distribution of dividends and/or income in all material respects *pari passu* with the PROs (on the assumption that the PROs still rank as Tier 1 Capital);

**“Paying Agents”** means the paying agents appointed pursuant to the Agency Agreement and such term shall, unless the context otherwise requires, include the Principal Paying Agent;

**“Payment”** means any Coupon Payment, Deferred Coupon Payment, Exceptionally Deferred Coupon Payment, Accrued Coupon Payment or Coupon Amount not falling within the definition of Coupon Payment;

**“Payment Business Day”** means a day (other than a Saturday or Sunday) on which commercial banks are open for general business in London and, in the case of a presentation or surrender of a PRO, in the place of the specified office of the relevant Paying Agent to whom the PRO or Coupon is presented or surrendered;

**“Payment Ordinary Stock”** has the meaning ascribed to it in Condition 6(b)(i);

**“Perpetual Preference Stock”** means the 8.117% non-cumulative perpetual preference stock, Class A and the 7.754% non-cumulative perpetual preference stock, Class B in the capital of the Issuer having in all material respects equivalent terms to those of the Jersey Preferred Securities and to be issued by the Issuer pursuant to the terms of the Jersey Preferred Securities;

**“principal amount”** means the par value of each relevant Authorised Denomination;

**“Principal Paying Agent”** means the principal paying agent appointed pursuant to the Agency Agreement;

**“PROs”** means the £150,000,000 7.286% Series A Perpetual Regulatory tier One securities, and such expression shall include, unless the context otherwise requires, any further securities issued pursuant to Condition 17 and forming a single series with the PROs and **“PRO”** means any one of them, and (save where the context otherwise requires) will include Coupons;

**“PRO Holder”** means the bearer of any PRO and (save where the context otherwise requires) a Couponholder;

**“Proprietors”** means the holders of the Ordinary Stock and a **“Proprietor”** means any holder of Ordinary Stock;

**“Reference Bond”** means, in relation to any calculation of the Special Redemption Price, the 8% Treasury Stock due 2015, or if such security is no longer in issue, such other United Kingdom government security as the Principal Paying Agent may, with the advice of the Reference Dealers, determine to be appropriate for determining the Special Redemption Price;

**“Reference Dealers”** means three brokers of gilts and/or gilt-edged market makers selected by the Principal Paying Agent in consultation with the Issuer and approved in writing by the Trustee, or such other three persons operating in the gilt-edged market as are selected by the Principal Paying Agent in consultation with the Issuer and approved in writing by the Trustee;

**“Relevant Date”** means (i) in respect of any payment other than a Winding-Up Claim, the date on which such payment first becomes due and payable but, if the full amount of the moneys payable on such date has not been received by the Principal Paying Agent or the Trustee on or prior to such date, the **“Relevant Date”** means the date on which such moneys shall have been so received and notice to that effect shall have been given to the PRO Holders in accordance with Condition 16, and (ii) in respect of a Winding-Up Claim, the date which is one day prior to the commencement of the winding-up;

**“Relevant Deferred Coupon Payment Date”** means, with respect to a deferral under Condition 4(a)(i), the Coupon Payment Date next following the 19th business day after such Exceptional Deferral Condition fails to be satisfied;

**“Reset Date”** means the First Reset Date and thereafter, every Coupon Payment Date falling on each fifth anniversary of the First Reset Date;

**“Reset Period”** means the period from (and including) a Reset Date to (but excluding) the next succeeding Reset Date;

**“Senior Creditors”** means creditors of the Issuer (a) who are unsubordinated depositors or other unsubordinated creditors of the Issuer, or (b) whose claims are, or are expressed to be, subordinated (whether only in the event of the winding-up of the Issuer or otherwise) to the claims of unsubordinated depositors and other unsubordinated creditors of the Issuer but not further or otherwise, or (c) whose claims are in respect of Junior Subordinated Debt or (d) who are subordinated creditors of the Issuer, other than those creditors whose claims rank, or are expressed to rank, *pari passu* with, or junior to, the claims of the PRO Holders;

the **“Solvency Condition”** shall be satisfied in relation to the Issuer if its Assets exceed its Liabilities to Senior Creditors;

**“Special Redemption Price”** means, in respect of each PRO, (a) the Authorised Denomination of such PRO or, if higher, (b) the price, expressed as a percentage of the Authorised Denomination of such PRO (rounded to four decimal places, 0.00005 being rounded upwards), at which the gross redemption yield (as calculated by the Principal Paying Agent on the basis set out by the Joint Index and Classification Committee of the Institute and Faculty of Actuaries as reported in the Journal of the Institute of Actuaries Vol. 105, part 1, 1978, page 18 (as amended from time to time)) of such PRO, if it was 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 (calculated by the Principal Paying Agent on the same basis as the gross redemption yield of the PRO is calculated) on such dealing day of the Reference Bond plus 0.50%, on the basis of the middle market price of the Reference Bond prevailing at 11.00 a.m. (London time) on such dealing day as determined by the Principal Paying Agent;

**“Subsidiary”** means each subsidiary for the time being of the Issuer;

**“subsidiary”** has the meaning ascribed to it under Section 736 of the Companies Act 1985;

**“Substituted Issuer”** has the meaning ascribed to it in Condition 13;

**“Suspension”** has the meaning ascribed to it in Condition 8(d);

**“Talon”** means a talon for further Coupons;

**“Tier 1 Capital”** has the meaning ascribed to it in the Financial Services Authority’s Guide to Banking Supervisory Policy or any successor publication replacing such guide;

**“Tier 2 Capital”** means Upper Tier 2 Capital and Lower Tier 2 Capital;

**“Trust Deed”** means the trust deed dated 28 February 2001 between the Issuer and the Trustee;

**“Trustee”** means The Bank of New York as trustee for the PRO Holders and includes its successor(s);

**“Upper Tier 2 Capital”** has the meaning ascribed to it in the Financial Services Authority’s Guide to Banking Supervisory Policy or any successor publication replacing such guide;

**“Upper Tier 2 Securities”** means securities of the Issuer that have substantially similar terms as the PROs save that (1) they shall contain terms no less favourable to an investor than the then current minimum requirements of the Financial Services Authority in relation to Upper Tier 2 Capital and (2) the coupon rate of such securities shall be determined in such manner as shall result in it being 0.40% per annum below the Coupon Rate from time to time (and whether before or after the First Reset Date) applying to the PROs;

**“winding-up”** means a winding-up or sequestration; and

**“Winding-Up Claim”** has the meaning ascribed to it in Condition 2(b)(ii).

### **Terms and Conditions of the Series B PROs**

The Series B PROs have identical Conditions to those for the Series A PROs on pages 10 to 29 of this Offering Memorandum, except that in:

- (i) Condition 5(b)(i) the rate “7.286%” is deleted and replaced by “7.281%”;
- (ii) Condition 5(b)(ii) the rate “3.645%” is deleted and replaced by “4.095%”;
- (iii) Condition 5(c) the amount “£55.05” is deleted and replaced by “£55.01”;
- (iv) Condition 21 in the definition of “First Reset Date”, the date “31 May 2016” is deleted and replaced by “31 May 2026”;
- (v) Condition 21 in the definition of “PROs”, the words “Series A” are deleted and replaced by “Series B” and the rate “7.286%” is deleted and replaced by “7.281%”;
- (vi) Condition 21 in the definition of “Reference Bond”, “8% Treasury Stock due 2015” is deleted and replaced by “6% Treasury Stock due 2028”;
- (vii) Condition 21 in the definition of “Special Redemption Price”, the percentage “0.50%” is deleted and replaced by “0.75%”.

## **USE OF PROCEEDS**

The net proceeds of the issue of the PROs are estimated to amount to £297,000,000 and will be used by the Issuer to augment its Tier 1 Capital base.

## SUMMARY OF PROVISIONS RELATING TO THE PROs WHILE IN GLOBAL FORM

### Exchange

The Series A PROs and the Series B PROs will each be represented initially by a Temporary Global PRO in bearer form without Coupons or Talons which will be deposited outside the United States with a common depositary for Clearstream, Luxembourg and Euroclear on or about 28 February 2001. Each Temporary Global PRO will be exchangeable in whole or in part (free of charge to the holder) for interests in a Permanent Global PRO in bearer form without Coupons or Talons on or after a date which is expected to be 10 April 2001 (the “**Exchange Date**”) upon certification as to non-US beneficial ownership as required by US Treasury regulations and as described in the Temporary Global PROs. Upon deposit of the relevant Temporary Global PRO or the relevant Permanent Global PRO (each a “**Global PRO**”) with a common depositary for Clearstream, Luxembourg and Euroclear, Clearstream, Luxembourg and Euroclear will credit each subscriber with a principal amount of PROs equal to the principal amount thereof for which it has subscribed and paid.

Each of the persons shown in the records of Clearstream, Luxembourg or Euroclear as the holder of a PRO represented by a Global PRO must look solely to Clearstream, Luxembourg or Euroclear (as the case may be) for his share of each payment made by the Issuer to the bearer of such Global PRO, subject to and in accordance with the respective rules and procedures of Clearstream, Luxembourg or Euroclear (as the case may be).

The Global PROs will contain provisions applicable to the PROs represented thereby, some of which modify the effect of the Terms and Conditions of the PROs. Certain of these are summarised in this section.

For so long as any of the PROs is represented by a Global PRO, the bearer of the Global PRO may, except as ordered by a court of competent jurisdiction or as required by law, be treated by the Issuer, the Trustee and the Paying Agents as the owner thereof and of all rights thereunder free from all encumbrances (in accordance with and subject to its terms and the Trust Deed) and the expression “**PRO Holder**” and related expressions shall be construed accordingly. Interests in PROs which are represented by a Global PRO will only be transferable in accordance with the rules and procedures for the time being of Clearstream, Luxembourg and/or Euroclear, as the case may be.

If any date on which a payment is due on the PROs occurs prior to the Exchange Date, the relevant payment will be made on the relevant Temporary Global PRO only to the extent that certification as to non-US beneficial ownership as required by US Treasury regulations (in substantially the form referred to in the Temporary Global PROs or in such other form as is customarily issued in such circumstances by the relevant clearing system or depositary) has been received by Clearstream, Luxembourg or Euroclear. Payment of amounts due in respect of a Permanent Global PRO will be made through Clearstream, Luxembourg or Euroclear without any requirement for certification.

The holder of a Temporary Global PRO shall not (unless, upon due presentation of such Temporary Global PRO for exchange (in whole or in part) for interests in a Permanent Global PRO, such exchange is improperly withheld or refused and such withholding or refusal is continuing at the relevant payment date) be entitled to receive any payment in respect of the PROs represented by such Temporary Global PRO which falls due on or after the Exchange Date.

Interests in a Permanent Global PRO will be exchangeable in whole but not in part (free of charge to the holder) for definitive bearer PROs (a) if such Permanent Global PRO is held on behalf of Clearstream, Luxembourg, Euroclear or the Alternative Clearing System (as defined below) and any such clearing system is closed for business for a continuous period of 14 days (other than by reason of public holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so by such holder giving notice to the Principal Paying Agent or (b) if the Issuer would suffer a material disadvantage in respect of the PROs as a result of a change in the laws or regulations (taxation or otherwise) of any jurisdiction referred to in Condition 7 which would not be suffered were the PROs in definitive form and a certificate to such effect signed by one Director of the Issuer is delivered to the Trustee, by the Issuer giving notice to the Principal Paying Agent and the relevant PRO Holders of its intention to exchange the Permanent Global PRO for definitive PROs on or after the Permanent Global Exchange Date (as defined below) specified in the notice.



On or after the Permanent Global Exchange Date, the holder of a Permanent Global PRO shall surrender such Permanent Global PRO to or to the order of the Principal Paying Agent. In exchange for a Permanent Global PRO, the Issuer shall deliver, or procure the delivery of, an equal aggregate principal amount of duly executed and authenticated definitive Series A PROs or Series B PROs, as the case may be, having attached to them all Coupons in respect of interest which has not already been paid on the relevant Permanent Global PRO and a Talon.

**“Alternative Clearing System”** means any such other clearing system as shall have been approved by the Trustee.

**“Permanent Global Exchange Date”** means a day falling not less than 60 days after that on which the notice requiring exchange is given and on which banks are open for business in the city in which the specified office of the Principal Paying Agent is located and except in the case of exchange pursuant to (a) above in the cities in which Euroclear and Clearstream, Luxembourg or, if relevant, the Alternative Clearing System are located.

### **Payments**

Principal and interest in respect of a Permanent Global PRO shall be paid to its holder against presentation and (if no further payment falls to be made on it) surrender of it to or to the order of any Paying Agent which shall endorse such payment or cause payment to be endorsed in the appropriate schedule to the Permanent Global PRO. No person shall however be entitled to receive any payment on a Permanent Global PRO falling due after the Permanent Global Exchange Date, unless exchange of such Permanent Global PRO for definitive PROs is improperly withheld or refused by or on behalf of the Issuer. So long as a Permanent Global PRO is held on behalf of Euroclear or Clearstream, Luxembourg or an Alternative Clearing System, payments on the Series A PROs or Series B PROs, as the case may be, will be made in accordance with the payment procedures applicable in such clearing systems.

### **Notices**

So long as a Permanent Global PRO is held on behalf of Euroclear or Clearstream, Luxembourg or an Alternative Clearing System, notices required to be given to Series A PRO Holders or Series B PRO Holders, as the case may be, may be given by their being delivered to Euroclear and/or Clearstream, Luxembourg or, as the case may be, the Alternative Clearing System, rather than by publication as required by the Conditions of the relevant PROs except that so long as the relevant PROs are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, notices shall also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*). Any notice delivered to Euroclear, Clearstream, Luxembourg and/or, as the case may be, the Alternative Clearing System shall be deemed to have been given to the Series A PRO Holders or Series B PRO Holders, as the case may be, on the day on which such notice is so delivered.

### **Meetings**

The holder of a Permanent Global PRO shall be treated at any meeting of Series A PRO Holders or Series B PRO Holders, as the case may be, as having one vote in respect of each £1,000 principal amount of the relevant PROs for which such Permanent Global PRO may be exchanged.

### **Purchase and cancellation**

Cancellation of any PRO represented by a Permanent Global PRO which is required by the Conditions of the relevant PROs to be cancelled will be effected by reduction in the principal amount of such Permanent Global PRO.

### **Trustee's powers**

In considering the interests of PRO Holders in circumstances where a Permanent Global PRO is held on behalf of any one or more of Euroclear, Clearstream, Luxembourg and an Alternative Clearing System, the Trustee may have regard to such information as may have been made available to it by or on behalf of the relevant clearing system or its operator as to the identity of its accountholders (either individually or by way of category) with entitlements in respect of such Permanent Global PRO and may consider such interests on the basis that such accountholders were the holders of such Permanent Global PRO.

## **THE ISSUER**

The Issuer, which is an unregistered company established in Scotland on 17 July 1695 by an Act of the Parliament of Scotland, is an “authorised institution” under the Banking Act 1987. It is governed by the Bank of Scotland Acts 1695 to 1970 and is a U.K. clearing bank with its headquarters in Edinburgh. As at 31 August 2000, the Issuer operated from locations throughout the world including 354 branch outlets in Scotland, London and other regional commercial centres in England, as well as from overseas branches in New York City, Hong Kong, Paris, Amsterdam, Singapore and Frankfurt and representative offices in Chicago, Illinois; Houston, Texas; Los Angeles, California; Boston, Massachusetts; Seattle, Washington; and Minneapolis, Minnesota. It is a member of the British Bankers’ Association and the Committee of Scottish Clearing Bankers. The Bank Notes (Scotland) Act 1845 confirmed the Issuer’s right to issue bank notes in Scotland. At 31 August 2000 circulation of such notes was approximately £584 million. At 31 August 2000, the Issuer had approximately 409 (directly and indirectly held) subsidiaries. The Issuer and its subsidiaries are collectively referred to as the “Group”.

As at 31 August 2000, the Group employed approximately 19,758 people.

The Issuer’s Ordinary Stock and the Existing Preference Stock are traded on the London Stock Exchange. The Head Office of the Issuer is located at The Mound, Edinburgh EH1 1YZ, Scotland (telephone (0131) 442-7777).

## **BUSINESS OF THE ISSUER AND ITS SUBSIDIARIES**

### **Introduction**

The Issuer and its subsidiaries are a diversified financial services group engaged in a range of banking, insurance broking, financial services and finance-related activities throughout the U.K. and internationally.

### **Bank of Scotland**

The Issuer is a U.K. clearing bank which provides a range of banking services to its corporate and personal customers in the U.K. and abroad, including commercial loans, property finance, letters of credit, overdraft facilities and foreign exchange.

The Issuer, including Bank of Scotland Treasury Services PLC ("Treasury Services"), accounted for approximately 69% of the total assets of the Group as at 31 August 2000.

The Issuer provides payment services through its U.K. clearing operations. It is a member of the Association of Payment and Clearing Services ("APACS") which oversees and regulates such operations.

The Issuer's clearing services include cheque and credit clearing, and the Issuer is a participant in Bankers Automated Clearing Services Limited ("BACS") and the Clearing House Automated Payment System ("CHAPS"). In the international payments area, the Issuer is a shareholder of and participant in the Society for Worldwide Interbank Financial Telecommunications ("SWIFT").

The Issuer's organisational structure comprises three customer facing divisions, Personal, Business and Corporate, supported by two internal centres of expertise, Services Division and Group Office.

The operations of the Issuer's direct and indirect U.K. subsidiaries, including Capital Bank plc ("Capital Bank"), The British Linen Bank Limited ("British Linen Bank") and Bank of Wales PLC ("Bank of Wales") and their respective subsidiaries, have been realigned to report through this structure along business lines, and not by corporate entity. For management purposes, the Group reports its results along business lines, and not by principal subsidiaries, effective from 1 March 2000. The management and reporting of Bank of Western Australia Limited ("BankWest") remains unchanged.

The strategic aims of this organisational structure are to:

- facilitate growth in the personal, business and corporate markets by allowing a more focused approach to business development and the provision of products and services tailored to customers' needs;
- enhance and expand customer relationships by widening the range and quality of products and services in the Group's portfolio;
- optimise customer flexibility in the choice of product and delivery channel combinations whilst maintaining a fully integrated banking service;
- promote the Group's growth in new markets by marshalling product development and marketing resources more effectively;
- encourage the use of rewarding and innovative practices consistently across all the Group's business activities; and
- further improve efficiency by removing duplication and achieving economies of scale.

### ***Personal Banking***

Personal Banking offers a range of personal banking products delivered through a variety of channels, including branches, intermediaries, affinity groups and partnerships, as well as by telephone and over the internet. The aim of Personal Banking is to provide customers with innovative products, advice and support, delivered to them through the channel of their choice. Personal Banking's key objective is to increase its market share in the personal banking sector in the U.K. and to be a leading provider of retail financial services products. Among the services provided by Personal Banking are:

- residential mortgage products provided through branches and intermediaries;
- credit cards and charge cards to branch-based customers, to other customers and to members of affinity groups;

- telephone banking services, including cheque accounts, savings accounts and unsecured personal loans; and
- other services, including offshore services, marketing at customers' workplaces, wire transfers, general insurance, trustee services and tax services.

Personal Banking offers services through the Issuer's branches, and also operates over 1,000 automated teller machines throughout the U.K. It administers the banking business of Sainsbury's Bank plc, in which the Issuer has a 45% ownership interest. Personal Banking has agreed access to the proprietary customer databases of its affinity group relationships and partnerships.

### ***Business Banking***

Business Banking offers a range of products and services principally to small and medium-sized businesses (businesses with an annual turnover of up to £10 million). Its goal is to become the first choice in banking for such businesses. Business Banking is pursuing this goal through a strategy of developing alternative and low-cost delivery channels for its products, integrating its operations across the different Group companies to develop seamless, streamlined operations and a common sales culture and minimising costs through efficient processing. Among the services provided by Business Banking are:

- a range of core banking services available through business centres and branches in Scotland, England and Wales (through Bank of Wales branches);
- a range of banking products tailored for the needs of businesses in the health care, property and hotel sectors;
- savings, cheque account and electronic banking facilities for small and medium-sized businesses;
- facilities and products designed to enable retailers to accept customer payment by credit and debit cards;
- business credit cards;
- invoice discounting and factoring services;
- a range of extended purchase and lease credit facilities that are offered to customers throughout the U.K., concentrating on construction, transport and distribution, bus and coach, engineering, marine, agriculture, vehicle management and contract hire businesses and corporate asset finance; and
- finance products to the U.K. motor sector through franchised and non-franchised dealers and through joint ventures with distributors, manufacturers and large dealer groups.

### ***Corporate Banking***

With effect from 1 May 2000 the activities of the formerly distinct Structured Banking function were merged with Corporate Banking to form an enlarged Corporate Banking Division. The Division is charged with developing and maintaining the corporate business of the Group and provides a variety of banking services to corporate and institutional customers whose annual turnover is over £10 million. These services include loans and deposits in a range of currencies, project and specialist finance, acquisition finance and syndicated lending.

Corporate Banking is organised both geographically and functionally. Within the U.K., Corporate Scotland and Corporate England service their respective customer bases whilst internationally, operations are split between North America, Europe and Australia. As well as its network of offices in Scotland and England, Corporate Banking also has loan origination offices in New York City, Chicago, Houston, Los Angeles, Boston, Seattle, Minneapolis, Paris, Frankfurt, Amsterdam, Hong Kong, Singapore and Sydney.

Functionally, there are a number of specialist lending teams responsible for the development and provision of structured and project finance services to medium-sized and large corporations throughout the U.K., Europe and internationally. The key objective of these teams is to expand and strengthen the Group's corporate market share by creating new products and delivering specialist services to existing and new customers.

## **Other U.K. Group Functions**

The Services Division encompasses primarily the processing and information technology functions of the Group in the U.K., including the three processing centres currently in operation.

The Group Office provides the accounting and finance, treasury, risk management, compliance monitoring, human resources and company secretarial functions of the Group.

## **Principal Group Subsidiaries**

### ***Bank of Scotland Treasury Services plc***

Treasury Services was established in 1992 to take over and develop the role previously carried out by the Bank's treasury division. It is a direct, wholly-owned subsidiary of the Bank and is an "authorised institution" under the Banking Act of 1987. Treasury Services provides centralised multi-currency funding, liquidity management and treasury services to the Bank. It operates in the world's foreign exchange and money markets and also provides global treasury services to certain of the Group's customers from offices in London and Glasgow. Treasury Services co-ordinates the debt issuance activities of the Group, both in the United Kingdom and abroad and also trades in foreign exchange and in a limited range of derivative instruments for risk management purposes. Treasury Services also provides hedging to certain customers of the Group. Treasury Services operates as part of the Group Office.

The Issuer has unconditionally and irrevocably guaranteed due payment of lawfully incurred present and future indebtedness and other obligations of Treasury Services. At the request of the Financial Services Authority, Treasury Services has unconditionally guaranteed due payment of all the Issuer's present and future indebtedness and other obligations. Payments under the guarantees by Treasury Services in respect of the Issuer's subordinated obligations are subordinated until the lawful claims of all Treasury Services' ordinary and unsubordinated creditors have been satisfied in full.

### ***Capital Bank plc***

Following the reorganisation of the Group's businesses, Capital Bank is a subsidiary which is no longer a core management or reporting entity. The activities of Capital Bank, which cover the Personal, Motor Vehicle, Business and Large Corporate sectors within the U.K. have now been integrated into the Personal, Business and Corporate divisions, respectively, under the Group's operational structure.

### ***Bank of Western Australia Limited***

BankWest, which is based in Perth, Western Australia, is listed on the Australian Stock Exchange. As at 17 January 2001 the Issuer held 55.85% of its issued shares. BankWest provides a range of retail and commercial products through its branches, of which there were 86 as at 29 February 2000, and through electronic and telephone banking channels. In its home state of Western Australia, BankWest is a market leader, with 24.4% of all bank loans and advances in February 2000. In other Australian states, BankWest markets a selected range of products primarily through third parties. It has offices in Sydney, Melbourne, Brisbane and Adelaide. BankWest's goals include strengthening its market leadership in Western Australia and expanding its operations in other Australian states.

On 24 February 2000, the board of directors of BankWest announced that it had appointed an adviser with a view to exploring options regarding the future ownership of BankWest. The review, which was designed to take into account the interests of all BankWest shareholders, did not result in any proposals that BankWest's board of directors believed should be recommended to shareholders.

### ***Bank of Wales PLC***

Bank of Wales, a wholly-owned subsidiary of the Issuer, is a regional bank headquartered in Cardiff. As at 29 February 2000, it had seven branch offices. Its primary activity is business lending. It also provides personal loans, deposit accounts, international services and venture capital funding.

## **Employees**

As at 31 August 2000, the Group employed approximately 19,758 people on a full-time equivalent basis. Certain of the Group's employees in the U.K. are members of the union UNIFI (formerly the Banking, Insurance & Finance Union), which is recognised by the Group as representing the interests of such employees. The Group considers its relations with its employees to be satisfactory.

## **Properties**

The Group operates throughout the world, principally in the U.K. The majority of the Group's properties are owned by the Issuer.

## **Recent Developments**

### ***Abbey National plc***

Discussions are continuing between the Issuer and Abbey National plc ("Abbey National") concerning a possible combination of the two groups. The outcome of these discussions is not yet certain.

Abbey National filed a formal submission with the Office of Fair Trading regarding a possible combination with the Issuer on 18 December 2000. On 5 February 2001 the Secretary of State for Trade and Industry confirmed that he would not refer a merger between the Issuer and Abbey National to the Competition Commission.

During December 2000 Lloyds TSB Group Plc ("Lloyds TSB") put forward two indicative proposals in connection with an acquisition of Abbey National by Lloyds TSB, both rejected by the board of Abbey National.

On 31 January 2001 Lloyds TSB confirmed its intention to make an offer to acquire Abbey National for a consideration of 1.5 new Lloyds TSB shares plus 260 pence in cash per Abbey National share. The making of the offer by Lloyds TSB is preconditional upon two matters; confirmation that the proposed transaction will not be referred to the Competition Commission, and the board of Abbey National agreeing to recommend the Lloyds TSB offer. The board of Abbey National issued a statement on 7 February 2001 that the Lloyds TSB proposed offer terms remain inadequate and subject to material uncertainties.

Lloyds TSB filed a formal submission with the Office of Fair Trading regarding a possible combination with Abbey National on 5 January 2001. The Secretary of State for Trade and Industry announced on 23 February 2001 his decision to refer the proposed acquisition of Abbey National by Lloyds TSB to the Competition Commission. The Competition Commission is to make its report by 12 June 2001.

### ***ICC Bank PLC***

On 14 February 2001 the Issuer's recommended offer for ICC Bank PLC became wholly unconditional. ICC Bank PLC is a specialist business bank operating in Ireland. The Issuer placed 27,971,015 units of Ordinary Stock to raise approximately £193 million to finance the cash element of the acquisition and associated costs.

## MANAGEMENT

### Board of Directors of the Issuer

<u>Name</u>	<u>Position in the Issuer</u>	<u>Principal Occupations</u>
Sir John Shaw .....	Governor	Company Director
Sir Bob Reid .....	Deputy Governor	Company Director
Peter A. Burt .....	Group Chief Executive	Group Chief Executive of Bank of Scotland
Gavin G. Masterton .....	Treasurer and Managing Director	Treasurer and Managing Director of Bank of Scotland
W. Gordon McQueen .....	Executive Director	Divisional Chief Executive Treasury & Finance
Colin Matthew .....	Executive Director	Divisional Chief Executive Business Banking
George E. Mitchell .....	Executive Director	Divisional Chief Executive Corporate Banking
Sir Ronald Garrick .....	Non-executive Director	Company Director
Allan G. Gormly .....	Non-executive Director	Company Director
Sir Russell Hillhouse .....	Non-executive Director	Company Director
Ian B. Inglis .....	Non-executive Director	Company Director
Brian G. Ivory .....	Non-executive Director	Company Director
Lesley M. S. Knox .....	Non-executive Director	Company Director
John N. Maclean .....	Non-executive Director	Company Director
Lord Simpson .....	Non-executive Director	Company Director

The business address for the Board is The Mound, Edinburgh EH1 1YZ.

## CAPITALISATION

The following table and notes thereto show the unaudited capitalisation and indebtedness of the Group as at the date set forth below and have been extracted without material adjustment from the Group's Interim Report and Accounts 2000

	As at 31 August 2000 (£ in millions)
<b>Authorised capital</b>	
Preference stocks (of £1 each) .....	504
Ordinary stock (units of 25p each) .....	381
	<u>£ 885</u>
<b>Issued capital</b>	
Preference stocks (of £1 each, fully paid) .....	£ 400
Ordinary stock (units of 25p each, fully paid) .....	316
Reserves .....	2,952
Proprietors' funds .....	3,668
Minority interests (equity) .....	169
(non-equity) .....	400
	<u>569</u>
<b>Subordinated loan capital</b>	
Undated <sup>(1)</sup> .....	1,145
Dated <sup>(2)</sup> .....	1,481
<b>Other Borrowings</b>	
Deposits by banks .....	7,770
Customer accounts .....	33,419
Debt securities in issue .....	26,683
Total indebtedness .....	<u>£67,872</u>
<b>Total capitalisation and indebtedness</b> .....	<u>£72,109</u>

### (1) Subordinated Undated Loan Capital

	As at 31 August 2000 (£ in millions)
U.S.\$250 million Floating Rate Primary Capital Notes .....	£ 172
£200 million Perpetual Notes .....	200
£100 million Perpetual Instruments .....	99
JPY 17 billion Perpetual Instruments .....	110
JPY 9 billion Perpetual Instruments .....	58
£150 million Perpetual Instruments .....	149
U.S.\$300 million Reset Subordinated Notes .....	207
£150 million Perpetual Instruments .....	150
	<u>£ 1,145</u>

The subordinated undated loan capital has no final date of maturity. All or some of the Capital Notes may be redeemed at the option of the Issuer at par on any interest payment date. The Perpetual Notes may, at the option of the Issuer 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 the Issuer on the fifth anniversary of their respective date(s) of issue. "New Notes" as used herein shall mean further notes the terms of which shall be identical to those of the existing Notes save that the rate of interest payable on the New Notes shall be greater than the rate of interest payable on the existing Notes.

The Instruments detailed under the heading "Subordinated Undated Loan Capital" above may, at the option of the Issuer or 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 the Issuer on the fifth anniversary of their respective date(s) of issue. The JPY 17 billion Instruments have been converted into an obligation of U.S.\$160 million, bearing interest at U.S.S LIBOR plus 1.01% by means of swap arrangements.

The Reset Subordinated Notes may be redeemed at the option of the Issuer at par on 20 November 2007 or on any interest payment date thereafter.



(2) **Subordinated Dated Loan Capital**

	<b>As at 31 August 2000</b>
	<b>(£ in millions)</b>
DFL 7 million 9.72% Registered Loans 2000/2001 .....	2
U.S.\$300 million 8.80% Notes 2004* .....	206
£60 million 9.00% Instruments 2006 .....	60
U.S.\$150 million 8.85% Notes 2006* .....	103
£75 million Floating Rate Instruments 2010 .....	75
U.S.\$150 million Notes 2011* .....	102
A\$100 million Callable Notes 2007 .....	40
Euro 500 million 5.50% Instruments 2009 .....	307
£250 million 6.375% Instruments 2019** .....	244
U.S.\$500 million 7.70% Notes 2010* .....	342
	<u>£1,481</u>

\* These are liabilities of SIF No. 2, a wholly-owned subsidiary undertaking of the Issuer, and are guaranteed unconditionally by the Issuer on a subordinated basis.

\*\* During the period to 31 August 2000, an additional £75 million was consolidated within the £175 million 6.375% Instruments 2019.

As indicated in the table above, as at 31 August 2000, the Group had other borrowings of £67,872 million (including deposits by banks of £7,770 million, customer accounts of £33,419 million and debt securities in issue of £26,683 million). Save for £342 million of the Group's debt securities in issue which is unguaranteed but secured on advances to customers and certain other assets of the Group, none of the other borrowings listed in this paragraph are secured or guaranteed. As at 31 August 2000, the Group had contingent liabilities (including guarantees) of £1,821 million. No account has been taken of intra-Group guarantees.

All loan capital issued by the Group, as detailed in the table above, has been issued on an unsecured basis. Where any specific issuance of loan capital by the Group has been guaranteed, this is indicated by an \* in the table above. Issues of loan capital which are not marked with an \* are unguaranteed. No account has been taken of intra-Group guarantees.

Save as disclosed above, since 31 August 2000 there have been no material changes in the Group's capitalisation, indebtedness, contingent liabilities or guarantees.

## UNITED KINGDOM TAXATION

*The following is a summary of the current United Kingdom taxation treatment of the PROs. It is not exhaustive. It relates only to the position of persons who are the absolute beneficial owners of the PROs and Coupons and may not apply to certain classes of PRO Holders, such as dealers in securities. PRO Holders who are in any doubt as to their tax position or who may be subject to tax in a jurisdiction other than the United Kingdom should consult their professional advisers.*

### Withholding tax

- 1 All payments of interest on the PROs made on or after 1 April 2001 can be paid gross provided that, at the time of the payment, the PROs are listed on a recognised stock exchange, as defined in section 841 of the Income and Corporation Taxes Act 1988 ("ICTA") (the Luxembourg Stock Exchange is so recognised). New machinery will also become effective 1 April 2001 enabling the United Kingdom Inland Revenue to obtain information about United Kingdom savings income of all individuals and, in certain circumstances, to exchange tax information with the tax authorities of other jurisdictions.
- 2 The interest on the PROs will have a United Kingdom source and, accordingly subject as set out below, may be chargeable to United Kingdom income tax by direct assessment even if paid without withholding or deduction. The profit realised on any disposal (which includes redemption) of any PRO issued at an issue price of less than the amount payable on redemption is similarly chargeable but does not attract United Kingdom withholding. However, neither such profit nor interest received without deduction or withholding is chargeable to United Kingdom tax in the hands of a PRO Holder who is not resident for tax purposes in the United Kingdom unless the PRO Holder carries on a trade, profession or vocation in the United Kingdom through a branch or agency in the United Kingdom in connection with which the interest or profit is received or to which the PROs are attributable. There are certain exceptions for income received by specified categories of agent (such as some brokers and investment managers).
- 3 Where interest on the PROs has been paid under deduction of United Kingdom income tax, PRO Holders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in an applicable double taxation treaty.
- 4 The provisions relating to additional payments referred to in Condition 11 of the "Terms and Conditions of the PROs" would not apply if the Inland Revenue sought to assess the person entitled to the relevant interest or (where applicable) profit on any PRO directly to United Kingdom income tax. However, exemption from or reduction of such United Kingdom tax liability might be available under an applicable double taxation treaty.

### Holders within the charge to United Kingdom corporation tax

- 5 The PROs may be "qualifying assets" for the purposes of the United Kingdom's provisions relating to the taxation of foreign exchange gains and losses (the "**FOREX provisions**"). A corporate PRO Holder which is within the charge to United Kingdom corporation tax and is subject to the FOREX provisions may, depending on the movement of sterling, the currency in which the PROs are denominated, against the local currency of the PRO Holder, realise an income gain or loss taxable on an accrual basis for United Kingdom tax purposes for each accounting period during which the PROs are held, notwithstanding that there has been no disposal of the PROs.
- 6 For corporate PRO Holders within the charge to United Kingdom corporation tax PROs will normally constitute "qualifying corporate bonds" within section 117 of the Taxation of Chargeable Gains Act 1992. Such corporate PRO Holders will normally recognise any gain or loss for corporation tax purposes under the "local relationship" rules in the Finance Act 1996. Under these rules, all interest, profits, gains and losses, measured and recognised in accordance with an authorised accruals or mark to market basis of accounting method, are taxed or relieved as income.

### Holders not within the charge to United Kingdom corporation tax

- 7 On a disposal or redemption of the PROs, a PRO Holder who is not within the charge to United Kingdom corporation tax and who is a UK taxpayer may realise a chargeable gain or an allowable loss for United Kingdom capital gains tax purposes.

- 8 PRO Holders who are within the charge to United Kingdom income tax on the interest payable on the PROs will generally be liable to tax on this interest when it is paid to them in cash or in the form of Ordinary Stock (see 11 below).
- 9 A transfer of PROs by a PRO Holder which is not a company within the charge to United Kingdom corporation tax and which is resident or ordinarily resident in the United Kingdom or which carries on a trade in the United Kingdom through a branch or agency to which the PROs are attributable may give rise to a charge to United Kingdom income tax in respect of an amount representing interest on the PROs which has accrued since the preceding Coupon Payment Date under the provisions of the “accrued income scheme” (the “**Scheme**”). The PROs will be variable rate securities within the meaning of section 717 of ICTA. Accordingly, on a transfer of a PRO, an amount of interest which is just and reasonable will be treated as accrued income under the Scheme. However, the transferee will not be entitled to any relief for that amount under the Scheme.

#### **Payment of interest in stock**

- 10 In certain cases the Issuer may issue Ordinary Stock to discharge its obligations to make an interest payment on the PROs (as described in the Summary under “Alternative coupon satisfaction mechanism” and as set out in more detail in Condition 6 of the “Terms and Conditions of the PROs”). Such Ordinary Stock will be issued to the Trustee acting on behalf of the Couponholders and will then be sold by the Trustee in the market. The Trustee will then make a cash payment to Couponholders which will be equal to the interest payment(s) in question.

It is intended that the Ordinary Stock issued by the Issuer will have a market value equal to the outstanding interest payment(s). Provided that this is the case, a Couponholder should not realise a capital gain as a result of sale of the Ordinary Stock. For Couponholders not within the charge to United Kingdom corporation tax in respect of the PROs, the issue of Ordinary Stock will be treated as a payment of the interest payment(s) in question.

- 11 Where the Issuer issues Ordinary Stock to satisfy a coupon payment, as described in Condition 6 of the “Terms and Conditions of the PROs”, the issue of the Ordinary Stock by the Issuer will be treated as representing payment of the interest payment in question. As explained in Condition 6 of the “Terms and Conditions of the PROs”, the Issuer will issue such amount of Ordinary Stock as is required in order to generate sufficient proceeds to discharge the interest payment in question. As the Issuer’s Ordinary Stock is denominated in sterling, and assuming that sterling is still the official currency of the United Kingdom, it is anticipated that the proceeds generated from the sale of such Ordinary Stock will be in sterling. This sterling amount will generally be the amount on which investors who are within the charge to United Kingdom income tax (and are not within the charge to corporation tax) will be liable to income tax in respect of the interest payment in question.

#### **Proposed European Union Directive on the taxation of savings income**

- 12 The European Union is currently considering proposals for a new directive regarding the taxation of savings income. 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 and subject to the proposals not being required to be applied to PROs issued before 1 March 2001.

## SUBSCRIPTION AND SALE

Under a subscription agreement entered into with the Issuer on 26 February 2001 (the “**Subscription Agreement**”), Salomon Brothers International Limited and Barclays Bank PLC (the “**Managers**”) have jointly and severally agreed to subscribe for the PROs at the issue price of 100% of their principal amount. The Issuer has agreed to pay to the Managers a combined management and underwriting commission of 1.00% of the principal amount of the PROs. The Subscription Agreement is subject to termination in certain circumstances prior to payment to the Issuer.

The PROs have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or to, or for the account or benefit of, US persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver PROs (i) as part of their distribution at any time, or (ii) otherwise until 40 days after the later of the commencement of the offering and the Closing Date (as defined in the Subscription Agreement), within the United States or to, or for the account or benefit of, US persons, and that it will have sent to each dealer to which it sells PROs during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of PROs within the United States or to, or for the account or benefit of, US persons. Terms used in this paragraph have the meanings given to them by Regulation S.

The PROs are being offered and sold outside the United States to non-U.S. persons in reliance on Regulation S. In addition, until 40 days after the commencement of the offering, an offer or sale of PROs within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

Each Manager has represented and agreed that:

- (1) it has not offered or sold and prior to the date six months after the date of issue of the PROs will not offer or sell any PROs to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995;
- (2) it has complied and will comply with all applicable provisions of the Financial Services Act 1986 with respect to anything done by it in relation to the PROs in, from or otherwise involving the United Kingdom; and
- (3) it has only issued or passed on, and will only issue or pass on, in the United Kingdom any document received by it in connection with the issue of the PROs, to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996 or is a person to whom the document may otherwise lawfully be issued or passed on.

No action has been or will be taken in any country or any jurisdiction by the Managers or the Issuer that would permit a public offering of the PROs, or possession or distribution of this Offering Memorandum or any other offering or publicity material relating to the PROs, in any country or jurisdiction where action for that purpose is required. Each Manager has agreed to comply with all applicable laws and regulations and directives in each jurisdiction in which it purchases, offers, sells or delivers PROs or has in its possession or distributes this Offering Memorandum or any such other material relating to the PROs, in all cases at its own expense. Each Manager has also undertaken to ensure that no obligations are imposed on the Issuer in any such jurisdiction as a result of any of the foregoing actions. The Issuer will have no responsibility for, and each Manager has agreed to obtain any consent, approval or permission required by it for, the acquisition, offer, sale or delivery by it of PROs under the laws and regulations in force in any jurisdiction to which it is subject or in or from which it makes any acquisition, offer, sale or delivery. The Managers have not been authorised to make any representation or use any information in connection with the issue, subscription and sale of the PROs other than as contained in this Offering Memorandum or any amendment or supplement to it.

The PROs may not be acquired by any entity that owns 10% or more of the voting stock of the Issuer, and the Issuer or the Managers may require a certification to this effect as a condition of subscription.

## GENERAL INFORMATION

- (1) In connection with the application to list the PROs on the Luxembourg Stock Exchange a legal notice relating to the issue of the PROs and copies of the Bank of Scotland Acts 1695 to 1970 and the Regulations for the Management and Administration of the Issuer will be deposited with the Chief Registrar of the District Court in Luxembourg ("*Greffier en Chef du Tribunal d'Arrondissement de et à Luxembourg*") where such documents may be examined and copies obtained.
- (2) The PROs have been accepted for clearance through Euroclear and Clearstream, Luxembourg with a Common Code of 012568134 in respect of the Series A PROs and 012568622 in respect of the Series B PROs. The ISIN code for the Series A PROs is XS0125681345 and XS0125686229 for the Series B PROs.
- (3) All PROs and Coupons will carry a legend to the following effect "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in sections 165(j) and 1287(a) of the Internal Revenue Code". The sections referred to in such legend provide that United States persons, with certain exceptions, will not be entitled to deduct any loss, and will not be entitled to capital gains treatment with respect to any gain, realised on any sale, exchange or redemption of a PRO or Coupon.
- (4) No member of the Group is or has been involved in any legal or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the PROs nor, so far as the Issuer is aware, are any such proceedings pending or threatened.
- (5) There has been no material adverse change in the financial position of the Issuer or the Group since 29 February 2000.
- (6) No redemption or purchase for cancellation of the PROs by the Issuer or by any of its subsidiaries will be made without the prior consent of the Financial Services Authority.
- (7) Copies of the latest annual report and consolidated accounts of the Issuer and the latest interim consolidated accounts of the Issuer may be obtained, and copies of the Trust Deed will be available for inspection, free of charge, at the specified office of each of the Paying Agents during normal business hours, so long as any of the PROs is outstanding. The interim accounts are currently produced on a semi-annual basis. The Issuer does not publish non-consolidated profit and loss accounts.
- (8) The consolidated accounts of the Issuer for the year ended 28 February 1999 have been audited, without qualification, in accordance with Auditing Standards issued by the Auditing Standards Board, by Ernst & Young. The consolidated accounts of the Issuer for the year ended 29 February 2000 have been audited, without qualification, in accordance with Auditing Standards issued by the Auditing Standards Board, and the consolidated unaudited interim accounts of the Issuer for the six months ended 31 August 2000 have been reviewed, by KPMG Audit Plc.
- (9) Schroders is a trademark of Schroders Holdings plc and is used under licence by Salomon Brothers International Limited.

## INTERIM FINANCIAL INFORMATION

*The following section sets out interim financial information in connection with the Issuer and has been extracted out of the Issuer's interim report for 2000. Reference to pages contained herein are to page numbers in that interim report.*

Bank of Scotland Interim Report 2000



### Consolidated Profit and Loss Account

	Half year ended 31 August 2000 £ million	Half year ended 31 August 1999 £ million	Half year ended 29 February 2000 £ million	Year ended 29 February 2000 £ million
<b>Interest receivable</b>				
Interest receivable and similar income arising from debt securities	242	134	179	313
Other interest receivable	2,683	1,978	2,342	4,320
	<b>2,925</b>	<b>2,112</b>	<b>2,521</b>	<b>4,633</b>
<b>Interest payable</b>	<b>(2,056)</b>	<b>(1,286)</b>	<b>(1,685)</b>	<b>(2,971)</b>
Dividend income from equity shares	2	3	5	8
Net interest and dividend income receivable	871	829	841	1,670
Fees and commissions receivable	412	391	411	802
Fees and commissions payable	(78)	(87)	(84)	(171)
Dealing profits	24	13	17	30
Other operating income	49	19	21	40
<b>Net operating income (all from continuing operations)</b>	<b>1,278</b>	<b>1,165</b>	<b>1,206</b>	<b>2,371</b>
Administrative expenses	(611)	(522)	(577)	(1,099)
Depreciation and amortisation	(40)	(38)	(43)	(81)
Operating expenses (Note 1(b) & (d))	(651)	(560)	(620)	(1,180)
Property revaluation surplus	-	-	3	3
Provisions for bad and doubtful debts	(172)	(151)	(166)	(317)
Amounts written off fixed asset investments	(5)	(4)	(2)	(6)
<b>Operating profit (all from continuing operations)</b>	<b>450</b>	<b>450</b>	<b>421</b>	<b>871</b>
Before exceptional items	516	450	475	925
Exceptional items (Note 1(d))	(66)	-	(54)	(54)
Share of operating profits of joint ventures	10	15	12	27
Share of operating profits of associated undertakings	9	6	7	13
<b>Profit on ordinary activities before taxation</b>	<b>469</b>	<b>471</b>	<b>440</b>	<b>911</b>
Before exceptional items	535	471	494	965
Exceptional items (Note 1(d))	(66)	-	(54)	(54)
Tax on ordinary activities (Note 2)	(143)	(154)	(135)	(289)
<b>Profit on ordinary activities after taxation</b>	<b>326</b>	<b>317</b>	<b>305</b>	<b>622</b>
Before exceptional items	374	317	353	670
Exceptional items (Note 1(d))	(48)	-	(48)	(48)
Minority interests (equity)	(17)	(16)	(18)	(34)
(non-equity)	(15)	-	-	-
<b>Profit attributable to proprietors</b>	<b>294</b>	<b>301</b>	<b>287</b>	<b>588</b>
Dividends				
Preference	19	19	18	37
Ordinary	67	57	112	169
	<b>86</b>	<b>76</b>	<b>130</b>	<b>206</b>
<b>Retained profit</b>	<b>208</b>	<b>225</b>	<b>157</b>	<b>382</b>
Earnings per 25p Ordinary Stock Unit – basic before exceptional items	25.7p	22.7p	25.5p	48.2p
Earnings per 25p Ordinary Stock Unit – basic	21.9p	22.7p	21.6p	44.3p
Earnings per 25p Ordinary Stock Unit – diluted	21.7p	22.3p	21.3p	43.6p



## Consolidated Statement of Total Recognised Gains and Losses

	Half year ended 31 August 2000 £ million	Half year ended 31 August 1999 £ million	Half year ended 29 February 2000 £ million	Year ended 29 February 2000 £ million
Profit attributable to proprietors	294	301	287	588
Currency translation differences	2	1	(1)	–
<b>Total recognised gains and losses for the period</b>	<b>296</b>	<b>302</b>	<b>286</b>	<b>588</b>

### Historical Cost Profits

It is estimated that Group profit on ordinary activities before taxation and retained profit of the half year calculated solely on a historical cost basis would not differ materially from those stated in the consolidated profit and loss account on page 16.



## Consolidated Balance Sheet

	As at 31 August 2000 £ million	As at 31 August 1999 £ million	As at 29 February 2000 £ million
<b>Assets</b>			
Cash and balances at central banks	768	622	587
Items in course of collection	500	533	544
Treasury bills and other eligible bills	685	782	524
Loans and advances to banks	4,457	4,481	3,954
Loans and advances to customers	62,065	51,705	55,901
Less: non-returnable finance	(1,108)	-	(404)
	60,957	51,705	55,497
Debt securities	8,560	6,031	7,960
Equity shares	135	86	96
Shares in joint ventures			
Share of gross assets	906	1,007	941
Share of gross liabilities	(866)	(983)	(908)
	40	24	33
Shares in associated undertakings	113	104	108
Intangible fixed assets	75	24	76
Tangible fixed assets	624	576	627
Other assets	1,368	964	1,113
Prepayments and accrued income	835	587	694
	79,097	66,519	71,813
<b>Liabilities</b>			
Deposits by banks	7,770	8,380	7,924
Customer accounts	33,419	28,561	30,037
Debt securities in issue	26,683	20,329	24,224
Notes in circulation	584	557	545
Corporate and deferred taxation	692	791	662
Proposed dividends	86	76	130
Other liabilities	1,656	1,111	1,507
Accruals and deferred income	1,284	1,036	922
Other provisions	60	46	52
	72,234	60,887	66,003
<b>Capital Resources</b>			
Subordinated liabilities			
Dated loan capital	1,481	1,184	1,165
Undated loan capital	1,145	1,090	1,099
	2,626	2,274	2,264
Called up share capital			
Preference stocks	400	400	400
Ordinary stock	316	311	313
	716	711	713
Share premium account	320	281	305
Other reserves	-	1	(4)
Profit and loss account	2,632	2,215	2,376
Proprietors' funds (including non-equity interests)	3,668	3,208	3,390
Minority interests (equity)	169	150	156
(non-equity)	400	-	-
	6,863	5,632	5,810
	79,097	66,519	71,813



**Consolidated Balance Sheet**

	<b>As at 31 August 2000 £ million</b>	<b>As at 31 August 1999 £ million</b>	<b>As at 29 February 2000 £ million</b>
<b>Memorandum Items</b>			
Contingent liabilities			
Acceptances and endorsements	<b>185</b>	<b>162</b>	<b>156</b>
Guarantees and assets pledged as collateral security	<b>1,656</b>	<b>1,440</b>	<b>1,550</b>
	<b>1,821</b>	<b>1,602</b>	<b>1,706</b>
Commitments			
Other commitments (primarily undrawn facilities)	<b>10,410</b>	<b>7,309</b>	<b>7,442</b>



## Consolidated Cash Flow Statement

	Half year ended 31 August 2000 £ million	Half year ended 31 August 1999 £ million	Year ended 29 February 2000 £ million
Net cash inflow from operating activities (Note 6)	654	1,958	3,664
Dividends received from joint ventures	-	-	18
Dividends received from associated undertakings	-	-	1
Returns on investments and servicing of finance	(126)	(74)	(184)
Taxation	(107)	(67)	(332)
Capital expenditure and financial investment	(545)	(1,414)	(3,340)
	(124)	403	(173)
Acquisitions and disposals	1	(49)	(141)
Equity dividends paid	(61)	(88)	(127)
	(184)	266	(441)
Financing	693	482	489
Increase in cash	509	748	48



## Notes on the Accounts

## 1. Operating Profit

	Half year ended 31 August 2000 £ million	Half year ended 31 August 1999 £ million	Half year ended 29 February 2000 £ million	Year ended 29 February 2000 £ million
(a) Net operating income includes:				
Finance lease rental income	275	352	265	617
Operating lease rental income	130	169	119	288
Operating lease depreciation	(71)	(138)	(65)	(203)
Profit on sale of investment securities	39	19	14	33
Mortgage incentives	(6)	(5)	(5)	(10)
Dealing Profits				
Foreign exchange	14	9	10	19
Interest rate related	10	4	7	11
(b) Operating expenses includes:				
Staff costs	282	272	273	545
Property rentals	15	15	16	31
Other occupation costs	19	22	21	43
Hire of equipment	-	-	1	1
Other equipment costs	13	11	12	23
Goodwill amortisation	3	-	2	2
Exceptional costs (Note 1(d))	66	-	54	54
(c) Provisions for bad and doubtful debts comprises:				
Specific	163	125	158	283
General	9	26	8	34
	172	151	166	317
(d) Exceptional items:				
Exceptional costs	66	-	54	54
Tax credit	(18)	-	(6)	(6)
	48	-	48	48

Exceptional costs for the half year ended 31 August 2000 are in respect of restructuring of Bank of Scotland Group. In the year ended 29 February 2000 the exceptional costs relate to the offer for National Westminster Bank Plc and the termination of the US Retail Banking joint venture.

2. The charge for taxation is based on a rate of 30% for UK Corporation Tax for the current year.

3. Provision has been made in the Interim Accounts towards the end of year allocation of profit to the Staff Profit Sharing Schemes. This provision is calculated on the results for the half year to 31 August 2000. The actual allocation will be calculated by reference to the results for the full year.



## Notes on the Accounts

### 4. Segmental Analysis

The Group results and assets relate predominantly to banking activities. 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.

In accordance with Statement of Standard Accounting Practice No. 25, net assets for each geographical area are stated below. Since the segmental allocation of liabilities, including Group capital resources, would be largely a matter of subjective judgement, the Directors are of the opinion that total assets provide a more meaningful comparison by segment and, accordingly, they are also analysed.

	Half year ended 31 August 2000 Australasia and Rest of World		Half year ended 31 August 1999 Australasia and Rest of World		Year ended 29 February 2000 Australasia and Rest of World	
	UK £ million	£ million	UK £ million	£ million	UK £ million	£ million
Interest receivable	2,447	478	1,744	368	3,861	772
Dividend income	2	–	2	1	4	4
Fees and commissions receivable	359	53	345	46	708	94
Dealing profits	21	3	8	5	20	10
Other operating income	46	3	15	4	29	11
Gross income	2,875	537	2,114	424	4,622	891
Operating profit before exceptional items	450	66	383	67	782	143
Total assets (excluding associates and joint ventures)	65,769	13,175	55,797	10,594	60,348	11,324
Net assets (excluding minority interests)	3,180	488	2,766	442	2,941	449

5. Accounting policies are unchanged from those stated in the 2000 Annual Report and Accounts, except as noted below.

The Group has adopted FRS15 "Tangible Fixed Assets" and FRS16 "Current Tax". The impact of adopting FRS15 will be to depreciate freehold and leasehold property over 50 years. The Group has applied the transitional rules available under FRS15. The Group will maintain the current revalued book value of property without subsequent revaluation. The impact of the adoption of FRS15 and FRS16 on current period results is not considered material.

In addition, following securitisation of a portfolio of mortgages, loans and advances to customers include loans which are subject to non-returnable finance arrangements. The principal benefits of these loans were acquired from the Bank by special purpose securitisation companies primarily through the issue of floating rate notes. These loans are shown separately on the balance sheet.



## Notes on the Accounts

## 6. Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	Half year ended 31 August 2000 £ million	Half year ended 31 August 1999 £ million	Year ended 29 February 2000 £ million
Group operating profit	450	450	871
(Increase)/decrease in accrued income and prepayments	(141)	54	(40)
Increase in accruals and deferred income	358	128	14
Provision for bad and doubtful debts	172	151	317
Depreciation and amortisation	40	38	81
Amortisation of debt securities	11	3	15
Revaluation surplus	-	-	(3)
Interest on subordinated loans	88	73	150
Profits on sale of investment securities	(39)	(19)	(33)
Provisions for liabilities and charges	8	6	12
Provision against debt securities and equity shares	5	4	6
Exchange differences	(104)	38	34
Net cash inflow from trading activities	848	926	1,424
Net increase in notes in circulation	39	36	24
Net decrease/(increase) in items in course of collection	44	(118)	(129)
Net increase in treasury and other bills	(141)	(372)	(114)
Net increase in loans and advances to banks and customers	(5,807)	(4,068)	(8,093)
Net increase in deposits by banks and customer accounts	3,228	2,102	3,065
Net increase in debt securities in issue	2,459	3,629	7,524
Net decrease/(increase) in other debt securities	90	(30)	(137)
Net increase in other assets	(255)	(29)	(178)
Net increase/(decrease) in other liabilities	149	(118)	278
	(194)	1,032	2,240
Net cash inflow from operating activities	654	1,958	3,664

7. The financial information included in this report contains details from the Annual Report and Accounts for the year ended 29 February 2000. Those Accounts have been reported on by the Group's auditors. The report of the auditors was unqualified and did not contain a statement under section 237(2) or (3) of the Companies Act 1985.



## Independent Review Report by KPMG Audit Plc to Bank of Scotland

### **Introduction**

We have been instructed by the company to review the financial information set out on pages 16 to 23 and we have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

### **Directors' responsibilities**

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by the Directors. The Listing Rules of the Financial Services Authority require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where they are to be changed in the next annual accounts in which case any changes, and the reasons for them, are to be disclosed.

### **Review work performed**

We conducted our review in accordance with guidance contained in Bulletin 1999/4: *Review of interim financial information* issued by the Auditing Practices Board. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

### **Review conclusion**

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 31 August 2000.

### **KPMG Audit Plc**

Chartered Accountants  
Edinburgh  
26 September 2000

## **ANNUAL CONSOLIDATED FINANCIAL STATEMENTS**

*The following section has been extracted out of the Issuer's 2000 annual report and accounts. Reference to pages contained herein are to page numbers in that annual report and accounts.*



## Corporate Governance Statement

The Board of Bank of Scotland aims to maintain the highest standards of Corporate Governance believing that they are essential to the process of delivering long term growth in profits and dividends for the benefit of Proprietors.

### Compliance

The Board has reviewed the Combined Code which is appended to the Listing Rules of the London Stock Exchange. This report, together with the Remuneration Report which is set out on pages 45 to 47, explains how the Bank has applied the Principles, and its compliance with the detailed Provisions, of Section 1 of the Combined Code during the year to 29th February 2000.

Except in relation to the procedure for determining the remuneration packages of the executive Directors, as explained in the Remuneration Report, the Bank has fully complied with all of the detailed Provisions of Section 1 of the Combined Code throughout the year to 29th February 2000.

### Directors

The Board of Bank of Scotland, which acts as the Group Board as well as the Board of the Clearing Bank, currently comprises thirteen non-executive Directors (including the Governor and the Deputy Governor) and three executive Directors (Mr Peter Burt, Mr Gavin Masterton and Mr John Mercer). Biographical details of each member of the Board are given on pages 6 and 7. Three additional executive Directors (Mr Gordon McQueen, Mr Colin Matthew and

Mr George Mitchell) have been appointed to the Board with effect from 1st May 2000. Their biographical details are given on page 45.

The roles of the Governor and the Group Chief Executive are separate and their responsibilities are clearly defined.

Throughout the year to 29th February 2000 the Board had an Audit Committee, a Remuneration Committee and a Nomination Committee each of which has formal terms of reference that have been approved, and are reviewed, by the Board.

The members of the Audit Committee are Mr John Maclean (Chairman), Sir Bob Reid, Sir Russell Hillhouse and Mr Ian Inglis. The main purpose of the Audit Committee is to assist the Board in discharging its responsibility for satisfying itself: that accounting and reporting systems provide accurate and up to date information on the Group's financial position; that the adequacy and effectiveness of the internal control procedures for the Group are regularly reviewed; that published financial statements and related commentaries report a true and fair view of the Bank's financial position and the Group's financial results and position; and that there is proper compliance throughout the Group with the requirements of the financial regulatory authorities. The Audit Committee receives reports from internal and external auditors on a regular basis. The duties of the Audit Committee also include keeping under review the scope and costs of audit and the nature and extent of non-audit services provided by the auditors.

Membership of the Remuneration Committee is shown in the Remuneration Report on page 45.

The members of the Nomination Committee are Sir John Shaw (Chairman), Sir Bob Reid, Sir Alistair Grant and Mr John Maclean. The main purpose of the Nomination Committee is to assist the Board in considering the need for and making Board appointments, both executive and non-executive. Recommendations are made to the Board for its decision.

The Board meets monthly, with additional meetings to consider the half-year and the full-year results. When necessary, the Board appoints a Committee for specific matters which require to be dealt with between Board meetings. The respective Chairmen take the lead in setting the agendas for Board and Committee meetings and papers are circulated some days in advance of the meetings. It is the responsibility of executive management to ensure that Board and Committee papers are comprehensive, relevant and timely.

All Directors have access to the advice and services of the Secretary and, in accordance with an agreed procedure, in the furtherance of their duties are able to take independent professional advice at the Bank's expense.

The Board recognises the value to the Group of being served by Directors who together have a wide range of skills from business and other backgrounds, and the particular contribution which can be made by Directors who have experience gained by serving on the Board for some years.





## Corporate Governance Statement

All of the Bank's Directors acknowledge their obligation to fulfil their duties with integrity and honesty, and to bring independent judgement to bear on issues of strategy, performance, resources (including key appointments) and standards of conduct in the interests of the Bank, its Proprietors, customers and staff.

All of the non-executive Directors are considered by the Board to be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. In the period to 31st December 1999 Mrs Lesley Knox was considered to be not independent because, until that date, she had certain executive responsibilities at The British Linen Bank Limited. Sir Bob Reid, who is Deputy Governor, is the senior independent non-executive Director (other than the Governor).

The non-executive Directors together have considerable experience of service as Directors of listed companies. Appropriate induction visits and briefings are arranged for non-executive Directors following their appointment to the Board. The Board is briefed and updated on the supervisory and regulatory structure which applies to the Bank and to other Group companies.

The Bank's Regulations (equivalent to Articles of Association) require the election of a Governor and not more than two Deputy Governors at the Annual General Meeting in each year. A Director who is appointed by the

Board during a year is required by the Regulations to retire from office at the next Annual General Meeting but is eligible for re-election at that meeting. Although the Regulations require one-third of the other Directors (rounded down) to retire from office at the Annual General Meeting in each year (such Directors are eligible for re-election at that meeting) the Bank's practice is that all Directors are required to submit themselves for re-election at least every three years. Subject to these requirements for re-election, non-executive Directors are appointed to the Board for a specified period, initially normally for five years, and any extension is in each case at the discretion of the Board.

The Group Management Board, which is chaired by the Group Chief Executive, comprises the senior executives of the Group. The Group Management Board meets monthly and normally is attended by the Governor and/or Deputy Governor. The Board of the Bank, and the Boards of each of its principal subsidiaries (other than BankWest) have delegated to the Group Management Board, within defined limits, responsibility for the day-to-day running of the Group. The Boards of the Bank's principal subsidiary companies are each chaired by one of their non-executive directors. Until 1st October 1999, the Board of the Bank had delegated to the Management Board, within defined limits, responsibility for the day-to-day running of the Clearing Bank.

For some years the Board has had a schedule of matters specifically reserved to it for decision. The Group Management Board also has (before it the Management Board of the Clearing Bank had) a schedule of matters specifically reserved to it for decision. These schedules cover, *inter alia*, budget and financial reporting procedures, and provide for delegation of tiered levels of authority for credit approvals, expenditure and investment. The schedules are updated when necessary and are formally reviewed annually.

### Relations with Proprietors

Immediately following the announcement of the half-year and full-year results, the Bank presents these results to investors and analysts. The Bank also carries out a programme of regular dialogue and individual meetings with institutional investors.

The Bank encourages the participation of private investors at its Annual General Meetings. The 1999 Annual General Meeting included a question and answer session and Proprietors had also been invited to submit questions in advance. The Chairmen of the Audit Committee and the Remuneration Committee were present. A separate resolution was proposed on each substantially separate issue, including a resolution to receive and adopt the 1999 Report and Accounts. The level of proxy votes for and against was announced after each resolution had been passed on a show of hands.



## Corporate Governance Statement

### Accountability and Audit

An assessment of the Group's position and prospects is given in this document, in particular within the Governor's Statement (pages 2 to 5) and the Operating and Financial Review (pages 10 to 43).

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can provide only reasonable – and not absolute – assurance against material misstatement or loss.

The Group has mechanisms for monitoring at executive level the risk management practices approved and adopted by individual business areas for credit, operational and market risk. Information on these mechanisms and on the Group's implementation of "Internal Control: Guidance for Directors on the Combined Code" (the "Turnbull Guidance") is provided in the Operating and Financial Review (on pages 36 to 40).

The Directors have satisfied themselves that the Group has adequate resources to continue in business for the foreseeable future and that it is therefore appropriate for the accounts for the year to 29th February 2000 to have been prepared on a going concern basis.

## Directors' Accounting Responsibilities

The Directors are required to prepare accounts for each financial year which comply with Part VII of the Companies Act 1985 and which give a true and fair view of the state of affairs of the Bank and of the Group as at the end of the year and of the profit or loss for the year. The Directors consider that in preparing the accounts on pages 56 to 97 the Group has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The Directors have responsibility for ensuring that the Group keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Group and which enable them to ensure that the accounts comply with Part VII of the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.



## Report of the Auditors to the Proprietors

We have audited the accounts on pages 56 to 97.

### **Respective responsibilities of directors and auditors**

The directors are responsible for preparing the Annual Report. As described on page 54, this includes responsibility for preparing the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the Directors' Report is not consistent with the accounts, if the Group has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if the information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on pages 52 to 54 reflects the Bank's compliance with the seven provisions of the Combined Code specified for our review by the Stock Exchange and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the Corporate Governance Statement, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

### **Basis of audit opinion**

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

### **Opinion**

In our opinion the accounts give a true and fair view of the state of affairs of the Bank and of the Group as at 29th February 2000 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

### **KPMG Audit Plc**

Chartered Accountants  
Registered Auditor  
Edinburgh, 25th April 2000



## Accounting Policies

The Group's accounting policies, detailed below, are unchanged other than those arising from implementation of FRS 12 "Provisions, Contingent Liabilities and Contingent Assets" and FRS 13 "Derivatives and Other Financial Instruments: Disclosure". The effect of these changes on the current year results is not material.

### Basis of Preparation

The accounts have been prepared under the historical cost convention modified by the revaluation of certain properties and items held for trading purposes and in accordance with currently applicable accounting standards and statements of recommended practice.

### Debt Securities

- (i) Debt securities and other fixed interest securities held for dealing are included at market value with gains or losses included in dealing profits.
- (ii) Debt securities and other fixed interest securities held for the longer term are included at cost less amounts written off and adjusted for the amortisation of premiums or discounts arising on purchase of investments redeemable at fixed dates. Such premiums or discounts are taken to interest receivable evenly over the period to redemption. Gains or losses on realisation are taken to revenue as they arise.

### Equity Shares

Equity shares are stated at cost less amounts written off. Income from listed equity shares is credited to revenue on the ex-dividend date and from unlisted equity shares on an equivalent basis.

### Associated Undertakings and Joint Ventures

The attributable share of results of associated undertakings, generally based on audited accounts, is included using the equity method of accounting. Shares in associated undertakings are stated in the consolidated balance sheet at the Group's share of their net tangible assets. In the Bank's balance sheet, the investments in shares in associated undertakings and joint ventures are stated at cost.

Joint ventures in which the Group has a long term interest and shares control under a contractual agreement with other parties are accounted for using the gross equity method.

### Tangible Fixed Assets and Depreciation

Freehold and long leasehold properties are revalued on a regular basis. Other tangible fixed assets are stated at cost less amounts written off.

Land is not depreciated. Freehold and long leasehold properties are not depreciated as it is considered that residual values, based on prices prevailing at the time of acquisition

or subsequent valuation, are such that any charge would not be significant. In addition, it is the policy to maintain properties to a high standard, with regular maintenance expenditure being charged against operating profit.

Improvements to leasehold properties with unexpired lease terms of fifty years or less are depreciated in equal instalments over the lesser of the remaining life of the lease or ten years. Premiums are amortised over the period of the lease.

Equipment, including fixtures and fittings, vehicles, computer hardware and software, which is capitalised is written off in equal instalments over the expected lives of the assets, generally between five and fifteen years.

Impairment charges are included within operating profit.

### Goodwill

Goodwill arising on acquisitions prior to 1st March 1998 was written off to reserves in the year in which it arose. These amounts will continue to be charged to the profit and loss account on a subsequent disposal of the business to which they relate.

Goodwill arising on acquisitions after 1st March 1998 is capitalised and included within Intangible Fixed Assets. Goodwill is amortised by equal instalments over its estimated useful life as stated. Impairment charges are included within operating profit.

## Accounting Policies

### Bad and Doubtful Debts

Specific provisions are made for advances which are recognised to be bad or doubtful. A general provision, to cover advances which are latently bad or doubtful, but not yet identified as such, is also maintained. Provisions made during the year are charged to revenue, net of recoveries.

Interest, receipt of which is considered to be doubtful, is not credited to revenue when applied to a customer's account but is held in suspense until collection is assured.

Loans and Advances are stated net of specific and general provisions and of interest in suspense in the balance sheet.

### Finance Leases, Instalment Credit and Operating Leases

Income from assets leased to customers and from instalment credit agreements is determined by spreading interest and charges over the period of repayment in proportion to the net cash investment.

The net investments in finance leases and operating leases are included as amounts receivable in advances and the net obligation under leases with third party finance lessors is included in customer accounts.

### Dated and Undated Loan Capital

Dated and undated loan capital is included at the nominal value adjusted for premiums, discounts and expenses, all of which are amortised over an appropriate period.

### Income Recognition

Arrangement fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done and those receivable in respect of bearing risk are recognised over the period of the advance or risk exposure. Other fees are recognised when receivable.

Mortgage incentive costs are taken through net interest income in the profit and loss account as they are incurred.

### Taxation

The charge for taxation takes into account the timing differences in the accounting and taxation treatment of certain items to the extent that they are expected to reverse in the future.

Deferred taxation is provided on the liability method.

### Pension Contributions

Pension fund liabilities are assessed by independent professionally qualified actuaries, normally at triennial valuations and at intervening dates if considered necessary. In accordance with the requirements of Statement of Standard Accounting Practice No. 24, pension costs are charged against profits using actuarial valuation methods intended to spread the pension cost systematically over the average service periods of the current employees in the schemes.

### Foreign Currencies

Assets and liabilities are translated at the rates of exchange ruling on the balance sheet date or at the forward exchange rate, as appropriate. Exchange differences arising on the translation of fixed assets are taken to reserves except to the extent that they are offset by corresponding differences arising on the translation of related borrowing. All other exchange differences are included in dealing profits.

### Derivatives

- (i) Trading derivatives, which include customer driven and proprietary transactions and hedges thereof, are carried in the accounts at fair value with gains or losses included in dealing profits.
- (ii) Non-trading derivatives, which are used to hedge on-balance sheet assets and liabilities, are accounted for on an accruals basis reflecting the treatment of the underlying items being hedged.

Where a hedge transaction is terminated early, any profit or loss is spread over the remaining life of the underlying asset or liability being hedged. In other circumstances, where the underlying item subject to the hedge is extinguished, the hedge transaction is measured at fair value and any profit or loss is recognised immediately.



# Consolidated Profit and Loss Account

For the year ended 29th February 2000

	Notes	2000 £ million	1999 £ million
<b>Interest receivable</b>			
Interest receivable and similar income arising from debt securities		313	260
Other interest receivable		4,320	3,866
		<b>4,633</b>	<b>4,126</b>
Interest payable		(2,971)	(2,602)
Dividend income from equity shares		8	5
Net interest and dividend income receivable		1,670	1,529
Fees and commissions receivable		802	707
Fees and commissions payable		(171)	(158)
Dealing profits		30	36
Other operating income		40	41
<b>Net operating income</b>	<b>1a</b>	<b>2,371</b>	<b>2,155</b>
of which:			
Continuing operations		2,371	2,093
Discontinued operations			62
		<b>2,371</b>	<b>2,155</b>
Administrative expenses		(1,099)	(985)
Depreciation and amortisation		(81)	(71)
Operating expenses (including exceptional costs of £54 million in 2000)	<b>1b, 1d</b>	<b>(1,180)</b>	<b>(1,056)</b>
Property revaluation surplus		3	
Provisions for bad and doubtful debts	<b>15</b>	(317)	(268)
Amounts written off fixed asset investments		(6)	(2)
<b>Operating profit</b>	<b>1c</b>	<b>871</b>	<b>829</b>
Before exceptional items		925	829
Exceptional items		(54)	
of which:			
Continuing operations		871	818
Discontinued operations			11
		<b>871</b>	<b>829</b>
Share of operating profits of joint ventures		27	19
Share of operating profits of associated undertakings		13	2
Gains on sale arising from discontinued operations	<b>1d</b>		162
<b>Profit on ordinary activities before taxation</b>		<b>911</b>	<b>1,012</b>
Before exceptional items		965	850
Exceptional items	<b>1d</b>	(54)	162
Tax on profit on ordinary activities	<b>7</b>	(289)	(431)
<b>Profit on ordinary activities after taxation</b>		<b>622</b>	<b>581</b>
Before exceptional items		670	562
Exceptional items	<b>1d</b>	(48)	19
Minority interests (equity)		(34)	(24)
<b>Profit attributable to proprietors</b>		<b>588</b>	<b>557</b>
Dividends	<b>8</b>		
Preference		37	37
Ordinary		169	144
		<b>206</b>	<b>181</b>
<b>Retained profit of the year</b>	<b>9</b>	<b>382</b>	<b>376</b>
Earnings per 25p Ordinary Stock unit – basic before exceptional items	<b>10</b>	<b>48.2p</b>	<b>40.6p</b>
Earnings per 25p Ordinary Stock unit – basic	<b>10</b>	<b>44.3p</b>	<b>42.1p</b>
Earnings per 25p Ordinary Stock unit – diluted	<b>10</b>	<b>43.6p</b>	<b>41.2p</b>

The statement of accounting policies on pages 56 and 57 and the notes on pages 65 to 97 form part of these accounts.

**Consolidated Statement of Total Recognised Gains and Losses**

For the year ended 29th February 2000

	2000 £ million	1999 £ million
Profit attributable to proprietors	588	557
Currency translation differences		(6)
Joint ventures and associated undertakings – other reserve movements		(1)
<b>Total recognised gains and losses for the year</b>	<b>588</b>	<b>550</b>

**Historical Cost Profits**

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 on page 58.

*The statement of accounting policies on pages 56 and 57 and the notes on pages 65 to 97 form part of these accounts.*



# Consolidated Balance Sheet

As at 29th February 2000

	Notes	2000 £ million	1999 £ million
<b>Assets</b>			
Cash and balances at central banks		587	615
Items in course of collection		544	415
Treasury bills and other eligible bills	12	524	410
Loans and advances to banks	13	3,954	4,815
Loans and advances to customers	14	55,497	46,581
Debt securities	18	7,960	4,633
Equity shares	19	96	61
Shares in joint ventures	20(i)	33	15
Share of gross assets		941	959
Share of gross liabilities		(908)	(944)
Shares in associated undertakings	20(ii)	108	87
Intangible fixed assets	22	76	4
Tangible fixed assets	23	627	584
Other assets		1,113	935
Prepayments and accrued income		694	641
		<b>71,813</b>	<b>59,796</b>
<b>Liabilities</b>			
Deposits by banks	25	7,924	6,152
Customer accounts	26	30,037	28,570
Debt securities in issue	27	24,224	16,700
Notes in circulation		545	521
Corporate taxation		247	320
Proposed dividends	8	130	113
Other liabilities		1,507	1,229
Accruals and deferred income		922	887
Provisions for liabilities and charges			
Deferred taxation	28(i)	415	390
Other provisions	28(ii)	52	40
		<b>66,003</b>	<b>54,922</b>
<b>Capital Resources</b>			
Subordinated liabilities	29		
Dated loan capital		1,165	682
Undated loan capital		1,099	1,088
Called up share capital	30		
Preference stocks		400	400
Ordinary stock		313	310
		<b>713</b>	<b>710</b>
Share premium account	31	305	278
Other reserves	31	(4)	(14)
Profit and loss account	31	2,376	1,997
Proprietors' funds (including non-equity interests)	32	3,390	2,971
Minority interests (equity)		156	133
		<b>5,810</b>	<b>4,874</b>
		<b>71,813</b>	<b>59,796</b>



**Consolidated Balance Sheet**

As at 29th February 2000

	Notes	2000 £ million	1999 £ million
<b>Memorandum Items</b>	<b>33</b>		
Contingent liabilities			
Acceptances and endorsements		156	215
Guarantees and assets pledged as collateral security		1,550	1,390
		<b>1,706</b>	<b>1,605</b>
Commitments			
Other commitments		<b>7,442</b>	<b>7,224</b>

**John C Shaw**

Governor

**John Maclean**

Director

**Peter Burt**

Group Chief Executive

**Gavin Masterton**

Treasurer and Managing Director

**Alistair Webster**

Group Chief Accountant

*The statement of accounting policies on pages 56 and 57 and the notes on pages 65 to 97 form part of these accounts.*



# Bank of Scotland Balance Sheet

As at 29th February 2000

	Notes	2000 £ million	1999 £ million
<b>Assets</b>			
Cash and balances at central banks		565	596
Items in course of collection		544	415
Loans and advances to banks	13	5,533	5,362
Loans and advances to customers	14	35,608	28,544
Debt securities	18	313	421
Equity shares	19	32	11
Shares in associated undertakings	20(ii)	76	72
Shares in group undertakings	21	737	590
Tangible fixed assets	23	410	356
Deferred tax asset	28(i)	7	1
Other assets		155	101
Prepayments and accrued income		417	191
		<b>44,397</b>	<b>36,660</b>
<b>Liabilities</b>			
Deposits by banks	25	17,777	13,299
Customer accounts	26	19,048	17,085
Debt securities in issue	27	1,084	870
Notes in circulation		545	521
Corporate taxation		133	138
Proposed dividends	8	130	113
Other liabilities		457	322
Accruals and deferred income		332	219
Provisions for liabilities and charges			
Other provisions	28(ii)	42	28
		<b>39,548</b>	<b>32,595</b>
<b>Capital Resources</b>			
Subordinated liabilities	29		
Dated loan capital		1,065	583
Undated loan capital		1,047	1,042
		<b>2,112</b>	<b>1,625</b>
Called up share capital	30		
Preference stocks		400	400
Ordinary stock		313	310
		<b>713</b>	<b>710</b>
Share premium account	31	305	278
Profit and loss account	31	1,719	1,452
Proprietors' funds (including non-equity interests)	32	2,737	2,440
		<b>4,849</b>	<b>4,065</b>
		<b>44,397</b>	<b>36,660</b>

**Bank of Scotland Balance Sheet**

As at 29th February 2000

	Notes	2000 £ million	1999 £ million
<b>Memorandum Items</b>	<b>33</b>		
Contingent liabilities			
Acceptances and endorsements		111	114
Guarantees and assets pledged as collateral security		1,615	1,572
		<b>1,726</b>	<b>1,686</b>
Commitments			
Other commitments		5,646	4,999

**John C Shaw**  
Governor

**John Maclean**  
Director

**Peter Burt**  
Group Chief Executive

**Gavin Masterton**  
Treasurer and Managing Director

**Alistair Webster**  
Group Chief Accountant

*The statement of accounting policies on pages 56 and 57 and the notes on pages 65 to 97 form part of these accounts.*



## Consolidated Cash Flow Statement

For the year ended 29th February 2000

	Notes	2000 £ million	1999 £ million
Net cash inflow from operating activities	42	3,664	1,205
Dividends received from joint ventures		18	15
Dividends received from associated undertakings		1	
Returns on investments and servicing of finance	43(i)	(184)	(192)
Taxation		(332)	(205)
Capital expenditure and financial investment	43(ii)	(3,340)	(1,834)
		(173)	(1,011)
Acquisitions and disposals	43(iii)	(141)	(26)
Equity dividends paid		(127)	(101)
		(441)	(1,138)
Financing	43(iv)	489	21
Increase/(decrease) in cash	45	48	(1,117)

*The statement of accounting policies on pages 56 and 57 and the notes on pages 65 to 97 form part of these accounts.*



## Notes on the Accounts

### 1. Operating Profit

1. Operating Profit		Notes	2000 £ million	1999 £ million
(a) Net operating income includes:				
Finance lease rental income			617	626
Operating lease rental income			288	279
Operating lease depreciation			(203)	(213)
Profit on sale of investment securities			33	33
Mortgage incentives			(10)	(14)
Dealing profits				
Foreign exchange		19		23
Interest rate related		11	30	13
(b) Operating expenses includes:				
Staff costs	2		545	528
Property rentals			31	29
Other occupation costs			43	40
Hire of equipment			1	1
Other equipment costs			23	17
Goodwill amortisation	22		2	
Exceptional costs	1d		54	
(c) Operating profit arises as follows:				
		2000 Continuing Total £ million	1999 Continuing £ million      Discontinued £ million      Total £ million	
Interest receivable				
Interest receivable and similar income arising from debt securities		313	247	13
Other interest receivable		4,320	3,737	129
		4,633	3,984	142
Interest payable		(2,971)	(2,500)	(102)
Dividend income from equity shares		8	5	
				5
Net interest and dividend income receivable		1,670	1,489	40
Fees and commissions receivable		802	682	25
Fees and commissions payable		(171)	(155)	(3)
Dealing profits		30	36	
Other operating income		40	41	
				36
				41
<b>Net operating income</b>		<b>2,371</b>	<b>2,093</b>	<b>62</b>
Administrative expenses		(1,099)	(942)	(43)
Depreciation and amortisation		(81)	(68)	(3)
Property revaluation surplus		3		
Provisions for bad and doubtful debts		(317)	(263)	(5)
Amounts written off fixed asset investments		(6)	(2)	
				(268)
				(2)
<b>Operating profit</b>		<b>871</b>	<b>818</b>	<b>11</b>
				829
(d) Exceptional items				
Exceptional costs			2000 £ million (54)	1999 £ million
Gains on sale arising from discontinued operations				186
Goodwill previously written off to reserves				(24)
			(54)	162
Tax credit/(charge)			6	(63)
			(48)	99
Additional provision for deferred tax				(80)
			(48)	19

Exceptional costs relate to the offer for National Westminster Bank Plc and the termination of the US Retail Banking joint venture.



## Notes on the Accounts

### 2. Staff

	2000 Number	1999 Number
The average number of persons employed by the Group during the year was:		
Full time	17,565	18,196
Part time	4,331	4,508
	<b>21,896</b>	<b>22,704</b>
	2000 £ million	1999 £ million
The aggregate remuneration payable to those employees comprises:		
Wages and salaries	440	433
Social security costs	35	33
Other pension costs (Note 6)	26	20
	<b>501</b>	<b>486</b>
Allocation to staff profit sharing schemes	44	42
	<b>545</b>	<b>528</b>

### 3. Directors' Emoluments

	2000 £000	1999 £000
Total emoluments	2,417	1,841
Total potential pre-tax gains on exercise of share options	397	
Highest paid Director – emoluments	426	486
– potential pre-tax gains on exercise of share options	397	
– accrued pension entitlement per annum	189	140

Retirement benefits accrued to five Directors under defined benefit schemes in the year to 29th February 2000.

A detailed analysis of Directors' stock options, emoluments and pension entitlements is given on pages 49 to 51 in the Appendix to Directors' Report.

### 4. Auditors' Remuneration

The aggregate remuneration for audit and other services payable in 2000 to KPMG and in 1999 to Ernst & Young and to subsidiary undertakings' auditors, where different, is analysed below. Consultancy payable in 2000 to KPMG and in 1999 to Ernst & Young comprises amounts mainly in respect of systems and advisory work.

		2000			1999		
		Audit £ million	Regulatory, Tax and Accounting £ million	Consultancy £ million	Audit £ million	Regulatory, Tax and Accounting £ million	Consultancy £ million
Group							
KPMG	– Within UK	1.0	0.3	2.4			
	– Outwith UK	0.2	0.2	0.1	0.2	0.1	0.2
Ernst & Young	– Within UK		0.2	0.1	1.1	0.3	1.0
	– Outwith UK				0.1	0.1	0.3
Others	– Within UK				0.1		
	– Outwith UK			0.3			
		<b>1.2</b>	<b>0.7</b>	<b>2.9</b>	<b>1.5</b>	<b>0.5</b>	<b>1.5</b>
Bank							
KPMG	– Within UK	0.2	0.2	2.0			
Ernst & Young	– Within UK		0.2	0.1	0.3	0.1	0.5



## Notes on the Accounts

## 5. Property Rentals

	Group		Bank	
	2000	1999	2000	1999
	£ million	£ million	£ million	£ million
There are commitments to make payments in the following year in respect of non-cancellable operating leases for property which expire:				
within 1 year	2	2	1	
between 1 and 5 years	6	7	4	5
after 5 years	19	22	8	11
	27	31	13	16

## 6. Pension Costs

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

The principal scheme (the Scheme), which covers 62 per cent of the Group's pensionable employees, is of the defined benefit type. The assets of the Scheme are held in a Trust Fund independently from the Bank's own assets.

In determining the level of contributions required to be made to the Scheme and the relevant charge to the Profit and Loss Account of the period, the Bank has been advised by Watson Wyatt Partners, Actuaries and Consultants. The most recently published formal valuation of the Scheme took place as at 31st December 1998. The main financial assumptions adopted in making this valuation were as follows:

	Rates per annum
Future price inflation	3.0 per cent
Return on new investments	7.1 per cent
Return on existing investments	5.8 per cent
Increases in earnings	4.5 per cent
Increases in pensions	3.0 per cent

Based on these assumptions and using the projected unit method, the market value of the assets amounted to 116 per cent of the accrued liabilities (after making allowance for expected future increases in earnings and increases to pensions in payment). The rate of contribution necessary to finance the benefits accruing in respect of current service was calculated at 19.4 per cent of pensionable salaries. The charge has been reduced as a result of the surplus assets, which have been spread over the average future working lifetime of the membership (which is expected to be 14 years) by fixed capital instalments plus interest on the reducing balance. This represents a change in the spreading method from previous years where the surplus was recognised as a level percentage of the ongoing pensionable salary roll. These elements, together with interest on the provision carried forward amount to £14 million (1999 – £8 million). As contributions to the Scheme remain suspended, a provision of £42 million (1999 – £28 million) is included in the balance sheet.

The market value of the Scheme assets at 31st December 1998 (after deducting the assets attributable to external AVC investments) amounted to £1,343 million.

The pension costs charged in the Profit and Loss Account include £12 million (1999 – £12 million) relating to schemes other than the Scheme.



## Notes on the Accounts

### 7. Taxation

	2000 £ million	1999 £ million
UK Corporation Tax at 30.08 per cent (1999 – 31 per cent)	229	261
Deferred taxation (Note 28 (i))	22	144
Relief for overseas taxation	(7)	(28)
	<b>244</b>	<b>377</b>
Overseas taxation	34	47
Share of joint ventures' taxation	7	7
Share of associated undertakings' taxation	4	
	<b>289</b>	<b>431</b>

The charge for deferred taxation in the year to 28th February 1999 includes an additional provision of £80 million in respect of a move to full provisioning for deferred taxation on assets leased to customers.

### 8. Dividends

	2000 £ million	1999 £ million
Preference dividends paid	19	19
payable	18	18
	<b>37</b>	<b>37</b>
Ordinary dividend		
Interim dividend of 4.60p per stock unit (1999 – 4.00p)	57	49
Proposed final dividend of 8.90p per stock unit (1999 – 7.60p)	112	95
	<b>169</b>	<b>144</b>
	<b>206</b>	<b>181</b>

The Ordinary Dividend Stock Alternative Scheme, which is offered as an alternative to the cash dividend, resulted in £7 million (1999 – £13 million) relating to the 1999 final dividend and £18 million (1999 – £14 million) relating to the 2000 interim dividend being retained by the Bank and added to reserves.

### 9. Retained Profit

	2000 £ million	1999 £ million
The profit of the Group has been retained by		
Bank of Scotland	260	351
Subsidiary undertakings	112	26
	<b>372</b>	<b>377</b>
Associated undertakings and joint ventures	10	(1)
	<b>382</b>	<b>376</b>

The Profit and Loss Account of the Bank is not presented by virtue of the exemption contained within Section 230 of the Companies Act 1985.





## Notes on the Accounts

## 10. Earnings per Ordinary Stock Unit

Basic and diluted earnings per Ordinary Stock unit are based upon Group profit attributable to Ordinary Stockholders of £551 million (1999 – £520 million). The earnings before exceptional items per Ordinary Stock unit are based upon Group profit attributable to Ordinary Stockholders before exceptional items after tax of £599 million (1999 – £501 million). For the basic earnings per Ordinary Stock unit the weighted average number of 25p Ordinary Stock units of 1,243 million (1999 – 1,233 million) is used and for the diluted earnings per Ordinary Stock unit the weighted average number of actual and potential 25p Ordinary Stock units of 1,263 million (1999 – 1,260 million) is used. Group profit attributable to Ordinary Stockholders equals profit attributable to proprietors of £588 million (1999 – £557 million) less preference dividends of £37 million (1999 – £37 million). The weighted average number of actual and potential stock units in issue is detailed below:

	2000 Number million	1999 Number million
Actual weighted average number of stock units in issue	1,243	1,233
Adjustment for weighted average number of stock units on which options have been granted but not yet exercised	20	27
Potential weighted average number of stock units in issue	1,263	1,260

The calculation of basic earnings per 25p Ordinary Stock unit before exceptional items presents a more consistent representation of earnings to proprietors over the last two years and is detailed below:

	2000	1999
Earnings per 25p Ordinary Stock unit – basic	44.3p	42.1p
Exceptional items (Note 1d)	3.9p	(1.5p)
Earnings per 25p Ordinary Stock unit – basic before exceptional items	48.2p	40.6p

## 11. Segmental Analysis

The Group results and assets relate predominantly to banking activities. 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.

In accordance with Statement of Standard Accounting Practice No. 25, net assets for each geographical area are stated below. Since the segmental allocation of liabilities, including Group capital resources, would be largely a matter of subjective judgement, the Directors are of the opinion that total assets provide a more meaningful comparison by segment and, accordingly, they are also analysed.

Accordingly, they are also analysed.

	2000			1999		
	UK £ million	Australasia and Rest of World £ million	Group Total £ million	UK £ million	Australasia and Rest of World £ million	Group Total £ million
Interest receivable	3,861	772	4,633	3,361	765	4,126
Dividend income	4	4	8	4	1	5
Fees and commissions receivable	708	94	802	620	87	707
Dealing profits	20	10	30	21	15	36
Other operating income	29	11	40	35	6	41
Gross income	4,622	891	5,513	4,041	874	4,915
Operating profit before exceptional items	782	143	925	703	126	829
Share of operating profits of joint ventures			27			19
Share of operating profits of associated undertakings			13			2
Exceptional items			(54)			162
Group profit before taxation			911			1,012
Total assets	60,348	11,324	71,672	49,746	9,948	59,694
Joint ventures			33			15
Associated undertakings			108			87
Group total assets			71,813			59,796
Net assets (excluding minority interests)	2,941	449	3,390	2,602	369	2,971



## Notes on the Accounts

### 12. Treasury Bills and other Eligible Bills

	Group £ million
Other eligible bills – held as investment securities	
At 1st March 1999	410
Additions	6,760
Disposals	(6,674)
Amortisation	28
<b>At 29th February 2000</b>	<b>524</b>
Aggregate unamortised discount at 29th February 2000	3

### 13. Loans and Advances to Banks

	Group		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
Sterling advances	3,137	2,913	3,340	3,484
Other currencies	809	1,885	2,193	1,878
Assets leased to banks	8	17		
<b>Loans and advances to Banks</b>	<b>3,954</b>	<b>4,815</b>	<b>5,533</b>	<b>5,362</b>
Repayable on demand	449	373	2,454	2,630
Other loans and advances repayable				
in 3 months or less	2,688	4,108	1,462	1,077
between 3 months and 1 year	631	256	780	910
between 1 year and 5 years	166	65	10	9
after 5 years	20	13	827	736
	3,954	4,815	5,533	5,362
Included above are loans:				
to subsidiary undertakings				
subordinated			624	510
unsubordinated			4,567	4,528
to associated undertakings		1		1
		1	5,191	5,039



## Notes on the Accounts

## 14. Loans and Advances to Customers

	Group		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
Advances to customers				
Banking advances	43,045	35,653	35,049	28,030
Instalment credit and other financial agreements	8,027	6,952		
Assets leased to customers	4,208	3,602		
Advances to joint ventures	917	971	20	44
Advances to associated undertakings	195	205	174	205
Advances to subsidiary undertakings			908	760
Gross advances	56,392	47,383	36,151	29,039
Provisions for bad and doubtful debts (Note 15)	(808)	(708)	(481)	(419)
Interest in suspense	(87)	(94)	(62)	(76)
<b>Loans and advances to customers</b>	<b>55,497</b>	<b>46,581</b>	<b>35,608</b>	<b>28,544</b>
Repayable on demand	10,001	9,884	8,844	8,032
Other loans and advances repayable				
in 3 months or less	9,883	6,091	7,657	4,836
between 3 months and 1 year	5,325	4,349	2,306	1,580
between 1 year and 5 years	11,129	10,127	3,511	3,113
after 5 years	20,054	16,932	13,833	11,478
Gross advances	56,392	47,383	36,151	29,039

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

	£ million
Cost	
At 1st March 1999	902
Additions	918
Disposals	(602)
Acquisition of subsidiary undertaking	87
At 29th February 2000	1,305
Aggregate depreciation	(306)
<b>Net Book Value at 29th February 2000</b>	<b>999</b>
Net Book Value at 28th February 1999	652

The cost of assets acquired during the year by the Group for the purpose of letting under finance leases to customers and banks amounted to £926 million (1999 – £954 million).

The Group's gross lending exposure is analysed below.

	2000 £ million	1999 £ million
Agriculture, forestry and fishing	887	802
Energy	1,203	872
Manufacturing industry	4,756	3,895
Construction and property	6,351	4,435
Hotels, restaurants and wholesale and retail trade	4,738	3,665
Transport, storage and communication	1,835	1,737
Financial	2,596	2,410
Other services	6,637	5,776
Individuals		
Home mortgages	15,898	13,900
Other personal lending	7,900	7,172
Overseas residents	3,591	2,719
<b>Gross loans and advances to customers</b>	<b>56,392</b>	<b>47,383</b>



## Notes on the Accounts

### 15. Provisions for Bad and Doubtful Debts

	Group			Bank		
	Specific £ million	General £ million	Total £ million	Specific £ million	General £ million	Total £ million
At 1st March 1999	370	338	708	207	212	419
Acquisition of subsidiary undertaking	1		1			
New provisions less releases	331	34	365	155	20	175
Amounts written off	(266)		(266)	(113)		(113)
<b>Cumulative provisions as at 29th February 2000</b>	<b>436</b>	<b>372</b>	<b>808</b>	<b>249</b>	<b>232</b>	<b>481</b>
New provisions less releases	331	34	365	155	20	175
Recoveries of amounts previously written off	(48)		(48)	(27)		(27)
Net charge to revenue	283	34	317	128	20	148

### 16. Interest in Suspense

The aggregate amount of advances, gross of suspended interest, at 29th February 2000 on which interest is being held in suspense amounted to £500 million (Bank £335 million). Net of specific provisions, those advances amounted to £326 million (Bank £232 million).

In addition, the aggregate amount of gross advances at 29th February 2000 on which interest is not being accrued amounted to £418 million (Bank £340 million).

### 17. Advances to Directors, Officers and Connected Persons

As at 29th February 2000 transactions, arrangements and agreements entered into with Directors, Officers and Connected Persons amounted to £1.3 million (number of persons – 13).



## Notes on the Accounts

## 18. Debt Securities

	2000				1999			
	Issued by public bodies £ million	Issued by others £ million	Total £ million	Market Value £ million	Issued by public bodies £ million	Issued by others £ million	Total £ million	Market Value £ million
<b>Group</b>								
<b>Investment securities</b>								
Listed								
British Government Securities	702		702	696	100		100	131
Others	2	2,259	2,261	2,268		145	145	152
Unlisted								
Certificates of deposit issued by banks and building societies		3,822	3,822	3,820		3,364	3,364	3,374
Others		493	493	507		479	479	478
<b>Total investment securities</b>	<b>704</b>	<b>6,574</b>	<b>7,278</b>	<b>7,291</b>	<b>100</b>	<b>3,988</b>	<b>4,088</b>	<b>4,135</b>
<b>Other securities</b>								
Listed	154		154	154	240		240	240
Unlisted	262	266	528	528	161	144	305	305
	<b>1,120</b>	<b>6,840</b>	<b>7,960</b>	<b>7,973</b>	<b>501</b>	<b>4,132</b>	<b>4,633</b>	<b>4,680</b>
of which:								
maturing within 1 year			5,273				3,607	
in more than 1 year			2,687				1,026	
			<u>7,960</u>				<u>4,633</u>	
<b>Bank</b>								
<b>Investment securities</b>								
Listed								
British Government Securities					95		95	125
Others	2	74	76	82		98	98	104
Unlisted								
Certificates of deposit issued by banks and building societies		79	79	79		53	53	53
Others		158	158	158		175	175	170
<b>Total investment securities</b>	<b>2</b>	<b>311</b>	<b>313</b>	<b>319</b>	<b>95</b>	<b>326</b>	<b>421</b>	<b>452</b>
of which:								
maturing within 1 year			83				86	
in more than 1 year			230				335	
			<u>313</u>				<u>421</u>	

"Other unlisted debt securities" held by the Bank includes £70 million (1999 – £70 million) issued by a subsidiary undertaking.



## Notes on the Accounts

### 18. Debt Securities (continued)

The movement on investment securities is as follows:

	Group			Bank		
	Amortised Cost £ million	Aggregate amount written off £ million	Book Value £ million	Amortised Cost £ million	Aggregate amount written off £ million	Book Value £ million
At 1st March 1999	4,092	(4)	4,088	422	(1)	421
Exchange translation	(17)		(17)	(1)		(1)
Additions	9,171		9,171	299		299
Amortisation	(15)		(15)			
Disposals	(5,943)		(5,943)	(402)		(402)
Amount written off		(6)	(6)		(4)	(4)
<b>At 29th February 2000</b>	<b>7,288</b>	<b>(10)</b>	<b>7,278</b>	<b>318</b>	<b>(5)</b>	<b>313</b>
Aggregate unamortised premium at 29th February 2000	(17)					

### 19. 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	
<b>Group</b>							
At 1st March 1999	11		11	51	(1)	50	61
Additions	5		5	37		37	42
Disposals	(3)		(3)	(4)		(4)	(7)
<b>At 29th February 2000</b>	<b>13</b>		<b>13</b>	<b>84</b>	<b>(1)</b>	<b>83</b>	<b>96</b>
<b>Bank</b>							
At 1st March 1999	5		5	6		6	11
Additions				21		21	21
<b>At 29th February 2000</b>	<b>5</b>		<b>5</b>	<b>27</b>		<b>27</b>	<b>32</b>

The total value of investments at 29th February 2000 for the Group was £241 million (1999 – £162 million) and for the Bank £165 million (1999 – £100 million) including for the Group £146 million (1999 – £97 million) and for the Bank £129 million (1999 – £85 million) in respect of listed equity shares.



## Notes on the Accounts

## 20. Shares in Joint Ventures and Shares in Associated Undertakings

(i) Joint Ventures	Group					Bank
	Book Value £ million	Equity Adjustments £ million	Share of Net Tangible Assets £ million	Intangible Fixed Assets £ million	Share of Net Assets £ million	Cost £ million
At 1st March 1999	12	1	13	2	15	
Acquisitions and subscriptions of capital	16		16		16	
Equity accounting adjustments		2	2		2	
<b>At 29th February 2000</b>	<b>28</b>	<b>3</b>	<b>31</b>	<b>2</b>	<b>33</b>	

  

(ii) Associated Undertakings	Group					Bank
	Book Value £ million	Equity Adjustments £ million	Share of Net Tangible Assets £ million	Intangible Fixed Assets £ million	Share of Net Assets £ million	Cost £ million
At 1st March 1999	88	(1)	87		87	72
Acquisitions and subscriptions of capital	13		13		13	4
Equity accounting adjustments		8	8		8	
<b>At 29th February 2000</b>	<b>101</b>	<b>7</b>	<b>108</b>		<b>108</b>	<b>76</b>

All the investments are unlisted.

The principal joint ventures and associated undertakings are listed in Note 48 on page 96.

## 21. Shares in Group Undertakings

	Banks £ million	Others £ million	Total £ million
At cost at 1st March 1999	299	291	590
Exchange translation		1	1
Disposals		(3)	(3)
Acquisitions and subscriptions of capital	72	77	149
<b>At cost at 29th February 2000</b>	<b>371</b>	<b>366</b>	<b>737</b>

The principal subsidiary undertakings are listed in Note 49 on page 97.

## 22. Intangible Fixed Assets

	Goodwill £ million
Cost	
At 1st March 1999	4
Additions (Note 44)	74
<b>At 29th February 2000</b>	<b>78</b>
Provisions for amortisation and impairment	
At 1st March 1999	—
Amortisation charged in period (Note 1(b))	2
<b>At 29th February 2000</b>	<b>2</b>
<b>Net Book Value</b>	
<b>At 29th February 2000</b>	<b>76</b>
At 28th February 1999	4

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



## Notes on the Accounts

### 23. Tangible Fixed Assets

	Group			Bank		
	Cost or Valuation £ million	Depreciation £ million	Book Value £ million	Cost or Valuation £ million	Depreciation £ million	Book Value £ million
<b>Property</b>						
At 1st March 1999	334	(16)	318	186	(7)	179
Additions and transfers	40		40	39		39
Revaluation	3		3	13		13
Disposals	(23)	2	(21)	(5)	2	(3)
Acquisition of subsidiary undertaking	8		8			
Depreciation for year		(3)	(3)		(1)	(1)
At 29th February 2000	362	(17)	345	233	(6)	227
of which:						
At valuation 31st December 1999	319			218		
At cost	43			15		
	362			233		
Freehold	326			218		
Long leasehold	4			4		
Short leasehold	32			11		
	362			233		
Occupied for own activities			328			217
<b>Equipment</b>						
At 1st March 1999	608	(342)	266	374	(197)	177
Additions and transfers	106		106	53		53
Disposals	(62)	47	(15)	(36)	30	(6)
Acquisition of subsidiary undertaking	3	(2)	1			
Depreciation for year		(76)	(76)		(41)	(41)
At 29th February 2000	655	(373)	282	391	(208)	183
<b>Total tangible fixed assets 2000</b>	<b>1,017</b>	<b>(390)</b>	<b>627</b>	<b>624</b>	<b>(214)</b>	<b>410</b>
Total tangible fixed assets 1999	942	(358)	584	560	(204)	356
Equipment includes amounts acquired under finance leases	35	(29)	6	32	(27)	5
Had the value of the Group's land and buildings been stated at historical cost, it is estimated they would have been included in the accounts as follows:	326	(17)	309	168	(6)	162

Freehold and long leasehold properties were valued at 31st December 1999 on the basis of existing use, mainly by external valuers who are members of the Royal Institution of Chartered Surveyors or similarly qualified employees of the Group.





## Notes on the Accounts

### 24. Capital and Other Commitments

	Group		Bank	
	2000	1999	2000	1999
	£ million	£ million	£ 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	9	21	1	3
Included in deposits by banks and in customer accounts are net obligations under finance leases payable as follows:				
within 1 year	2	4	1	2
between 2 and 5 years	10	3	1	1

### 25. Deposits by Banks

	Group		Bank	
	2000	1999	2000	1999
	£ million	£ million	£ million	£ million
Sterling	4,891	2,580	372	184
Currency	2,648	3,178	453	567
	7,539	5,758	825	751
Subsidiary undertakings			16,949	12,548
Associated undertakings	385	394	3	
	7,924	6,152	17,777	13,299
of which:				
Repayable on demand	1,251	1,524	4,555	2,825
Repayable				
in 3 months or less	4,779	3,264	7,758	5,546
between 3 months and 1 year	1,884	1,207	1,841	1,120
between 1 and 5 years	10	157	2,822	2,925
after 5 years			801	883
	7,924	6,152	17,777	13,299



## Notes on the Accounts

### 26. Customer Accounts

	Group		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
Sterling – non interest bearing	1,334	1,248	1,329	1,241
– interest bearing	22,905	22,592	16,273	14,509
	24,239	23,840	17,602	15,750
Other currencies – non interest bearing	149	122	10	
– interest bearing	5,643	4,606	1,017	1,036
	30,031	28,568	18,629	16,786
Subsidiary undertakings			415	297
Associated undertakings	6	2	4	2
	30,037	28,570	19,048	17,085
of which:				
Repayable on demand	18,916	15,936	15,353	13,188
Repayable				
in 3 months or less	9,119	10,742	3,257	3,342
between 3 months and 1 year	1,591	1,628	263	475
between 1 and 5 years	402	232	175	80
after 5 years	9	32		
	30,037	28,570	19,048	17,085

### 27. Debt Securities in Issue

	Group		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
Bonds and Medium Term Notes				
due within 1 year	2,525	1,135		
between 1 and 2 years	2,919	481		
between 2 and 5 years	2,421	1,355		
after 5 years	181	798		
	8,046	3,769		
Other Debt Securities				
Repayable				
in 3 months or less	12,928	9,838	554	772
between 3 months and 1 year	2,693	2,407	446	14
between 1 and 2 years	274	478		
between 2 and 5 years	283	163	42	42
after 5 years		45	42	42
	16,178	12,931	1,084	870
Total debt securities in issue	24,224	16,700	1,084	870

Bonds and Medium Term Notes includes £352 million (1999 – £371 million) secured on advances to customers and certain other assets of the Group. "Other Debt Securities" issued by the Bank includes £84 million (1999 – £84 million) held by subsidiary undertakings.



## Notes on the Accounts

## 28. Provisions for Liabilities and Charges

## (i) Deferred Taxation

	Group £ million	Bank £ million
At 1st March 1999	390	(1)
Acquisition of subsidiary undertaking	6	
Charge/(credit) in year (Note 7)	22	(6)
Other movements	(3)	
<b>At 29th February 2000</b>	<b>415</b>	<b>(7)</b>

	2000		1999	
	Provided for in Accounts £ million	Full Potential Liability £ million	Provided for in Accounts £ million	Full Potential Liability £ million
Deferred taxation comprises:				
<b>Group</b>				
Capital allowances –				
on assets leased to customers	353	353	323	323
on other assets	17	17	24	24
Other timing differences	45	45	43	43
	<b>415</b>	<b>415</b>	<b>390</b>	<b>390</b>
<b>Bank</b>				
Capital allowances on fixed assets	9	9	11	11
Other timing differences	(16)	(16)	(12)	(12)
	<b>(7)</b>	<b>(7)</b>	<b>(1)</b>	<b>(1)</b>

It has been assumed that no Group properties will be sold and no material liability is likely to arise in the foreseeable future. No provision is made therefore for any liability for taxation which may arise if properties are disposed of at their balance sheet values.

## (ii) Other Provisions

	Group		Bank
	Pension Provisions £ million	Other Provisions £ million	Pension Provisions £ million
At 1st March 1999	28	12	28
Charge for year	14		14
Provision utilised		(2)	
<b>At 29th February 2000</b>	<b>42</b>	<b>10</b>	<b>42</b>



## Notes on the Accounts

### 29. Subordinated Liabilities

		Group		Bank	
	Interest rate	2000 £ million	1999 £ million	2000 £ million	1999 £ million
<b>Dated Loan Capital</b>					
US\$208.5 million Floating Rate Notes 2000	US\$ LIBOR plus 0.725%	132	130	132	130
DFL7 million 9.72% Registered Loans 2000/2001	9.72%	2	4	2	4
US\$300 million 8.80% Notes 2004*	8.80%	190	188	190	188
£60 million 9.00% Instruments 2006	9.00%	61	60		
US\$150 million 8.85% Notes 2006*	8.85%	94	93	94	93
£75 million Floating Rate Instruments 2010	LIBOR plus 0.45%	75	75	75	75
US\$150 million Notes 2011*	6.50%	94	93	94	93
A\$100 million Callable Notes 2007	A\$Bank Bill Rate plus 0.48%	39	39		
Euro 500 million 5.50% Instruments 2009	5.50%	306		306	
£175 million 6.375% Instruments 2019	6.375%	172		172	
		1,165	682	1,065	583
<b>Repayable</b>					
within 1 year		134	2	134	2
between 1 and 2 years			132		132
between 2 and 5 years		190	188	190	188
after 5 years		841	360	741	261
		1,165	682	1,065	583

\* These Notes, which are onlent to the Bank, are liabilities of wholly-owned subsidiary undertakings of the Bank and are guaranteed unconditionally by the Bank on a subordinated basis.

		Group		Bank	
	Interest rate	2000 £ million	1999 £ million	2000 £ million	1999 £ million
Undated Loan Capital					
US\$250 million Floating Rate					
Primary Capital Notes	US\$ LIMEAN plus 0.25%	158	157	158	157
£200 million Perpetual Notes	8.625%	200	200	200	200
£100 million Instruments	10.25%	99	99	99	99
JPY 17 billion Instruments	4.25%	101	100	101	100
JPY 9 billion Instruments	4.55%	52	46		
£150 million Instruments	8.375%	149	148	149	148
US\$300 million Reset Notes	7.00%	190	188	190	188
£150 million Instruments	7.375%	150	150	150	150
		1,099	1,088	1,047	1,042

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 Bank at par on any interest payment date. The Perpetual Notes may, at the option of the Bank on 4th 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 the Bank on the fifth anniversary of their respective date(s) of issue.

The Instruments may, at the option of the Bank or relevant subsidiary undertaking on giving 30 days notice, be redeemed at par or exchanged for new instruments on 10th August 2015 (£100 million); 9th February 2016 (JPY 17 billion); 30th May 2016 (JPY 9 billion); 30th October 2006 (£150 million) and 10th 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 the Bank 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 the Bank at par on 20th November 2007 or on any interest payment date thereafter.



## Notes on the Accounts

## 30. Share Capital

	Ordinary Stock £ million	9¼% Non- Cumulative Irredeemable Preference Stock £ million	9¾% Non- Cumulative Irredeemable Preference Stock £ million
<b>Authorised</b>			
At 1st March 1999 and 29th February 2000	381	375	125
<b>Allotted, called up and fully paid</b>			
At 1st March 1999	310	300	100
Issued in lieu of dividends and under employee Stock Schemes	3		
<b>At 29th February 2000</b>	<b>313</b>	<b>300</b>	<b>100</b>

At 29th February 2000, options in respect of Ordinary Stock units of 25p were outstanding under the Savings-Related Stock Option Schemes and Executive Stock Option Schemes, as follows:

Savings-Related Schemes	on 116,144 units exercisable at 89.20p in 2000
	on 1,635,962 units exercisable at 150.80p between 2000 and 2001
	on 1,839,226 units exercisable at 163.60p between 2000 and 2002
	on 3,405,601 units exercisable at 207.86p between 2000 and 2003
	on 3,286,792 units exercisable at 218.93p between 2000 and 2004
	on 3,697,105 units exercisable at 428.27p between 2000 and 2005
	on 3,829,439 units exercisable at 459.47p between 2001 and 2006
	on 3,809,032 units exercisable at 570.00p between 2002 and 2007
Executive Schemes	on 15,081 units exercisable at 90.44p in 2000
	on 2,154 units exercisable at 323.82p in 2000
	on 75,500 units exercisable at 119.50p between 2000 and 2001
	on 179,540 units exercisable at 110.17p between 2000 and 2002
	on 732,100 units exercisable at 188.50p between 2000 and 2003
	on 1,545,880 units exercisable at 201.50p between 2000 and 2004
	on 10,054 units exercisable at 221.17p between 2000 and 2005
	on 1,699,150 units exercisable at 259.83p between 2000 and 2005
	on 2,536,572 units exercisable at 273.67p between 2000 and 2006
	on 1,834,700 units exercisable at 535.33p between 2000 and 2007
	on 581,416 units exercisable at 574.33p between 2001 and 2008
	on 1,414,958 units exercisable at 583.50p between 2001 and 2008
	on 1,277,750 units exercisable at 712.50p between 2002 and 2009

The exercise price for options granted under the Executive Stock Option Schemes is the market price on or shortly before the date of grant, in accordance with the rules of the respective Schemes. The exercise price for options granted under the Savings-Related Stock Option Schemes is at the maximum discount of 20 per cent to the market price which is permitted for an Inland Revenue approved Scheme.



## Notes on the Accounts

### 31. Reserves

	Other Reserves				
	Share Premium £ million	Bank and Subsidiaries £ million	Joint Ventures and Associated Undertakings £ million	Total Other Reserves £ million	Profit and Loss Account £ million
<b>Group</b>					
At 1st March 1999	278	(16)	2	(14)	1,997
Reserves capitalised	(1)				
Premium arising on issue of stock	28				
Dividends retained on account of stock dividends					25
Contribution to Employee Share Trust					(18)
Retained profit			10	10	372
<b>At 29th February 2000</b>	<b>305</b>	<b>(16)</b>	<b>12</b>	<b>(4)</b>	<b>2,376</b>
<b>Bank</b>					
At 1st March 1999	278				1,452
Reserves capitalised	(1)				
Premium arising on issue of stock	28				
Dividends retained on account of stock dividends					25
Contribution to Employee Share Trust					(18)
Retained profit					260
<b>At 29th February 2000</b>	<b>305</b>				<b>1,719*</b>

\* Distributable

The cumulative amount of positive goodwill on acquisitions of subsidiary undertakings written off in the Group reserves is £228 million (1999 – £228 million) and in respect of Joint Ventures and Associated Undertakings £1 million (1999 – £1 million).

### 32. Reconciliation of Proprietors' Funds

	Group		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
Profit attributable to proprietors	588	557	466	532
Dividends	(206)	(181)	(206)	(181)
Other recognised gains and losses		(7)		
Dividends retained on account of stock dividends	25	27	25	27
Contribution to Employee Share Trust	(18)	(19)	(18)	(19)
Capital subscribed	30	42	30	42
Goodwill		24		
	419	443	297	401
Proprietors' Funds at 1st March 1999	2,971	2,528	2,440	2,039
<b>Proprietors' Funds at 29th February 2000</b>	<b>3,390</b>	<b>2,971</b>	<b>2,737</b>	<b>2,440</b>
of which:				
Attributable to non-equity interests	400	400	400	400
Attributable to equity interests	2,990	2,571	2,337	2,040
	3,390	2,971	2,737	2,440



## Notes on the Accounts

## 33. 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 or other risks, which are significantly lower as indicated by the risk weighted amount using the Bank for International Settlements' capital adequacy amounts.

	2000		1999	
	Contract Amount £ million	Risk Weighted Amount £ million	Contract Amount £ million	Risk Weighted Amount £ million
<b>Group</b>				
<b>Contingent Liabilities</b>				
Acceptances and endorsements	156	149	215	198
Guarantees and assets pledged as collateral security				
Guarantees and irrevocable letters of credit	1,550	1,056	1,390	863
	1,706	1,205	1,605	1,061
<b>Commitments</b>				
Other commitments				
Short term trade related transactions	116	23	54	11
Undrawn note issuance and revolving underwriting facilities			250	25
Undrawn formal standby facilities, credit lines and other irrevocable commitments to lend				
up to and including 1 year	2,803		2,987	
over 1 year	4,523	2,292	3,933	2,055
	7,442	2,315	7,224	2,091
<b>Bank</b>				
<b>Contingent Liabilities</b>				
Acceptances and endorsements	111	111	114	114
Guarantees and assets pledged as collateral security				
Guarantees and irrevocable letters of credit	1,615	1,149	1,572	1,075
	1,726	1,260	1,686	1,189
Amounts included above in respect of guarantees to subsidiary undertakings	259	244	366	352
<b>Commitments</b>				
Other commitments				
Short term trade related transactions	105	21	47	9
Undrawn note issuance and revolving underwriting facilities			250	25
Undrawn formal standby facilities, credit lines and other irrevocable commitments to lend				
up to and including 1 year	1,160		948	
over 1 year	4,381	2,124	3,754	1,828
	5,646	2,145	4,999	1,862
Amounts included above in respect of commitments to subsidiary undertakings	219	93	171	84



## Notes on the Accounts

### 34. Derivatives

The Bank and Group use 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 predominantly customer driven and are generally matched whilst proprietary activity is restricted within modest limits.

The Bank and Group have entered into derivative contracts as noted below. The underlying risks involved are significantly lower than the contract or notional principal amounts, as shown by the risk weighted amount using the Bank for International Settlements' capital adequacy rules and the replacement cost.

	2000			1999		
	Notional Principal Amount £ million	Replace- ment Cost £ million	Risk Weighted Amount £ million	Notional Principal Amount £ million	Replace- ment Cost £ million	Risk Weighted Amount £ million
<b>Group</b>						
<b>Exchange Rate Related Contracts</b>						
expiring within 1 year	26,018	574	202	25,817	486	148
between 1 and 5 years	2,503	88	59	2,398	50	41
after 5 years	332	49	22	361	35	14
	<b>28,853</b>	<b>711</b>	<b>283</b>	<b>28,576</b>	<b>571</b>	<b>203</b>
<b>Interest Rate Related Contracts</b>						
expiring within 1 year	20,313	202	34	15,894	175	35
between 1 and 5 years	30,194	206	54	19,552	210	43
after 5 years	7,378	140	43	4,273	232	43
	<b>57,885</b>	<b>548</b>	<b>131</b>	<b>39,719</b>	<b>617</b>	<b>121</b>
<b>Equity and Commodity Related Contracts</b>						
expiring within 1 year	75	5	1			
between 1 and 5 years	188		3	174	2	3
	<b>263</b>	<b>5</b>	<b>4</b>	<b>174</b>	<b>2</b>	<b>3</b>
<b>Total Group Derivatives</b>	<b>87,001</b>	<b>1,264</b>	<b>418</b>	<b>68,469</b>	<b>1,190</b>	<b>327</b>

The notional principal amounts and fair values of these derivatives are analysed between non-trading and trading activity. "Fair value" is the amount at which instruments could be exchanged in an arms length transaction.





# Notes on the Accounts

## 34. Derivatives (continued)

	2000			1999		
	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million
<b>Non Trading</b>						
<b>Exchange Rate Related Contracts</b>						
Forward foreign exchange	6,216	144	14	3,912	84	16
Cross currency swaps	5,323	234	80	4,017	147	49
	11,539	378	94	7,929	231	65
<b>Interest Rate Related Contracts</b>						
Interest rate swaps	25,828	290	339	20,107	382	620
Forward rate agreements	312			354		1
Options	25			59		
	26,165	290	339	20,520	382	621
<b>Equity and Commodity Related Contracts</b>						
Options and swaps	218	2	68	174	2	
<b>Total Non Trading Derivatives</b>	<b>37,922</b>	<b>670</b>	<b>501</b>	<b>28,623</b>	<b>615</b>	<b>686</b>
	2000			1999		
	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million
<b>Trading</b>						
<b>Exchange Rate Related Contracts</b>						
Forward foreign exchange	16,814	317	314	20,489	336	324
Cross currency swaps	210	10		51	2	
Options	290	6	4	107	2	1
	17,314	333	318	20,647	340	325
<b>Interest Rate Related Contracts</b>						
Interest rate swaps	25,466	249	235	11,338	223	216
Forward rate agreements	775			1,168	1	1
Options	3,576	9	10	3,384	10	9
Futures	1,903		2	3,309	1	1
	31,720	258	247	19,199	235	227
<b>Equity and Commodity Related Contracts</b>						
Options and swaps	45	3	3			
<b>Total Trading Derivatives</b>	<b>49,079</b>	<b>594</b>	<b>568</b>	<b>39,846</b>	<b>575</b>	<b>552</b>
<b>Total Group Derivatives</b>	<b>87,001</b>	<b>1,264</b>	<b>1,069</b>	<b>68,469</b>	<b>1,190</b>	<b>1,238</b>



## Notes on the Accounts

### 34. Derivatives (continued)

	2000			1999		
	Notional Principal Amount £ million	Replace- ment Cost £ million	Risk Weighted Amount £ million	Notional Principal Amount £ million	Replace- ment Cost £ million	Risk Weighted Amount £ million
<b>Bank</b>						
<b>Exchange Rate Related Contracts</b>						
expiring within 1 year	641	10	5	586	8	4
between 1 and 5 years	21			50	1	1
after 5 years	98	10	4	89		1
	<b>760</b>	<b>20</b>	<b>9</b>	<b>725</b>	<b>9</b>	<b>6</b>
<b>Interest Rate Related Contracts</b>						
expiring within 1 year	1,330	34		32		
between 1 and 5 years	3,131	4	1	252	20	4
after 5 years	1,239	49	5	823	83	10
	<b>5,700</b>	<b>87</b>	<b>6</b>	<b>1,107</b>	<b>103</b>	<b>14</b>
<b>Equity and Commodity Related Contracts</b>						
expiring within 1 year	40	2	1			
between 1 and 5 years	178		3	174	2	3
	<b>218</b>	<b>2</b>	<b>4</b>	<b>174</b>	<b>2</b>	<b>3</b>
<b>Total Bank Derivatives</b>	<b>6,678</b>	<b>109</b>	<b>19</b>	<b>2,006</b>	<b>114</b>	<b>23</b>

The notional principal amounts and fair values of these derivatives are analysed below between non trading and trading activity. "Fair value" is the amount at which instruments could be exchanged in an arms length transaction.

	2000			1999		
	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million
<b>Non Trading</b>						
<b>Exchange Rate Related Contracts</b>						
Cross currency swaps	100	9		94		3
	<b>100</b>	<b>9</b>		<b>94</b>		<b>3</b>
<b>Interest Rate Related Contracts</b>						
Interest rate swaps	5,688	87	96	1,106	103	76
Options	12			1		
	<b>5,700</b>	<b>87</b>	<b>96</b>	<b>1,107</b>	<b>103</b>	<b>76</b>
<b>Equity and Commodity Related Contracts</b>						
Options and swaps	218	2	68	174	2	
<b>Total Non Trading Derivatives</b>	<b>6,018</b>	<b>98</b>	<b>164</b>	<b>1,375</b>	<b>105</b>	<b>79</b>



## Notes on the Accounts

### 34. Derivatives (continued)

	2000			1999		
	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million	Notional Principal Amount £ million	Year End Fair Values Asset £ million	Liability £ million
<b>Trading</b>						
<b>Exchange Rate Related Contracts</b>						
Forward foreign exchange	660	11	11	631	9	9
<b>Total Trading Derivatives</b>	<b>660</b>	<b>11</b>	<b>11</b>	<b>631</b>	<b>9</b>	<b>9</b>
<b>Total Bank Derivatives</b>	<b>6,678</b>	<b>109</b>	<b>175</b>	<b>2,006</b>	<b>114</b>	<b>88</b>

The Bank has no interest rate, equity or commodity contracts in the trading book.

#### 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		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
<b>Institutional</b>				
Financial Institutions	1,127	959	103	110
Non-financial Institutions	137	231	6	4
	<b>1,264</b>	<b>1,190</b>	<b>109</b>	<b>114</b>
<b>Geographical</b>				
UK	1,071	1,090	109	114
Australasia and Rest of World	193	100		
	<b>1,264</b>	<b>1,190</b>	<b>109</b>	<b>114</b>



## Notes on the Accounts

### 35. 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 34 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:

	2000				1999			
	Assets		Liabilities		Assets		Liabilities	
	Carrying Amount £ million	Fair Values £ million	Carrying Amount £ million	Fair Values £ million	Carrying Amount £ million	Fair Values £ million	Carrying Amount £ million	Fair Values £ million
<b>Group</b>								
<b>Non Trading</b>								
Debt securities	7,278	7,291			4,088	4,135		
Equity shares	96	241			61	162		
Debt securities in issue			24,224	24,195			16,700	16,785
Derivatives	286	670	129	501	228	615	143	686
<b>Total Non Trading</b>	<b>7,660</b>	<b>8,202</b>	<b>24,353</b>	<b>24,696</b>	<b>4,377</b>	<b>4,912</b>	<b>16,843</b>	<b>17,471</b>
<b>Trading</b>								
Debt securities	682	682			545	545		
Derivatives	594	594	568	568	575	575	552	552
<b>Total Trading</b>	<b>1,276</b>	<b>1,276</b>	<b>568</b>	<b>568</b>	<b>1,120</b>	<b>1,120</b>	<b>552</b>	<b>552</b>

The fair value of subordinated loan stock, inclusive of associated hedge instruments at £2,264 million (1999 – £1,770 million), is similar to book value.

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 29th February 2000.



## Notes on the Accounts

## 36. 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:

	Gains £ million	Losses £ million	Total Net Gains/(Losses) £ million
Unrecognised gains and losses on hedges at 1st March 1999	396	552	(156)
Gains and losses arising in previous years that were recognised in the year ended 29th February 2000	183	252	(69)
Gains and losses arising before 1st March 1999 that were not recognised in the year ended 29th February 2000	213	300	(87)
Gains and losses arising in the year ended 29th February 2000 that were not recognised in that year	209	110	99
Unrecognised gains and losses on hedges at 29th February 2000	422	410	12
of which:			
Gains and losses expected to be recognised in the year ended 28th February 2001	247	177	70
Gains and losses expected to be recognised after 28th February 2001	175	233	(58)



## Notes on the Accounts

### 37. Interest Rate Sensitivity Gap

The table below summarises the repricing profiles of the Group's non trading book as at 29th February 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
<b>Assets:</b>								
Treasury bills and other eligible bills	514	10						524
Loans and advances to banks	3,061	289	305	98	20	28	153	3,954
Loans and advances to customers	37,507	3,283	2,942	9,272	1,776	704	13	55,497
Debt securities and equity shares	2,827	951	3,204	68	109	215	682	8,056
Other assets	1					3,187	594	3,782
<b>Total assets</b>	<b>43,910</b>	<b>4,533</b>	<b>6,451</b>	<b>9,438</b>	<b>1,905</b>	<b>4,134</b>	<b>1,442</b>	<b>71,813</b>
<b>Liabilities:</b>								
Deposits by banks	5,848	547	1,446	10			73	7,924
Customer accounts	26,846	587	799	232	10	1,439	124	30,037
Debt securities in issue	20,589	1,541	1,383	637	74			24,224
Other liabilities	30	1	1	19	10	3,189	568	3,818
Subordinated liabilities	272	132	2	190	1,668			2,264
Minority interests and proprietors' funds						3,546		3,546
<b>Total liabilities</b>	<b>53,585</b>	<b>2,808</b>	<b>3,631</b>	<b>1,088</b>	<b>1,762</b>	<b>8,174</b>	<b>765</b>	<b>71,813</b>
On-balance sheet gap	(9,675)	1,725	2,820	8,350	143	(4,040)	677	
Non trading derivatives	1,125	451	1,466	(3,157)	115			
Net interest rate repricing gap 2000	(8,550)	2,176	4,286	5,193	258	(4,040)	677	
Cumulative gap 2000	(8,550)	(6,374)	(2,088)	3,105	3,363	(677)		

A description of interest rate risk is included on page 38 of the Operating and Financial Review.



## Notes on the Accounts

## 38. 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 40 of the Operating and Financial Review. The Group's trading market risk exposure for the year ended 29th February 2000 is analysed below.

	As at 29th February 2000 £ million	Twelve months to 29th February 2000		
		Average £ million	High £ million	Low £ million
Total Value at Risk	0.9	1.3	2.4	0.4

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

## 39. Structural 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.

Functional currency of the operation	Net investments in overseas operations £ million	2000		Remaining structural currency exposure £ million
		Borrowing taken out to hedge the net investments £ million		
US Dollar	37	11		26
Euro	49	44		5
Australian Dollar	246	159		87
Other	1			1
Total	333	214		119

## 40. Assets and Liabilities in Foreign Currencies

	Group		Bank	
	2000 £ million	1999 £ million	2000 £ million	1999 £ million
The aggregate amounts of assets and liabilities at 29th February 2000 denominated in currencies other than sterling were:				
Assets	16,371	14,339	5,127	3,772
Liabilities	24,314	19,186	3,868	3,410

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



## Notes on the Accounts

### 41. Other Contingent Liabilities

The Bank unconditionally and irrevocably guarantees due payment of all lawfully incurred present and future indebtedness and other obligations of its wholly-owned subsidiary undertakings Bank of Scotland Treasury Services PLC and BOS International (Australia) Limited.

### 42. Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2000 £ million	1999 £ million
Group operating profit	871	829
Increase in accrued income and prepayments	(40)	(23)
Increase in accruals and deferred income	14	90
Provision for bad and doubtful debts	317	268
Depreciation and amortisation	81	71
Amortisation of debt securities	15	
Revaluation surplus	(3)	
Interest on subordinated loans	150	138
Profits on sale of investment securities	(33)	(33)
Provisions for liabilities and charges	12	(6)
Provision against debt securities and equity shares	6	3
Exchange differences	34	30
Net cash inflow from trading activities	1,424	1,367
Net increase in notes in circulation	24	43
Net increase in items in course of collection	(129)	(10)
Net (increase)/decrease in treasury and other bills	(114)	481
Net increase in loans and advances to banks and customers	(8,093)	(7,421)
Net increase in deposits by banks and customer accounts	3,065	1,538
Net increase in debt securities in issue	7,524	4,978
Net (increase)/decrease in other debt securities	(137)	217
Net increase in other assets	(178)	(429)
Net increase in other liabilities	278	441
	2,240	(162)
Net cash inflow from operating activities	3,664	1,205





## Notes on the Accounts

## 43. Gross Cash Flows

	Notes	2000 £ million	1999 £ million
<b>(i) Returns on investments and servicing of finance</b>			
Interest paid on loan capital		(133)	(139)
Preference dividends paid		(37)	(37)
Dividends paid to minority shareholders in subsidiary undertakings		(14)	(16)
		<b>(184)</b>	<b>(192)</b>
<b>(ii) Capital expenditure and financial investment</b>			
Purchase of investment securities		(9,213)	(6,605)
Sale and maturity of investment securities		5,983	4,907
Purchase of property and equipment		(146)	(160)
Sale of property and equipment		36	24
		<b>(3,340)</b>	<b>(1,834)</b>
<b>(iii) Acquisitions and disposals</b>			
Investment in subsidiary undertakings		(112)	
Investment in associated undertakings, joint ventures and business interests		(29)	(30)
Disposal of associated undertakings, joint ventures, subsidiary undertakings and business interests			2
Minority interest acquired			2
		<b>(141)</b>	<b>(26)</b>
<b>(iv) Financing</b>			
Issue of ordinary stock	46	30	42
Issue of subordinated loan capital	46	478	
Repayments of subordinated loan capital	46	(1)	(2)
Contribution to Employee Share Trust		(18)	(19)
		<b>489</b>	<b>21</b>



## Notes on the Accounts

### 44. Acquisitions and Disposals

In August 1999, Bank of Scotland acquired 100% of the share capital of Smurfit Finance and Leasing Limited, a company based in Ireland. In October 1999, the Bank acquired 100% of the share capital of Hill Hire plc, a contract hire company based in the United Kingdom.

The profit attributable to Proprietors for the period since the dates of acquisition up to 29th February 2000 was £3 million. The cashflows generated in respect of the Group's net operating cashflow, paid in respect of net returns on investments and servicing of finance, paid in respect of taxation and utilised for capital expenditure and financial investment were not material. The net assets at date of acquisition were as follows:

	£ million
Loans and advances to banks and customers	204
Tangible fixed assets	11
Other assets, prepayments and accrued income	12
	227
Deposits by banks, customer accounts and debt securities in issue	174
Other liabilities, accruals and deferred income and other provisions	4
Deferred taxation	3
	181
Net assets acquired	46
Fair value adjustments	(6)
Goodwill	72
	112
Consideration	
Cash	112

In addition, £2 million of goodwill has arisen on acquisition of additional shares in Bank of Western Australia Ltd through the dividend reinvestment plan.

There were no material disposals in the year to 29th February 2000.



## Notes on the Accounts

## 44. Acquisitions and Disposals (continued)

In September 1998, Bank of Scotland disposed of 100% of the share capital of Countrywide Banking Corporation Limited. The profit attributable to Proprietors for the period up to the date of disposal was £7 million, and the cashflows generated £46 million of the Group's net operating cashflow, paid £3 million in respect of net returns on investments and servicing of finance, paid £3 million in respect of taxation and utilised £40 million for capital expenditure and financial investment. The net assets of Countrywide Banking Corporation Limited, converted at a rate of NZ\$3.24 to the £ at the date of disposal, were as follows:

	£ million
Treasury bills and other eligible bills	27
Loans and advances to banks and customers	2,224
Debt securities and equity shares	341
Shares in associated undertakings	2
Tangible fixed assets	31
Other assets, prepayments and accrued income	145
	2,770
Deposits by banks, customer accounts and debt securities in issue	2,607
Corporate taxation	1
Other liabilities, accruals and deferred income and other provisions	50
Deferred taxation	(2)
Subordinated liabilities	45
	2,701
Net assets disposed	69
Profit on disposal before tax	162
Goodwill written back	14
	245
Deferred consideration (less expenses)	248
Cash sold	(3)
	245

There were no other material disposals in the year to 28th February 1999. Gains on sale arising from discontinued operations also relate to the disposal of Registrar Services within the Clearing Bank and the part disposal of Haydock Finance Limited.

Bank of Scotland acquired the following companies in the year to 28th February 1999 but the net assets and liabilities were not material:

Tweed Premier 1 Plc	Ettrick Premier 1 Plc
Tweed Premier 2 Plc	Ettrick Premier 2 Plc
Tweed Premier 3 Plc	Ettrick Premier 3 Plc
Tweed Premier 4 Plc	Ettrick Premier 4 Plc
Tweed Premier 5 Plc	
Tweed Premier 6 Plc	

In addition Bank of Western Australia Ltd acquired a controlling interest in Terrace Counsellors Pty Ltd. The net assets and liabilities were not material.



## Notes on the Accounts

### 45. Analysis of the Balances of Cash as shown in the Balance Sheet

	As at 1st March 1999 £ million	Cashflow £ million	As at 29th February 2000 £ million	As at 1st March 1998 £ million	Cashflow £ million	As at 28th February 1999 £ million
Cash and balances at central banks	615	(28)	587	574	41	615
Loans and advances to other banks repayable on demand	373	76	449	1,531	(1,158)	373
	988	48	1,036	2,105	(1,117)	988

The Group maintains balances with the Bank of England which, at 29th February 2000, amounted to £488 million (1999 – £515 million).

### 46. Analysis of the Changes in Financing During the Year

	2000		1999	
	Share Capital (including Premium) £ million	Loan Capital £ million	Share Capital (including Premium) £ million	Loan Capital £ million
At 1st March 1999	988	1,770	946	1,788
Effect of foreign exchange differences		17		29
Proceeds of capital issues – ordinary stock	30		42	
Proceeds of loan capital issues		478		
Disposal of subsidiary undertaking				(45)
Repayments of loan capital		(1)		(2)
At 29th February 2000	1,018	2,264	988	1,770

### 47. Related Party Transactions

In the year ended 29th February 2000, 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 period were £20 million (1999 – £18 million), of which £4 million was outstanding at the year end (1999 – £5 million).

### 48. Principal Joint Ventures and Associated Undertakings

10. Principal Joint Ventures and Associated Undertakings						
	Nature of Business	Issued Share and Loan Capital		Bank's Interest	Accounts Made up to	Principal Area of Operations
<i>Registered in England</i>						
Joint Ventures:						
Automobile Association Financial Services Limited	Finance	ordinary loan	£3,000,000 £4,500,000	50.0%* 50.0%*	December 1999	UK
NFU Mutual Finance Limited	Finance	ordinary	£500,002	50.0%*	December 1999	UK
RFS Limited	Finance	ordinary	£6,000,006	50.0%*	December 1999	UK
Associated Undertaking:						
Sainsbury's Bank plc	Banking	ordinary	£130,000,000	45.0%	February 2000	UK
* Held by subsidiary undertakings.						



## Notes on the Accounts

## 49. Principal Subsidiary Undertakings

	Bank's Interest in Ordinary Share Capital and Voting Rights	Principal Business	Country of Incorporation
CAPITAL BANK plc	100%*	Personal finance and banking services	UK
and subsidiaries, including			
Capital Finance Australia Limited	100%	Finance	Australia
Bank of Scotland (Ireland) Limited (formerly Equity Bank Limited)	100%	Banking	Ireland
Forthright Finance Limited	100%	Finance	UK
Godfrey Davis (Contract Hire) Limited	100%	Contract hire	UK
Inchcape Financial Services Limited	51%	Finance	UK
International Motors Finance Limited	51%	Finance	UK
Capital Bank Cashflow Finance Limited	100%†	Debt factoring	UK
British Linen Asset Finance Limited	100%	Asset finance	UK
St Andrew's Group plc	100%†	Insurance	UK
Bank of Wales PLC	100%	Banking	UK
Bank of Western Australia Ltd	55.4%†	Banking	Australia
Bank of Scotland Treasury Services PLC	100%	Banking	UK
Bank of Scotland Independent Financial Advisers Limited	100%	Financial advisers	UK
Bank of Scotland Offshore Limited	100%	Banking	Jersey
Bank of Scotland Trust Company (International) Limited	100%	Trust company	Jersey
BOS International (Australia) Limited	100%	Commercial deposits	Australia
Uberior Investments PLC	100%	Investment	UK
First Banking Systems Limited	51%	Computer related services	UK
Hill Hire plc	100%	Contract hire	UK
Horizon Capital Limited	100%	Property	UK

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

† Held by a subsidiary undertaking.

## 50. Approval of Accounts

The accounts, which have been prepared under the Bank Accounts Directive (Miscellaneous Banks) Regulations 1991 and comply with Part VII of the Companies Act 1985, were approved by the Directors on 25th April 2000.



## Appendix to Directors' Report

### (i) Directors' Interests in Bank Stock

	Interests at 29th February and 25th April 2000		Interests at 1st March 1999	
	Ordinary Stock units of 25p each Beneficial	Non-beneficial	Ordinary Stock units of 25p each Beneficial	Non-beneficial
Sir John Shaw	109,833		106,695	
Sir Bob Reid	22,705		22,368	
Peter A Burt	302,158		301,240	
Gavin G Masterton	299,005		293,745	
John A Mercer	34,016		32,662	
Sir Ronald Garrick	2,000*			
Allan G Gormly	6,936	1,440	6,936	1,440
Sir Alistair Grant	49,664		48,927	
Sir Russell Hillhouse	1,209		1,200	
Ian B Inglis	7,500		7,500	
Brian G Ivory	10,000	18,000	10,000	18,000
Lesley M S Knox	1,759		1,733	
John N Maclean	5,000		5,000	
James Miller	17,525	10,165	17,650	9,815
Angus M Pelham Burn	108,649	11,310	116,649	11,310
Sir Robert Smith	5,500		5,500	

At 1st March 1999, 29th February 2000 and 25th April 2000 Mr Allan Gormly had a beneficial interest in 60,669 £1 units of the Bank's 9<sup>3</sup>/<sub>4</sub>% Non-Cumulative Irredeemable Preference Stock.

No Director had an interest in any of the Group's Loan Stocks or in the shares in any of the Bank's subsidiary undertakings at any time in the period 1st March 1999 to 25th April 2000.

\* At 1st March 2000 (date of appointment) and 25th April 2000.



## Appendix to Directors' Report

**(ii) Stock Options held by Directors in respect of Ordinary Stock units of 25p each****(a) Executive Stock Options**

	Date Options granted	Options held as at 1st March 1999	Options exercised	Options held as at 29th Feb and 25th April 2000	Options exercise price per stock unit (p)	Options* exercisable
Peter A Burt	2.11.93	90,000		90,000	188.50	2000-2003
	1.11.94	90,000		90,000	201.50	2000-2004
	17.10.95	72,000		72,000	259.83	2000-2005
	21.10.96	90,000		90,000	273.67	2000-2006
	17.10.97	53,000		53,000	535.33	2000-2007
	19.10.98	60,000		60,000	583.50	2001-2008
		455,000		455,000		
Gavin G Masterton	2.11.93	75,000		75,000	188.50	2000-2003
	1.11.94	75,000		75,000	201.50	2000-2004
	17.10.95	60,000		60,000	259.83	2000-2005
	21.10.96	70,000		70,000	273.67	2000-2006
	17.10.97	42,000		42,000	535.33	2000-2007
	19.10.98	50,000		50,000	583.50	2001-2008
		372,000		372,000		
John A Mercer	17.10.95	60,000	60,000		259.83	
	21.10.96	59,500		59,500	273.67	2000-2006
		119,500	60,000	59,500		

Options granted in 1995 and subsequently are subject to a performance pre-condition on exercise, as detailed in the Remuneration Report on page 47. No executive stock options were granted to Directors in the period 1st March 1999 to 25th April 2000. Mr John Mercer exercised 60,000 executive stock options on 22nd April 1999. The market price of the Bank's Ordinary Stock units on 22nd April 1999 was 921.5p and Mr Mercer's potential pre-tax gain at that date was therefore £397,000. No Directors' executive stock options lapsed in the period 1st March 1999 to 25th April 2000 and, in respect of Mr Peter Burt and Mr Gavin Masterton, no such options were exercised in that period. The closing market price of the Bank's Ordinary Stock at 29th February 2000 was 565p per Ordinary Stock unit and the range during the year was 505.5p to 933.5p.

**(b) Savings-Related Stock Options**

	Date Options granted	Options held as at 1st March 1999	Options held as at 29th Feb and 25th April 2000	Options exercise price per stock unit (p)	Options* exercisable
Gavin G Masterton	2.11.93	3,161	3,161	150.80	2000-2001
		3,161	3,161		
John A Mercer	7.11.95	4,495	4,495	207.86	2000-2001
	5.11.96	2,273	2,273	218.93	2003-2004
	4.11.97	370	370	428.27	2000-2001
	3.11.98	63	63	459.47	2001-2002
		7,201	7,201		

\* Reflects the final exercise date under the rules of the respective Schemes. Retirement may advance the final exercise date.



## Appendix to Directors' Report

### (iii) Directors' Emoluments

	Governors			Deputy Governor	Executive Directors			Total Year to 29th Feb 2000	Total Year to 28th Feb 1999
	Sir John Shaw £000	Sir Alistair Grant £000	Sir Bruce Pattullo £000	Sir Bob Reid £000	Peter A Burt £000	Gavin G Masterton £000	John A Mercer £000	£000	£000
Salary/Remuneration	171	63		123	377	306	263	1,303	969
Fees as Director of the Bank	20	20		20	20	20	20	120	99
	191	83		143	397	326	283	1,423	1,068
Benefits	8	4			13	7	18	50	35
Bonus					120	100	80	300	220
Profit Sharing					65	53	45	163	82
	199	87		143	595	486	426	1,936	1,405
1999	137	164	94†	120	486	404			

  

	Fees as Director of the Bank £000	Fees from other Group boards and committees £000	Total Year to 29th Feb 2000 £000	Total Year to 28th Feb 1999 £000
Allan G Gormly	20	20	40	32
Sir Russell Hillhouse	20	9	29	6*
Ian B Inglis	20	27	47	39
Brian G Ivory	20	11	31	19
Lesley M S Knox#	20	21	41	33
John N Maclean	20	45	65	44
James Miller	20	14	34	47
Angus M Pelham Burn	20	24	44	36
Sir Robert Smith	20	5	25	6*
Sir Alick Rankin	8		8†	19
Lord Macdonald of Tradeston				1*†
Roger Young				18†
	188	176	364	300
1999	181	119		
			2,300	1,705

\* From date of appointment.

† Until date of leaving Board.

# In addition to being a non-executive Director of the Bank, up to 31st December 1999 Mrs Lesley Knox had certain executive responsibilities at The British Linen Bank Limited in respect of which she received remuneration (inclusive of fees) of £109,375 and benefits of £7,389 in the period from 1st March 1999 to 31st December 1999 (1999 – remuneration £127,597 and benefits £8,867). These amounts are not reflected in the above table.

The salaries of the executive Directors and the remuneration of the Governors and the Deputy Governor include fees paid in respect of membership of other Group boards and committees. Benefits comprise taxable benefits in kind relating mainly to the provision of motor vehicles, medical insurance and preferential interest rates on certain borrowings.

The potential pre-tax gains made by Directors on the exercise of share options in the year are disclosed on page 49.





## Appendix to Directors' Report

**(iv) Directors' Pension Entitlements**

	Additional pension earned in year to 29th February 2000 £000 pa	Accrued pension entitlement at 29th February 2000 £000 pa	Transfer value of additional pension earned in year to 29th February 2000 £000	Accrued pension entitlement at 28th February 1999 £000 pa
Peter A Burt	46	188	817	140
Gavin G Masterton	43	216	585	171
John A Mercer	45	189	815	139*
Sir John Shaw	10	53	133	43
Lesley M S Knox	2	6	28	4

\* At 1st March 1999 (date of appointment)

The additional pension earned in the year to 29th February 2000 excludes adjustment for inflation on the accrued pension entitlement at the start of the year. The transfer value of the additional pension earned in the year to 29th February 2000 is a measure of the capital cost of providing future pension payments, calculated in accordance with actuarial advice, and is not a sum paid or due to the individual.

**(v) Group Management Board Interests**

The members of the Group Management Board as at 1st May 2000 had the following beneficial interests in the Bank's Stock:

	Interests at 25th April 2000 in Ordinary Stock units of 25p each		
	Beneficial	Executive stock options	Savings-Related stock options
Roy Littler	39,541	108,500	9,099
W Gordon McQueen	52,731	160,000	
Colin Matthew	37,408	161,000	
Robert Mee	62,056	55,000	7,355
George E Mitchell	30,410	125,000	

The interests of Mr Peter Burt, Mr Gavin Masterton and Mr John Mercer are shown at (i) and (ii) above.

Executive stock options are exercisable between 2000 and 2008 at prices ranging from 188.50p to 583.50p per Ordinary Stock unit. Savings-Related stock options are exercisable between 2000 and 2004 at prices ranging from 150.80p to 459.47p per Ordinary Stock unit.

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