



**Bank of Scotland plc**

*(Incorporated with limited liability in Scotland with registered number SC 327000)*

**€60 billion Covered Bond Programme unconditionally guaranteed by  
HBOS plc**

*(incorporated with limited liability in Scotland with registered number SC218813)*

and

**unconditionally and irrevocably guaranteed as to payments of interest and principal by  
HBOS Covered Bonds LLP**

*(a limited liability partnership incorporated in England and Wales)*

Under this €60 billion covered bond programme (the "**Programme**"), Bank of Scotland plc (the "**Issuer**") may from time to time issue bonds (the "**Covered Bonds**") denominated in any currency agreed between the Issuer and the relevant Dealer(s) (as defined below).

The payments of all amounts due in respect of the Covered Bonds have been unconditionally guaranteed by HBOS plc ("**HBOS**" in its capacity as guarantor, the "**HBOS Group Guarantor**"). HBOS Covered Bonds LLP (the "**LLP**") and, together with the HBOS Group Guarantor, the "**Guarantors**") has guaranteed payments of interest and principal under the Covered Bonds pursuant to a guarantee which is secured over the Portfolio (as defined below) and its other assets. Recourse against the LLP under its guarantee is limited to the Portfolio and such assets.

The Covered Bonds may be issued in bearer or registered form (respectively "**Bearer Covered Bonds**" and "**Registered Covered Bonds**"). The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed €60 billion (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.

The Covered Bonds may be issued on a continuing basis to one or more of the Dealers specified under General Description of the Programme and any additional Dealer appointed under the Programme from time to time by the Issuer (each a "**Dealer**" and together the "**Dealers**"), which appointment may be for a specific issue or on an ongoing basis. References in this Offering Circular to the "**relevant Dealer(s)**" shall, in the case of an issue of Covered Bonds being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to subscribe such Covered Bonds.

**An investment in Covered Bonds issued under the Programme involves certain risks.** See *Risk Factors* for a discussion of certain factors to be considered in connection with an investment in Covered Bonds.

The Covered Bonds and the guarantees in respect of the Covered Bonds have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the "**Securities Act**"), and may not be offered or sold in the United States or to, or for the benefit of, U.S. persons unless such securities are registered under the Securities Act or pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. See *Form of the Covered Bonds* for a description of the manner in which Covered Bonds will be issued. Registered Covered Bonds are subject to certain restrictions on transfer, see *Subscription and Sale and Transfer and Selling Restrictions*.

Application has been made to the Commission de Surveillance du Secteur Financier (the "**CSSF**") in its capacity as competent authority under the Luxembourg Act dated 10 July 2005 on prospectuses for securities to approve this offering circular as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for Covered Bonds issued under the Programme to be admitted to trading on the Bourse de Luxembourg, which is the Luxembourg Stock Exchange's regulated market (the "**Luxembourg Stock Exchange's regulated market**") and to be listed on the Official List of the Luxembourg Stock Exchange.

References in this Offering Circular to Covered Bonds being "**listed**" and all related references shall mean that such Covered Bonds are intended to be admitted to trading on the Luxembourg Stock Exchange's regulated market and have been listed on the Official List of the Luxembourg Stock Exchange.

The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of the markets in financial instruments directive (Directive 2004/39/EC ("**MiFID**")).

The Issuer has been admitted by the Financial Services Authority (the "**FSA**") to the register of issuers and the Programme and the Covered Bonds previously issued under the Programme have been admitted by the FSA to the register of regulated covered bonds under the Regulated Covered Bonds Regulations 2008 (SI 2008/346) as amended by the Regulated Covered Bonds (Amendment) Regulations 2008 (SI 2008/1714) (the "**RCB Regulations**").

Notice of the aggregate nominal amount of Covered Bonds, interest (if any) payable in respect of Covered Bonds, the issue price of Covered Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under Terms and Conditions of the Covered Bonds) of Covered Bonds will be set out in a final terms document (the "**Final Terms**") which, with respect to Covered Bonds to be listed on the Luxembourg Stock Exchange, will be filed with the CSSF.

The Programme provides that Covered Bonds may be listed and/or admitted to trading, as the case may be, on such other or further stock exchange(s) or markets as may be agreed between the Issuer, the Guarantors, the Bond Trustee (as defined herein), the Security Trustee (as defined herein) and the relevant Dealer(s). The Issuer may also issue unlisted Covered Bonds and/or Covered Bonds not admitted to trading on any market provided that the terms of any such issue are made available to all holders of listed Covered Bonds.

The Issuer and the Guarantors may agree with any Dealer and the Bond Trustee that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered Bonds herein, in which event a supplement to the Offering Circular, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Covered Bonds.

**Arranger for the Programme  
Lloyds TSB Corporate Markets**

The date of this Offering Circular is 10 March 2010.

This document comprises a base prospectus for the purposes of Article 5.4 of Directive 2003/71/EC (the “Prospectus Directive”) but is not a prospectus for the purposes of Section 12(a)(2) or any other provision of or rule under the Securities Act.

The Issuer and the Guarantors (the “Responsible Persons”) accept responsibility for the information contained in this offering circular (the “Offering Circular”). To the best of the knowledge of the Issuer and the Guarantors (each having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Issuer has been admitted by the FSA to the register of issuers and the Programme and all Covered Bonds previously issued under the Programme have been admitted by the FSA to the register of regulated covered bonds under the RCB Regulations. This Offering Circular is to be read in conjunction with all documents which are incorporated herein by reference (see *Documents Incorporated by Reference*). This Offering Circular shall be read and construed on the basis that such documents are incorporated and form part of this Offering Circular.

The information contained in this Offering Circular was obtained from the Issuer and other sources, but no assurance can be given by the Dealers, the Bond Trustee or the Security Trustee as to the accuracy or completeness of such information. None of the Dealers, the Bond Trustee or the Security Trustee makes any representation, express or implied, or accepts any responsibility, with respect to the accuracy or completeness of any of the information contained or incorporated in this Offering Circular. Neither the Dealers nor the Bond Trustee nor the Security Trustee accepts any liability in relation to the information contained or incorporated by reference in this Offering Circular or any other information provided by the Issuer and the Guarantors in connection with the Programme.

No person is or has been authorised by the Issuer, the Guarantors, any of the Dealers, the Bond Trustee or the Security Trustee to give any information or to make any representation not contained in or not consistent with this Offering Circular or any other information supplied in connection with the Programme or the Covered Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the Guarantors, any of the Dealers, the Bond Trustee or the Security Trustee.

Neither this Offering Circular nor any other information supplied in connection with the Programme or any Covered Bonds (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Issuer, the Guarantors, the Sellers (as defined below), any of the Dealers, the Bond Trustee or the Security Trustee that any recipient of this Offering Circular or any other information supplied in connection with the Programme or any Covered Bonds should purchase any Covered Bonds. Each investor contemplating purchasing any Covered Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer and/or the Guarantors. Neither this Offering Circular nor any other information supplied in connection with the Programme or the issue of any Covered Bonds constitutes an offer or invitation by or on behalf of the Issuer, the Guarantors, the Sellers, any of the Dealers, the Bond Trustee or the Security Trustee to any person to subscribe for or to purchase any Covered Bonds.

Neither the delivery of this Offering Circular nor the offering, sale or delivery of any Covered Bonds shall in any circumstances imply that the information contained herein concerning the Issuer and/or HBOS and/or the LLP and/or the Sellers is correct at any time subsequent to the date hereof or that any other information supplied in connection with the

Programme is correct as of any time subsequent to the date indicated in the document containing the same. The Dealers, the Bond Trustee and the Security Trustee expressly do not undertake to review the financial condition or affairs of the Issuer, the Guarantors or the Sellers during the life of the Programme or to advise any investor in the Covered Bonds of any information coming to their attention. Investors should review, *inter alia*, the most recently published documents incorporated by reference into this Offering Circular when deciding whether or not to purchase any Covered Bonds.

This Offering Circular does not constitute an offer to sell or the solicitation of an offer to buy any Covered Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Offering Circular and the offer or sale of Covered Bonds may be restricted by law in certain jurisdictions. The Issuer, the Guarantors, the Sellers, the Dealers, the Bond Trustee and the Security Trustee do not represent that this Offering Circular may be lawfully distributed, or that any Covered Bonds 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, the Guarantors, the Sellers, the Dealers, the Bond Trustee or the Security Trustee which would permit a public offering of any Covered Bonds outside the Grand Duchy of Luxembourg or distribution of this Offering Circular in any jurisdiction where action for that purpose is required. Accordingly, no Covered Bonds may be offered or sold, directly or indirectly, and neither this Offering Circular 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 Circular or any Covered Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Offering Circular and the offering and sale of Covered Bonds. In particular, there are restrictions on the distribution of this Offering Circular and the offer or sale of Covered Bonds in the United States, the European Economic Area (including the United Kingdom and The Netherlands) and Japan, see *Subscription and Sale and Transfer and Selling Restrictions*.

The Covered Bonds and the guarantees from the Guarantors in respect thereof have not been and will not be registered under the Securities Act. The Covered Bonds in bearer form are subject to U.S. tax law requirements and, subject to certain exceptions may not be offered, sold or delivered within the United States or to U.S. persons.

In this Offering Circular, references to “UK”, “U.K.” and “United Kingdom” are used interchangeably; references to “£”, “sterling”, “pounds sterling” and “pence” are to the lawful currency of the United Kingdom; references to “U.S.\$”, “\$”, “U.S. dollars” and “cents” are to the lawful currency of the United States; references to “€” or “euro” are to the currency established for participating members of the European Union as of the beginning of stage three of European Monetary Union on 1 January 1999; and references to “¥” or “Yen” are to the lawful currency of Japan. Merely for convenience, this Offering Circular contains translations of certain sterling amounts into U.S. dollars at specified rates. These translations should not be construed as representations that the sterling amounts actually represent such U.S. dollar amounts or could be converted into U.S. dollars at the rate indicated. See *Exchange Rate and Currency Information*.

In connection with the issue of any Tranche of Covered Bonds, the Dealer or Dealers (if any) named as the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Final Terms may over-allot Covered Bonds (provided that, in the case of any Tranche of Covered Bonds to be admitted to trading on a regulated market in the European Economic Area, the aggregate principal amount of Covered Bonds allotted does not exceed 105 per cent. of the aggregate principal amount of the relevant Tranche) or effect transactions with a view to supporting the market

price of the Covered Bonds at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the final terms of the offer of the relevant Tranche of Covered Bonds is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Covered Bonds and 60 days after the date of the allotment of the relevant Tranche of Covered Bonds.

Any stabilisation action or over-allotment must be conducted by the relevant stabilising manager(s) (or persons acting on behalf of any stabilising manager(s)) in accordance with all applicable laws and rules.

**In making an investment decision, investors must rely on their own examination of the Issuer and the Guarantors and the terms of the Covered Bonds being offered, including the merits and risks involved. The Covered Bonds have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities approved this Offering Circular or confirmed the accuracy or determined the adequacy of the information contained in this Offering Circular. Any representation to the contrary is unlawful.**

None of the Dealers, the Issuer or the Guarantors makes any representation to any investor in the Covered Bonds regarding the legality of its investment under any applicable laws. Any investor in the Covered Bonds should be able to bear the economic risk of an investment in the Covered Bonds for an indefinite period of time.

#### U.S. INFORMATION

This Offering Circular may be distributed on a confidential basis in the United States to a limited number of “qualified institutional buyers” within the meaning of Rule 144A under the Securities Act (“QIBs”) or institutional “accredited investors” as defined in Rule 501(a)(1), (2), (3) or (7) of Regulation D under the Securities Act (“Institutional Accredited Investors”) in connection with the consideration of the purchase of the Covered Bonds being offered hereby. Its use for any other purpose in the United States is not authorised. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Registered Covered Bonds may be offered or sold within the United States only to QIBs or Institutional Accredited Investors, in either case in transactions exempt from registration under the Securities Act. Each U.S. purchaser of Registered Covered Bonds is hereby notified that the offer and sale of any Registered Covered Bonds to it may be being made in reliance upon the exemption from the registration requirements of the Securities Act provided by Rule 144A under the Securities Act (“Rule 144A”).

Purchasers of Definitive IAI Registered Covered Bonds (as defined under *Form of the Covered Bonds*) will be required to execute and deliver an IAI Investment Letter (as defined under *Form of the Covered Bonds*). Each purchaser or holder of IAI Registered Covered Bonds (as defined under *Form of the Covered Bonds*), Covered Bonds represented by a Rule 144A Global Covered Bond (as defined under *Form of the Covered Bonds*) or any Covered Bonds issued in registered form in exchange or substitution therefor (together “Legended Covered Bonds”) will be deemed, by its acceptance or purchase of any such Legended Covered Bonds, to have made certain representations and agreements intended to restrict the resale or other transfer of such Covered Bonds as set out in *Subscription and Sale and Transfer and Selling*

**Restrictions.** Unless otherwise stated, terms used in this paragraph have the meanings given to them in *Form of the Covered Bonds*.

#### **NOTICE TO NEW HAMPSHIRE RESIDENTS**

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

#### **AVAILABLE INFORMATION**

**To permit compliance with Rule 144A in connection with any resales or other transfers of Covered Bonds that are “restricted securities” within the meaning of the Securities Act, the Issuer and Guarantors have undertaken in a deed poll dated 29 April 2008 (the “Deed Poll”) to furnish, upon the request of a holder of such Covered Bonds or any beneficial interest therein, to such holder or to a prospective purchaser designated by him, the information required to be delivered under Rule 144A(d)(4) under the Securities Act if, at the time of the request, the Issuer is neither a reporting company under Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”), nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder.**

Notwithstanding anything herein to the contrary, investors (and each employee, representative or other agent of the investors) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the offering and all materials of any kind (including opinions or other tax analyses) that are provided to the investors relating to such tax treatment and tax structure (as such terms are defined in Treasury Regulation Section 1.6011-4). This authorisation of tax disclosure is retroactively effective to the commencement of discussions between the Issuer, the Dealers or their respective representatives and a prospective investor regarding the transactions contemplated herein.

## FORWARD-LOOKING STATEMENTS

This Offering Circular contains various forward-looking statements regarding events and trends that are subject to risks and uncertainties that could cause the actual results and financial position of HBOS or HBOS and its consolidated subsidiaries and subsidiary undertakings (collectively, the “**HBOS Group**” or the “**Group**”) to differ materially from the information presented herein. When used in this Offering Circular, the words “estimate”, “project”, “intend”, “anticipate”, “believe”, “expect”, “should” and similar expressions, as they relate to the Group and its management, are intended to identify such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Group does not undertake any obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

## SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

**The Issuer is a corporation organised under the laws of Scotland, the LLP is a limited liability partnership organised under the laws of England and Wales and the HBOS Group Guarantor is a corporation organised under the laws of Scotland. All of the officers and directors named herein reside outside the United States and all or a substantial portion of the assets of the Issuer and of such officers and directors are located outside the United States. As a result, it may not be possible for investors to effect service of process outside England or Scotland (as applicable) upon the Issuer, the LLP, the HBOS Group Guarantor or such persons, or to enforce judgments against them obtained in courts outside England or Scotland (as applicable) predicated upon civil liabilities of the Issuer or such directors and officers under laws other than English or Scots law (as applicable), including any judgment predicated upon United States federal securities laws. The Issuer has been advised by Allen & Overy LLP, its counsel, that there is doubt as to the enforceability in England and Wales in original actions or in actions for enforcement of judgments of United States courts of civil liabilities predicated solely upon the federal securities laws of the United States.**

## PRESENTATION OF FINANCIAL INFORMATION

The consolidated annual financial statements of HBOS for the years ended 31 December 2008 and 31 December 2007 were prepared in accordance with International Financial Reporting Standards as adopted by the EU (“**IFRS**”). IFRS relevant to the Group differs from generally accepted accounting principles in the United States (“**U.S. GAAP**”) in certain material aspects. In addition, the audited financial information incorporated by reference herein is subject to auditing and auditor independence standards applicable in the United Kingdom, which differ from those applicable in the United States.

Unless otherwise indicated, any reference in this Offering Circular to the *IFRS Financial Statements* is to the audited Consolidated Financial Statements (including the notes thereto) of the Group incorporated by reference in this Offering Circular.

For the purposes of the presentation of financial information in the sections entitled *Summary of Terms* and *HBOS*, the term “**Group**” refers to HBOS plc together with its consolidated subsidiaries and subsidiary undertakings (including, among others, Bank of Scotland plc).

In this Offering Circular, all references to “**billions**” are references to one thousand millions. Due to rounding, the numbers presented throughout this Offering Circular may not add up precisely, and percentages may not precisely reflect absolute figures.

Certain financial and statistical information in this Offering Circular is presented separately for domestic and foreign activities. Foreign activities include transactions in which the debtor or customer is domiciled outside the United Kingdom. For the purposes of such financial and statistical information, the United Kingdom includes the Channel Islands and the Isle of Man.

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## PRINCIPAL CHARACTERISTICS OF THE PROGRAMME

<b>Issuer:</b>	Bank of Scotland plc
<b>Guarantors:</b>	HBOS plc and HBOS Covered Bonds LLP
<b>Regulated Covered Bonds:</b>	The Issuer, the Programme and all Covered Bonds previously issued under the Programme have been registered under the RCB Regulations
<b>Nature of eligible property:</b>	Residential mortgage loans, Substitution Assets up to the prescribed limit and Authorised Investments
<b>Compliant with the Banking Consolidation Directive (Directive 2006/48/EC):<sup>1</sup></b>	Yes
<b>Location of eligible residential property underlying Mortgage Loans:</b>	England, Wales or Scotland
<b>Maximum Loan to Value Ratio given credit under the Asset Coverage Test:</b>	60 per cent.
<b>Maximum Asset Percentage:</b>	92.5 per cent.
<b>Asset Coverage Test:</b>	As set out on page 212
<b>Amortisation Test:</b>	As set out on page 215
<b>Hard Bullet Maturities:</b>	Available
<b>Asset Monitor:</b>	KPMG Audit Plc
<b>Asset Segregation:</b>	Yes
<b>Extended Maturities:</b>	No
<b>Namenschuldverschreibungen option:</b>	No

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<sup>1</sup> The Programme is intended to be compliant with the Banking Consolidation Directive now that the Issuer has been accepted to the register of issuers and the Programme and any Covered Bonds previously issued under the Programme have been admitted to the register of regulated covered bonds under the RCB Regulations.

## DOCUMENTS INCORPORATED BY REFERENCE

The following documents which have previously been published and have been filed with the CSSF shall, unless otherwise stated, be incorporated by reference herein, and form part of, this Offering Circular:

- 1.1 the audited consolidated and non-consolidated annual financial statements of the Issuer for each of the financial years ended 31 December 2007 and 31 December 2008, in each case, together with the audit report thereon, as set out on pages 32 to 89 of the Issuer's Annual Report and Accounts for the financial year ended 31 December 2007 (the "**Issuer's 2007 Annual Report**") and on pages 32 to 110 of the Issuer's Annual Report and Accounts for the financial year ended 31 December 2008 (the "**Issuer's 2008 Annual Report**");
- 1.2 the interim management report of the Issuer for the half-year to 30 June 2009;
- 1.3 the Issuer's Results Announcement for the year ended 31 December 2009 (the "**Issuer's 2009 Results Announcement**");
- 1.4 the audited consolidated and non-consolidated annual financial statements of the HBOS Group Guarantor for each of the financial years ended 31 December 2007 and 31 December 2008, in each case, together with the audit report thereon, as set out on pages 151 to 224 of the HBOS Group Guarantor's Annual Report and Accounts 2007 (the "**HBOS Group Guarantor's 2007 Annual Report**") and on pages 40 to 140 of the HBOS Group Guarantor's Annual Report and Accounts 2008 (the "**HBOS Group Guarantor's 2008 Annual Report**");
- 1.5 the interim management report of the HBOS Group Guarantor for the half-year to 30 June 2009;
- 1.6 the HBOS Group Guarantor's Results Announcement for the year ended 31 December 2009 (the "**HBOS Group Guarantor's 2009 Results Announcement**");
- 1.7 the Members' Report and Financial Statements and the audited consolidated and non-consolidated annual financial statements for each of the financial years ended 31 December 2007 and 31 December 2008 of the LLP;
- 1.8 the section titled "Risk Management" as set out in each of pages 8 to 19 in the Issuer's 2007 Annual Report, pages 11 to 28 of the Issuer's 2008 Annual Report, pages 85 to 104 of the HBOS Group Guarantor's 2007 Annual Report and pages 13 to 33 of the HBOS Group Guarantor's 2008 Annual Report; and
- 1.9 the first sentence of the fourth complete paragraph on page 17 of Lloyds Banking Group plc's 2009 Results News Release for the year ended 31 December 2009.

The audited consolidated financial statements referred to in paragraphs 1.1 and 1.4 above are collectively referred to herein as the "**Consolidated Financial Statements**".

Any information not listed in the cross reference lists below, but which is contained in a document incorporated by reference, is given for information purposes only.

Following the publication of this Offering Circular a supplement may be prepared by the Issuer and approved by the CSSF in accordance with Article 16 of the Prospectus Directive. Statements contained in any such supplement to the Offering Circular (or contained in any document

incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or otherwise), modify or supersede statements contained in this Offering Circular or in a document which is incorporated by reference in this Offering Circular. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Offering Circular.

The Issuer and the Guarantors will provide, without charge, to each person to whom a copy of this Offering Circular has been delivered, upon the request of such person, a copy of any or all of the documents deemed to be incorporated herein by reference unless such documents have been modified or superseded as specified above. Requests for such documents should be directed either to the Issuer, the HBOS Group Guarantor or the LLP, at their respective registered offices set out at the end of this Offering Circular and such documents will also be published on the website of the Luxembourg Stock Exchange ([www.bourse.lu](http://www.bourse.lu)). In addition, such documents will be available upon request from the principal office of The Bank of New York Mellon (Luxembourg) S.A. in Luxembourg.

The Issuer and the Guarantors will, in the event of any significant new factor, material mistake or inaccuracy relating to information included or incorporated by reference in this Offering Circular which is capable of affecting the assessment of any Covered Bonds, prepare a supplement to this Offering Circular or publish a new offering circular for use in connection with any subsequent issue of Covered Bonds.

## Cross Reference List

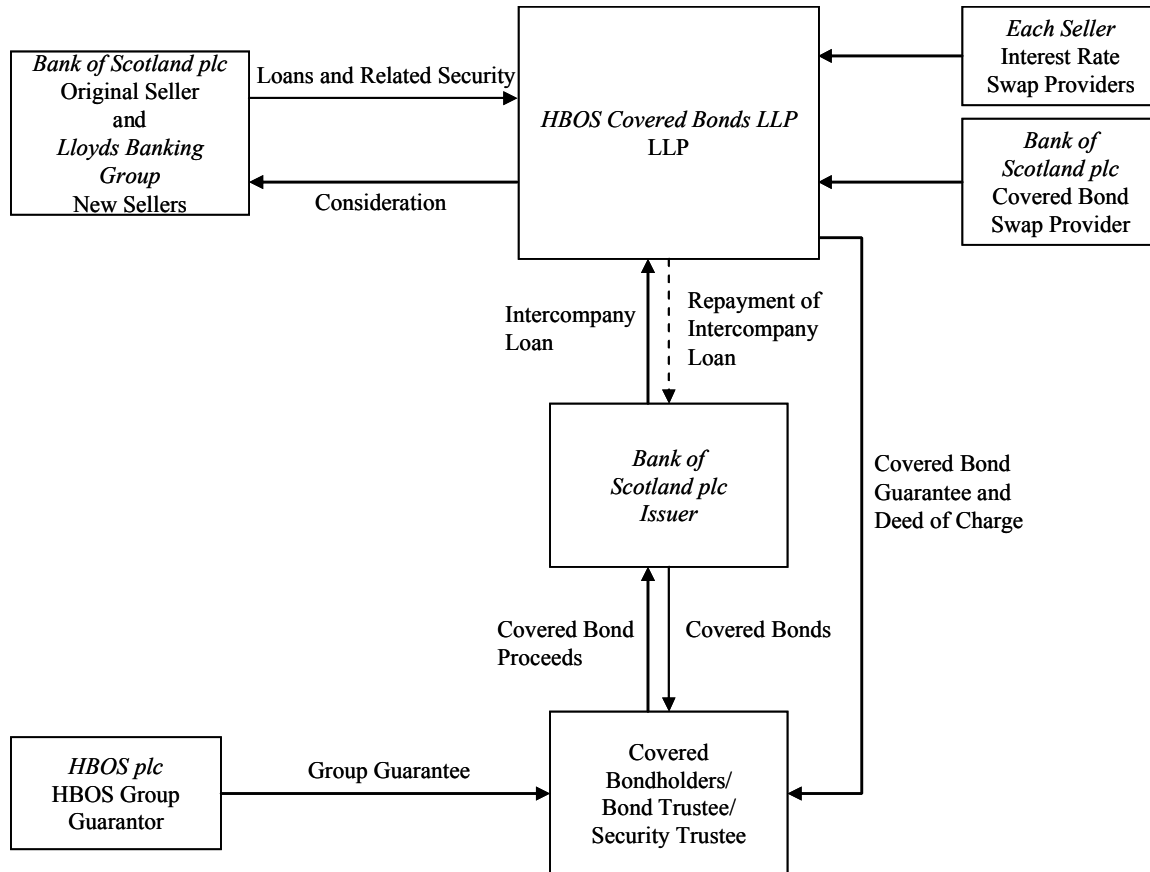
<i>IFRS Financial Statement Commission Regulation (EC) No. 809/2004, Annex IX, 11.1</i>	<b>Annual Report 2007</b>	<b>Annual Report 2008</b>	<b>Results Announcement 2009</b>
<i>HBOS plc</i>			
Consolidated Balance Sheet .....	Pages 154-155	Page 42	Page 9
Consolidated Income Statement .....	Page 153	Page 41	Page 7
Consolidated Statement of Recognised income and Expense .....	Page 156	Page 44	Not applicable
Consolidated Cash Flow Statement .....	Pages 156-157	Page 44	Page 12
Company Balance Sheet, Statement of recognised Income and Expense and Cash Flow Statement .....	Pages 158-159	Pages 46-47	Not applicable
Accounting Policies and Explanatory Notes .....	Pages 160-223*	Pages 48-140*	Pages 13-40*
Statement of Directors' responsibilities .....	Page 150	Page 39	Not applicable
Auditors' Report .....	Page 152	Page 40	Not applicable
Risk Management .....	Page 8-19	Page 11-28	Not applicable
<i>Bank of Scotland plc</i>			
Consolidated Balance Sheet .....	Pages 34-35	Page 34	Page 8
Consolidated Income Statement .....	Page 33	Page 33	Page 6
Consolidated Statement of Recognised Income and Expense .....	Page 36	Page 35	Not applicable
Consolidated Cash Flow Statement .....	Pages 36-37	Page 36	Page 11
Bank Balance Sheet, Statement of Recognised Income and Expense and Cash Flow Statement .....	Pages 38-40	Pages 37-39	Not applicable
Accounting Policies and Explanatory Notes .....	Pages 41-89*	Pages 40-110*	Pages 12-33*
Statement of Directors' Responsibilities .....	Page 31	Page 31	Not applicable
Auditors' Report .....	Page 32	Page 32	Not applicable
Risk Management .....	Page 85-104	Page 13-33	Not applicable
<i>HBOS Covered Bonds LLP</i>			
Balance Sheet .....	Pages 11-12	Pages 10-11	Not applicable
Income Statement .....	Page 9	Page 9	Not applicable
Statement of Recognised Income and Expense ...	Page 10	Not applicable	Not applicable
Cash Flow Statement .....	Page 13	Page 12	Not applicable
Accounting Policies and Explanatory Notes .....	Pages 14-38	Pages 13-39	Not applicable
Statement of Member's Responsibilities .....	Page 6	Page 6	Not applicable
Auditors' Reports .....	Pages 7-8	Pages 7-8	Not applicable

\* Including such other information in the annual report as is cross-referenced therein.

## STRUCTURE OVERVIEW

The information in this section is an overview of the structure relating to the Programme and does not purport to be complete. The information is taken from, and is qualified in its entirety by, the remainder of this Offering Circular. Words and expressions defined elsewhere in this Offering Circular shall have the same meanings in this overview. An index of certain defined terms used in this document is contained at the end of this Offering Circular.

### Structure Diagram



### Structure Overview

- Programme:** Under the terms of the Programme, the Issuer will issue Covered Bonds to Covered Bondholders on each issue date (each, an “**Issue Date**”). The Covered Bonds will be direct, unsecured and unconditional obligations of the Issuer.
- Intercompany Loan Agreement:** Under the terms of the Intercompany Loan Agreement, the Issuer will make Term Advances to the LLP in an amount equal to the Sterling Equivalent of the gross proceeds of each Series or, as applicable, Tranche of Covered Bonds. The Term Advances will not be repaid by the LLP until all amounts payable under the corresponding Series of Covered Bonds have been repaid in full. Payments by the Issuer of amounts due under the Covered Bonds will be satisfied out of its own moneys or, failing that, out of the HBOS Group Guarantee and are not conditional upon receipt by the Issuer of payments from the LLP pursuant to the Intercompany Loan Agreement. Amounts owed by the LLP under the Intercompany Loan Agreement will be subordinated to amounts owed by the LLP under the Covered Bond Guarantee.

- *HBOS Group Guarantee:* The HBOS Group Guarantor has, under the terms of the Trust Deed, provided a guarantee, on a several basis (as between itself and the LLP), in respect of all Covered Bonds issued from time to time by the Issuer under the Programme and all other amounts payable by the Issuer under the Trust Deed. The obligations of the HBOS Group Guarantor under the HBOS Group Guarantee constitute direct, unsecured and unconditional obligations of the HBOS Group Guarantor and rank *pari passu* among themselves and equally with all other unsecured and unsubordinated obligations.
- *Covered Bond Guarantee:* Under the terms of the Trust Deed, the LLP has also provided a guarantee on a several basis (as between the HBOS Group Guarantor and itself) as to payments of interest and principal under the Covered Bonds (the “**Covered Bond Guarantee**”). The LLP has agreed to pay an amount equal to the Guaranteed Amounts when the same shall become Due for Payment but which would otherwise be unpaid by the Issuer or the HBOS Group Guarantor. The obligations of the LLP under the Covered Bond Guarantee constitute direct and (following the occurrence of an HBOS Event of Default, the service of an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor and the service of a Notice to Pay on the LLP or, if earlier, the service on the Issuer and the LLP of an LLP Acceleration Notice) unconditional and unsubordinated obligations of the LLP, secured as provided in the Deed of Charge. The recourse of the Covered Bondholders to the LLP under the Covered Bond Guarantee will be limited to the assets of the LLP from time to time. Payments made by the LLP under the Covered Bond Guarantee will be made subject to, and in accordance with, the Guarantee Priority of Payments or the Post-Enforcement Priority of Payments, as applicable.
- *The LLP’s Assets:* The LLP will use the proceeds of the Term Advances received under the Intercompany Loan Agreement from time to time (i) to purchase the Loans and their Related Security, from the Sellers in accordance with the terms of the Mortgage Sale Agreement and/or (ii) to invest in Substitution Assets in an amount not exceeding the prescribed limit to the extent required to meet the requirements of Regulations 23 and 24(1)(a) of the RCB Regulations and the Asset Coverage Test and thereafter may be applied by the LLP: (a) to purchase Loans and their Related Security, from the Seller in accordance with the terms of the Mortgage Sale Agreement; and/or (b) to invest in Substitution Assets in an amount not exceeding the prescribed limit; and/or (c) (subject to complying with the Asset Coverage Test (as described below)) to make a Capital Distribution to a Member; and/or (d) if an existing Series or Tranche, or part of an existing Series or Tranche, of Covered Bonds is being refinanced (by the issue of a further Series or Tranche of Covered Bonds), to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or (e) to make a deposit of all or part of the proceeds in the GIC Account (including, without limitation, to fund the Reserve Fund to an amount not exceeding the prescribed limit). To protect the value of the Portfolio under the terms of the LLP Deed, the LLP and the Members will be obliged to ensure that the Asset Coverage Test (as described below) will be satisfied on each Calculation Date.
- *Consideration:* Under the terms of the Mortgage Sale Agreement, the consideration payable to the relevant Seller for the sale of Loans and their Related Security to the LLP on any Transfer Date will be a combination of (i) a cash payment paid by the LLP to the relevant Seller and/or (ii) the relevant Seller being treated as having made a Capital Contribution to the LLP (in an amount equal to the difference between the Current Balance of the Loans sold by the relevant Seller as at the relevant Transfer Date and the cash payment (if any) paid by the LLP) and (iii) Deferred Consideration.

- *Security:* To secure its obligations under the Covered Bond Guarantee and the Transaction Documents to which it is a party, the LLP has granted security over the Charged Property (which consists principally of the LLP's interest in the portfolio of Loans and their related Security, the Substitution Assets, the Transaction Documents to which it is a party, the LLP Accounts and the Authorised Investments) in favour of the Security Trustee (for itself and on behalf of the other Secured Creditors) pursuant to the Deed of Charge.
- *Cashflows:* Prior to service of a Notice to Pay on the LLP and/or the realisation of the Security and/or the commencement of winding-up proceedings against the LLP under the Covered Bond Guarantee, the LLP will:
  - apply Available Revenue Receipts to pay Deferred Consideration to each Seller in respect of the Loans sold by each Seller to the LLP, but only after payment of certain items ranking higher in the Pre-Acceleration Revenue Priority of Payments (including certain expenses, amounts due to the Interest Rate Swap Providers, amounts to be credited (if any) to the Reserve Fund and the Pre-Maturity Liquidity Ledger and interest due and payable on the Term Advances). For further details of the Pre-Acceleration Revenue Priority of Payments, see *Cashflows* below; and
  - apply Available Principal Receipts towards making Capital Distributions to the Members but only after, *inter alia*, funding any liquidity that may be required in respect of Hard Bullet Covered Bonds following any breach of the Pre-Maturity Test and acquiring New Loans and their Related Security offered by the Sellers to the LLP. For further details of the Pre-Acceleration Principal Priority of Payments, see *Cashflows* below.

Following service on the LLP of a Notice to Pay (but prior to an LLP Event of Default and service of an LLP Acceleration Notice and/or the realisation of the Security and/or the commencement of winding-up proceedings against the LLP) the LLP will use all moneys (other than Third Party Amounts) to pay Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment subject to paying certain higher ranking obligations of the LLP in the Guarantee Priority of Payments. In such circumstances, the Sellers (as Members of the LLP) will only be entitled to receive any remaining income of the LLP after all amounts due under the Covered Bond Guarantee in respect of the Covered Bonds have been paid in full or have otherwise been provided for.

Following the occurrence of an LLP Event of Default and service of an LLP Acceleration Notice and/or the realisation of the Security and/or the commencement of winding-up proceedings against the LLP, the Covered Bonds will become immediately due and repayable (if not already immediately due and payable following the occurrence of an HBOS Event of Default as against the Issuer and the HBOS Group Guarantor) and the Bond Trustee will then have a claim against the LLP under the Covered Bond Guarantee for the Early Redemption Amount in respect of each Covered Bond together with accrued interest and any other amounts due under the Covered Bonds and the security created by the LLP over the Charged Property will become enforceable. Any monies received or recovered by the Security Trustee following enforcement of the Security created by the LLP in accordance with the Deed of Charge, realisation of such Security and/or the commencement of winding-up proceedings against the LLP, will be distributed according to the Post-Enforcement Priority of Payments.

- *Asset Coverage:* The Programme provides that the assets of the LLP are subject to an asset coverage test in respect of the Covered Bonds. Accordingly, for so long as the Covered Bonds remain outstanding, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date, the Adjusted Aggregate Loan Amount will be in an

amount equal to or in excess of the aggregate Principal Amount Outstanding of the Covered Bonds from time to time. The Asset Coverage Test will be tested by the Cash Manager on each Calculation Date. A breach of the Asset Coverage Test will constitute an HBOS Event of Default, which will entitle the Bond Trustee to serve an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor and, upon service of such notice, the Bond Trustee shall serve a Notice to Pay on the LLP under the Covered Bond Guarantee.

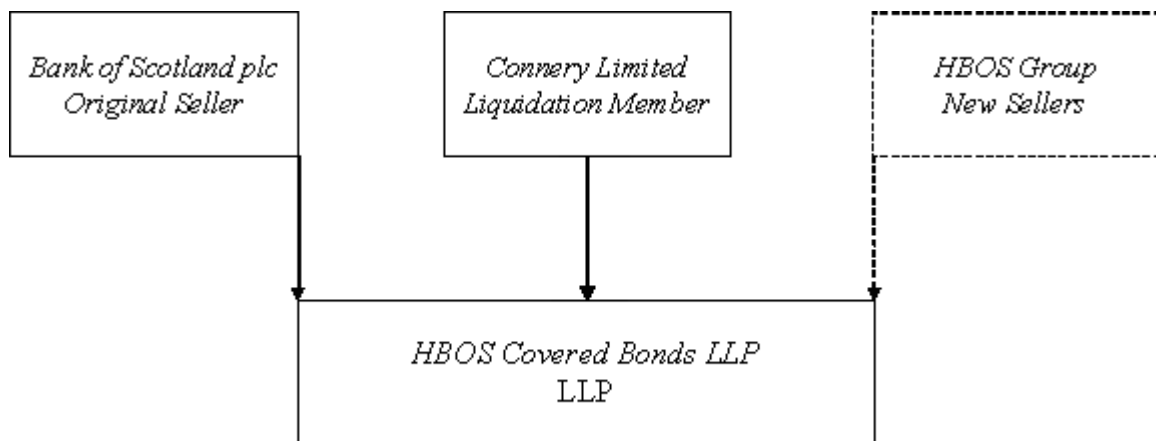
- *Amortisation Test:* In addition, following service of a Notice to Pay on the LLP (but prior to service of an LLP Acceleration Notice) and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security, for so long as Covered Bonds remain outstanding, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date following an HBOS Event of Default, the Amortisation Test Aggregate Loan Amount will be in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds from time to time. The Amortisation Test will be tested by the Cash Manager on each Calculation Date following an HBOS Event of Default. A breach of the Amortisation Test will constitute an LLP Event of Default, which will entitle the Bond Trustee to serve an LLP Acceleration Notice on the Issuer and LLP declaring the Covered Bonds immediately due and repayable and entitle the Security Trustee to enforce the Security over the Charged Property.
- *Servicing:* In its capacity as Original Servicer, the Original Seller has entered into the Original Servicing Agreement with the LLP and the Security Trustee, pursuant to which the Original Servicer has agreed to provide administrative services in respect of the Loans and their Related Security sold by the Original Seller to the LLP and the Loans and their Related Security sold by New Sellers to the LLP, unless any New Seller and the Original Servicer agree that such New Seller shall act as Servicer in relation to the Loans and their Related Security sold by such New Seller to the LLP.
- *New Sellers:* Subject to meeting certain conditions precedent set out in the Transaction Documents, New Sellers will accede to the Programme by, amongst other things:
  - acceding to the terms of the Mortgage Sale Agreement and, accordingly, selling Loans and their Related Security to the LLP pursuant to the terms of the Mortgage Sale Agreement;
  - acceding to the terms of the LLP Deed;
  - if any New Seller and the Original Servicer agree that such New Seller shall act as Servicer in relation to the Loans and their Related Security sold by such New Seller to the LLP, entering into a New Servicing Agreement with the LLP and the Security Trustee on substantially the same terms as the Original Servicing Agreement; and
  - acceding to the terms of the Programme Agreement.

The prior consent of the Bond Trustee on behalf of the Covered Bondholders and/or the Security Trustee will not be required and will not be obtained in relation to the accession of any New Seller to the Programme, provided that the relevant conditions precedent are satisfied at the time of the intended accession.

- *Further Information:* For a more detailed description of the transactions summarised above relating to the Covered Bonds see, amongst other relevant sections of this Offering Circular, *General Description of the Programme, Terms and Conditions of the Covered Bonds, Summary of the Principal Documents, Credit Structure, Cashflows and The Portfolio*, below.

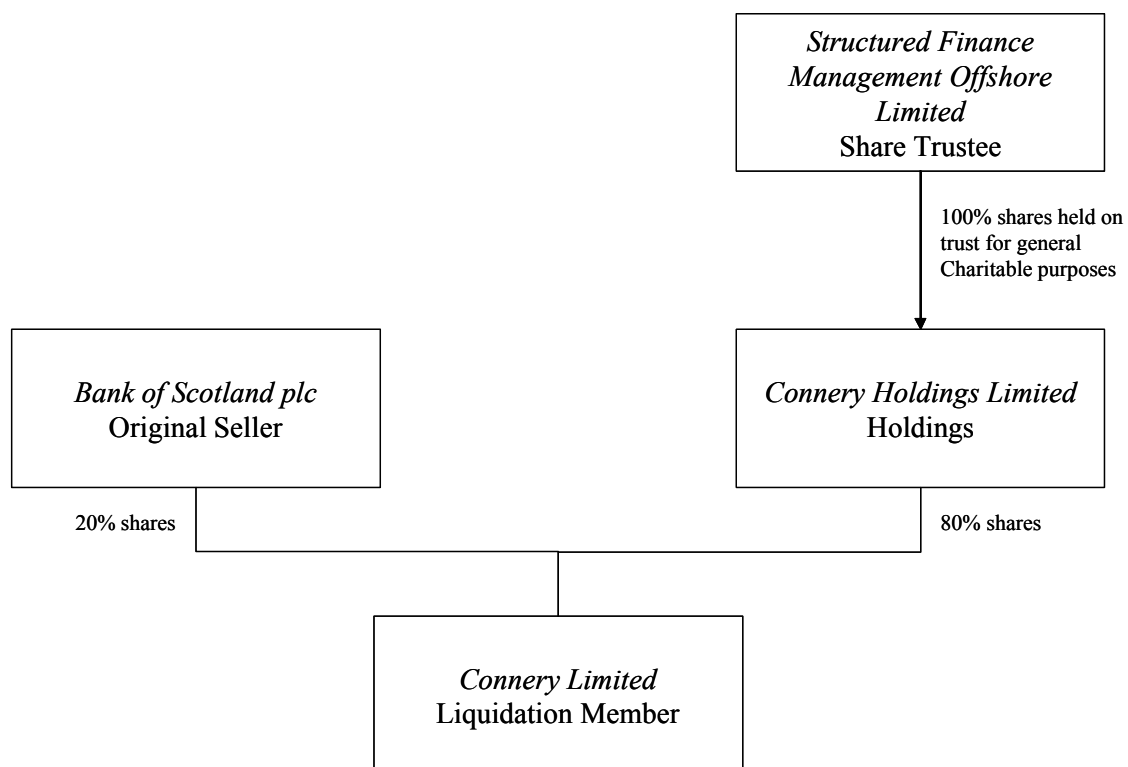


### Ownership Structure of HBOS Covered Bonds LLP



- As at the date hereof the Members of the LLP are the Original Seller, the Issuer and the Liquidation Member.
- Any New Seller that wishes to sell Loans and their Related Security to the LLP will, amongst other things, become a Member of the LLP and will accede to, *inter alia*, the LLP Deed.
- Other than in respect of those decisions reserved to the Members, the Management Board (comprised of, as at the date hereof, directors and/or employees of the Original Seller and the Issuer) will manage and conduct the business of the LLP and will have all the rights, power and authority to act at all times for and on behalf of the LLP.

### Ownership Structure of Connery Limited



## GENERAL DESCRIPTION OF THE PROGRAMME

*The following general description does not purport to be complete and is taken from, and is qualified in its entirety by, the remainder of this Offering Circular and, in relation to the terms and conditions of any particular Tranche of Covered Bonds, the applicable Final Terms. Words and expressions defined elsewhere in this Offering Circular shall have the same meanings in this general description. An index of certain defined terms is contained at the end of this Offering Circular.*

*Under the terms of the Programme, the Issuer may from time to time issue Covered Bonds including, without limitation, Index Linked Covered Bonds, Dual Currency Covered Bonds and Zero Coupon Covered Bonds in accordance with and subject to all applicable laws and regulations and denominated in any currency, subject as set out herein. The applicable terms of any Covered Bonds will be agreed between the Issuer and the relevant Dealer prior to the issue of the Covered Bonds and will be set out in the Terms and Conditions of the Covered Bonds endorsed on, attached to, or incorporated by reference into, the Covered Bonds, as modified and supplemented by the applicable Final Terms document attached to, or endorsed on, such Covered Bonds, as more fully described under Form of the Covered Bonds.*

Issuer: Bank of Scotland plc (“**Bank of Scotland**”) incorporated in Scotland with limited liability (registered no. SC327000).

In 2001 Bank of Scotland merged with the Halifax to form HBOS plc (**HBOS**). Following the acquisition of HBOS by Lloyds Banking Group plc (formerly Lloyds TSB Group plc) on 16 January 2009, and the subsequent transfer of 100 per cent. of the ordinary share capital of HBOS plc to Lloyds TSB Bank plc by Lloyds Banking Group plc on 1 January 2010, BOS is now a directly owned and controlled subsidiary of HBOS plc who in turn is directly owned and controlled by Lloyds TSB Bank plc and is indirectly owned and controlled by Lloyds Banking Group plc.

For a more detailed description of the Issuer see *The Issuer*, below.

HBOS Group Guarantor: Prior to the Effective Date (as defined below) HBOS, a public limited company incorporated in Scotland (registered no. SC218813) and The Governor and Company of the Bank of Scotland, established by an Act of the Parliament of Scotland in 1695, unconditionally guaranteed on a joint and several basis all Covered Bonds issued from time to time under the Programme and all other obligations of the Issuer under the Trust Deed.

On the Effective Date (as defined below) The Governor and Company of the Bank of Scotland became registered as a public limited company under the Companies Act 1985 and changed its corporate name to Bank of Scotland plc. In addition, the existing undertakings, including all assets and liabilities, of the Transferor Entities (as defined below) were transferred to Bank of Scotland plc which assumed any existing obligations relating to the Transferor Entities, including the obligations of HBOS Treasury Services plc (**HBOSTS**) in respect of Covered Bonds issued by it prior to the Effective Date.

As of the Effective Date, the guarantee given by The Governor and Company of the Bank of Scotland prior to the Effective Date was discharged as a consequence of Bank of Scotland plc both assuming HBOSTS' obligations as Issuer prior to the Effective Date and being unable to maintain an action against itself. Notwithstanding this, the guarantee given by HBOS prior to the Effective Date continues to survive.

Following the acquisition of HBOS by Lloyds Banking Group plc (formerly Lloyds TSB Group plc) on 16 January 2009, and the subsequent transfer of 100 per cent. of the ordinary share capital of HBOS plc to Lloyds TSB Bank plc by Lloyds Banking Group plc on 1 January 2010, HBOS plc is now a directly owned and controlled subsidiary of Lloyds TSB Bank plc and is indirectly owned and controlled by Lloyds Banking Group plc.

For a more detailed description of the HBOS Group Guarantor see *The HBOS Group Guarantor*, below.

The LLP:

HBOS Covered Bonds LLP, a limited liability partnership incorporated in England and Wales (registered no. OC304674). The LLP is a subsidiary of the Original Seller, and its Members on the date hereof are Bank of Scotland plc (as successor to the businesses of the Original Seller and the Issuer) and the Liquidation Member. The LLP is a special purpose vehicle whose business is to acquire, *inter alia*, Loans and their Related Security from the relevant Sellers pursuant to the terms of the Mortgage Sale Agreement. The LLP will hold the Portfolio and the other Charged Property in accordance with the terms of the Transaction Documents.

The LLP has provided the Covered Bond Guarantee covering all Guaranteed Amounts when the same shall become Due for Payment, but only following the occurrence of an HBOS Event of Default, the service of an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor and service on the LLP of a Notice to Pay. The obligations of the LLP under the Covered Bond Guarantee and the other Transaction Documents to which it is a party are secured by the assets from time to time of the LLP and recourse against the LLP is limited to such assets.

For a more detailed description of the LLP see *The LLP*, below.

Original Seller:

Original Seller shall, to the extent any such reference relates to any time prior to the Effective Date, be construed as a reference to Halifax plc ("**Halifax**") and, to the extent any such reference relates to any time on or after the Effective Date, be construed as a reference to Bank of Scotland plc, the successor to Halifax's business (pursuant to the HBOS Group Reorganisation Act 2006). The Original Seller is in the business of originating residential mortgage loans and carrying on other banking activities.

As of the Effective Date, the existing undertakings, including all

assets and liabilities of Halifax have been transferred to Bank of Scotland plc. For a more detailed description see *HBOS Group Reorganisation* below.

New Sellers: Any other member of the Lloyds Banking Group which is a “connected person” as defined in Regulation 5 of the RCB Regulations and that accedes to, amongst other things, the Mortgage Sale Agreement, the LLP Deed and the Programme Agreement from time to time.

For a more detailed description of the HBOS Group see *HBOS*, below.

Sellers: The Original Seller and any New Sellers.

Original Servicer: Pursuant to the terms of the Original Servicing Agreement, Bank of Scotland (as successor to Halifax’s business pursuant to the HBOS Group Reorganisation Act 2006) has been appointed to service, on behalf of the LLP, the Loans and their Related Security sold by the Original Seller and the Loans and their Related Security sold by New Sellers to the LLP, unless any New Seller and the Original Servicer agree that such New Seller shall act as servicer in relation to the Loans and their Related Security sold by such New Seller to the LLP.

New Servicers: Each New Seller may be appointed to service, on behalf of the LLP, the Loans and their Related Security sold by such New Seller to the LLP pursuant to the terms of a New Servicing Agreement.

Servicers: As applicable, the Original Servicer and/or each New Servicer.

Cash Manager: Bank of Scotland (as successor to Halifax’s business pursuant to the HBOS Group Reorganisation Act 2006) has also been appointed to, *inter alia*, provide cash management services to the LLP and to monitor compliance by the LLP with the Asset Coverage Test and the Amortisation Test pursuant to the terms of the Cash Management Agreement.

Issuing and Principal Paying Agent, Bond Registrar and Agent Bank: Citibank, N.A., London Branch, acting through its offices at 21st Floor, Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, has been appointed pursuant to the Agency Agreement as issuing and principal paying agent, bond registrar and agent bank.

Bond Trustee: Citicorp Trustee Company Limited, having its registered office at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, has been appointed to act as bond trustee on behalf of the Covered Bondholders in respect of the Covered Bonds and holds the benefit of, *inter alia*, the Covered Bond Guarantee on behalf of the Covered Bondholders pursuant to the terms of the Trust Deed.

Security Trustee: Citicorp Trustee Company Limited, having its registered office at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, has been appointed to act as Security Trustee to hold the benefit of the security granted by the LLP to the security trustee (for itself, the

Covered Bondholders and other Secured Creditors) under the Deed of Charge.

Asset Monitor: KPMG Audit Plc, having its registered office at 8 Salisbury Square, London EC4Y 8BB, has been appointed pursuant to the Asset Monitor Agreement as an independent monitor to perform tests in respect of the Asset Coverage Test and the Amortisation Test when required.

Covered Bond Swap Provider: Bank of Scotland (as successor to HBOSTS' business pursuant to the HBOS Group Reorganisation Act 2006) (in its capacity as the Covered Bond Swap Provider) has agreed to act as Covered Bond Swap Provider to the LLP to hedge (after service on the LLP of a Notice to Pay) certain interest rate, currency and/or other risks in respect of amounts received by the LLP under the Loans and the Interest Rate Swap(s) and amounts payable by the LLP under the Covered Bond Guarantee in respect of the Covered Bonds by entering into Covered Bond Swaps with the LLP and the Security Trustee under the Covered Bond Swap Agreements. The Covered Bond Swap Provider will be required to obtain a guarantee of its obligations or put in place some other arrangement in the event that the ratings or the Deemed Ratings, as applicable, of the Covered Bond Swap Provider fall below a specified ratings level.

For a more detailed description of the Covered Bond Swap Provider, see *The Issuer*, below.

Original Interest Rate Swap Provider: Bank of Scotland (as successor to Halifax's business pursuant to the HBOS Group Reorganisation Act 2006) (in its capacity as the Original Interest Rate Swap Provider) has agreed to act as a swap provider to the LLP in respect of possible variances between the rates of interest payable on the Loans sold by the Original Seller to the LLP and the rate of interest applicable to the relevant Term Advances by entering into the Original Interest Rate Swap with the LLP and the Security Trustee under the Original Interest Rate Swap Agreement. The Original Interest Rate Swap Provider will be required to obtain a guarantee of its obligations or put in place some other arrangement in the event that the ratings of the Original Interest Rate Swap Provider fall below a specified ratings level.

For a more detailed description of the Original Interest Rate Swap Provider, see *The Original Seller*, below.

New Interest Rate Swap Providers: Each New Seller (in its capacity as a New Interest Rate Swap Provider) will act as a swap provider to the LLP in respect of possible variances between the rates of interest payable on the Loans sold by the relevant New Seller to the LLP and the rate of interest applicable to the relevant Term Advances by entering into a New Interest Rate Swap with the LLP and the Security Trustee under a New Interest Rate Swap Agreement. Each New Interest Rate Swap Provider will be required to obtain a guarantee of its obligations or to put in place some other arrangement in the event that the ratings of the relevant New Interest Rate Swap Provider fall

below a specified ratings level.

Interest Rate Swap Providers:	The Original Interest Rate Swap Provider and any New Interest Rate Swap Providers.
GIC Provider:	Bank of Scotland has agreed to act as GIC Provider to the LLP pursuant to the terms of the Guaranteed Investment Contract.
Stand-by GIC Provider:	Citibank, N.A. London Branch has agreed to act as Stand-by GIC Provider to the LLP pursuant to the terms of the Stand-by Guaranteed Investment Contract.
Account Bank:	Bank of Scotland has agreed to act as Account Bank to the LLP pursuant to the terms of the Bank Account Agreement.
Stand-by Account Bank:	Citibank, N.A. London Branch has agreed to act as Stand-by Account Bank to the LLP pursuant to the terms of the Stand-by Bank Account Agreement and, in certain circumstances giving rise to the termination of the Bank Account Agreement, will perform the duties set out in the Stand-by Bank Account Agreement.
Liquidation Member:	Connery Limited (the “ <b>Liquidation Member</b> ”), a special purpose vehicle incorporated in Jersey as a private limited company (registered no. 85666). The Liquidation Member is 20 per cent. owned by Bank of Scotland (as successor to Halifax’s business pursuant to the HBOS Group Reorganisation Act 2006) and 80 per cent. owned by Holdings.
Holdings:	Connery Holdings Limited (“ <b>Holdings</b> ”), a special purpose vehicle incorporated in Jersey as a private limited company (registered no. 85667). All of the shares of Holdings are held by a trustee (the “ <b>Share Trustee</b> ”) on trust for general charitable purposes.
Share Trustee:	Structured Finance Management Offshore Limited, having its registered office at 47 Esplanade, St. Helier, Jersey JE1 0BD.
Corporate Services Provider:	Structured Finance Management Offshore Limited, having its registered office at 47 Esplanade, St. Helier, Jersey JE1 0BD, has been appointed to provide certain corporate services to the Liquidation Member and Holdings pursuant to the Corporate Services Agreement.
Description:	Covered Bond Programme.
Arranger:	Lloyds TSB Corporate Markets
Dealers:	Any Dealers appointed from time to time in accordance with the Programme Agreement.
Certain Restrictions:	Each issue of Covered Bonds denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or reporting requirements from time to time (see <i>Subscription and</i>

*Sale and Transfer and Selling Restrictions).*

Programme Size:	Up to €60 billion (or its equivalent in other currencies calculated as described in the Programme Agreement) outstanding at any time. The Issuer and the Guarantors may increase the amount of the Programme in accordance with the terms of the Programme Agreement.
Distribution:	Covered Bonds may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis, subject to the restrictions set forth in <i>Subscription and Sale and Transfer and Selling Restrictions</i> , below.
Specified Currencies:	Subject to any applicable legal or regulatory restrictions, such currencies as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).
Redenomination:	The applicable Final Terms may provide that certain Covered Bonds may be redenominated in euro.
Maturities:	<p>Such maturities as may be agreed between the Issuer and the relevant Dealer(s), subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank or regulatory authority (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.</p> <p>Under the Luxembourg Act on Prospectuses for Securities which implements the Prospectus Directive, prospectuses for the listing of money market instruments having a maturity at issue of less than 12 months and complying also with the definition of securities are not subject to the approval provisions of Part II of such Act.</p>
Issue Price:	Covered Bonds may be issued on a fully-paid or a partly-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Form of Covered Bonds:	The Covered Bonds will be issued in bearer or registered form, as described in <i>Form of the Covered Bonds</i> . Registered Covered Bonds will not be exchangeable for Bearer Covered Bonds and vice versa.
Fixed Rate Covered Bonds:	Fixed interest will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer(s) and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).
Floating Rate Covered Bonds:	Floating Rate Covered Bonds will bear interest at a rate determined: <ol style="list-style-type: none"><li>(i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2000 ISDA Definitions (as published by the International Swaps</li></ol>

and Derivatives Association, Inc., (“ISDA”) and as amended and updated as at the Issue Date of the first Tranche of Covered Bonds of the relevant Series); or

- (ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or
- (iii) on such other basis as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).

The margin (if any) relating to such floating rate will be agreed between the Issuer and the relevant Dealer(s) for each Series of Floating Rate Covered Bonds.

**Index Linked Covered Bonds:** Payments of principal in respect of Index Linked Redemption Covered Bonds or of interest in respect of Index Linked Interest Covered Bonds will be calculated by reference to such index and/or formula or to changes in the prices of securities or commodities or to such other factors as the Issuer and the relevant Dealer(s) may agree (as set out in the applicable Final Terms).

**Other provisions in relation to Floating Rate Covered Bonds and Index Linked Interest Covered Bonds:** Floating Rate Covered Bonds and Index Linked Interest Covered Bonds may also have a maximum interest rate, a minimum interest rate or both. Interest on Floating Rate Covered Bonds and Index Linked Interest Covered Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer(s), will be payable on such Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Issuer and the relevant Dealer(s).

**Dual Currency Covered Bonds:** Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Dual Currency Covered Bonds will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer(s) may agree (as set out in the applicable Final Terms).

**Zero Coupon Covered Bonds:** Zero Coupon Covered Bonds may be offered and sold at a discount to their nominal amount and will not bear interest except in the case of late payment, as described in Condition 6(h).

**Redemption:** The applicable Final Terms will indicate either that the relevant Covered Bonds cannot be redeemed prior to their stated maturity (other than in specified instalments, if applicable, or for taxation reasons or if it becomes unlawful for any Term Advance to remain outstanding or following an HBOS Event of Default or an LLP Event of Default) or that such Covered Bonds will be redeemable at the option of the Issuer upon giving notice to the Covered Bondholders, on a date or dates specified prior to such stated maturity and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).



The applicable Final Terms may provide that Covered Bonds may be redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Final Terms.

Denomination of Covered Bonds: Covered Bonds will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer(s) save that the minimum denomination of each Covered Bond will be such as may be allowed or required from time to time by the relevant central bank or regulatory authority (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency and save that the minimum denomination of each Covered Bond admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive will be €50,000 (or, if the Covered Bonds are denominated in a currency other than euro, the equivalent amount in such currency).

Unless otherwise stated in the applicable Final Terms, the minimum denomination of each Definitive IAI Registered Covered Bond will be U.S.\$500,000 or its approximate equivalent in other Specified Currencies and the minimum denomination of each Definitive Rule 144A Covered Bond will be U.S.\$100,000 or its approximate equivalent in other Specified Currencies.

Taxation: All payments in respect of the Covered Bonds will be made without withholding or deduction for or on account of taxes imposed by any Tax Jurisdiction, subject as provided in Condition 8. In the event that any such withholding or deduction is made, the Issuer or, as the case may be, the HBOS Group Guarantor will, save in certain limited circumstances provided in Condition 8, be required to pay additional amounts to cover the amounts so deducted. The LLP will not be liable to pay any such additional amounts under the Covered Bond Guarantee.

Cross Default: Each Series of Covered Bonds will cross accelerate at the same time but will not otherwise contain a cross default provision.

Status of the Covered Bonds: The Covered Bonds issued from time to time in accordance with the Programme will constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and will rank *pari passu* among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Issuer, from time to time outstanding.

Guarantees: The Covered Bonds will be unconditionally guaranteed by the HBOS Group Guarantor. The obligations of the HBOS Group Guarantor under its guarantee constitute direct, unconditional, unsubordinated and unsecured obligations of the HBOS Group Guarantor and rank *pari passu* and (save for certain obligations required to be preferred by law) equally with all other unsecured

obligations (other than subordinated obligations, if any) of the HBOS Group Guarantor from time to time outstanding.

As of the Effective Date, the undertakings, including all assets and liabilities of HBOSTS, have been transferred to Bank of Scotland, which has assumed any existing obligations of HBOSTS. As a consequence of Bank of Scotland assuming the obligations of HBOSTS, in its capacity as Issuer prior to the Effective Date, and Bank of Scotland being unable to maintain an action against itself, the guarantee given by The Governor and Company of the Bank of Scotland (as Bank of Scotland was formerly known) prior to the Effective Date has been discharged as of the Effective Date. The guarantee given by HBOS prior to the Effective Date, on the other hand, continues to survive.

Payment of Guaranteed Amounts in respect of the Covered Bonds when Due for Payment will be irrevocably and severally (as between the HBOS Group Guarantor and the LLP) guaranteed by the LLP. The obligations of the LLP to make payment in respect of the Guaranteed Amounts when Due for Payment are subject to the condition that an HBOS Event of Default occurs, an HBOS Acceleration Notice is served on the Issuer and the HBOS Group Guarantor and a Notice to Pay is served on the LLP. The obligations of the LLP under its guarantee constitute direct obligations of the LLP secured against the assets from time to time of the LLP and recourse against the LLP is limited to such assets.

Approval, Listing  
Admission to Trading:

and Application has been made to the CSSF to approve this document as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for Covered Bonds issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange. The Covered Bonds may also be listed or admitted to trading, as the case may be, on other or further stock exchange(s) or markets as may be agreed between the Issuer and the relevant Dealer(s) in relation to each Series.

Covered Bonds which are neither listed nor admitted to trading on any market may also be issued.

The applicable Final Terms will state whether or not the relevant Covered Bonds are to be listed and/or admitted to trading and, if so, on which stock exchange(s) and/or markets.

Securities will be treated as listed on a recognised stock exchange if (and only if) they are admitted to trading on that exchange and they are officially listed, in accordance with provisions corresponding to those generally applicable in European Economic Area states, in a country outside the United Kingdom in which there is a recognised stock exchange.

The Regulated Covered Bonds  
Regulations 2008:

The Issuer has been admitted by the FSA to the register of issuers and the Programme and all Covered Bonds previously issued under

the Programme have been admitted by the FSA to the register of regulated covered bonds under the RCB Regulations.

- Governing Law: The Covered Bonds and any non-contractual obligations arising out of or in connection with the Covered Bonds will be governed by, and construed in accordance with, English law.
- Selling Restrictions: There are restrictions on the offer, sale and transfer of the Covered Bonds in the United States, the European Economic Area (including the United Kingdom and The Netherlands) and Japan. Other restrictions may apply in connection with the offering and sale of a particular Tranche of Covered Bonds. See *Subscription and Sale and Transfer and Selling Restrictions*.
- HBOS Group Reorganisation: On 21 June 2006, the HBOS Group Reorganisation Act 2006 (the “**HBOS Group Reorganisation Act**”) received Royal Assent. Pursuant to the provisions of the HBOS Group Reorganisation Act, on 17 September 2007 (the “**Effective Date**”), The Governor and Company of the Bank of Scotland became registered as a public limited company under the Companies Act 1985 and changed its corporate name to Bank of Scotland plc. In addition, the existing undertakings at that time, including all assets and liabilities, of Capital Bank plc, Halifax and HBOSTS (the “**Transferor Entities**”) were transferred to Bank of Scotland, at which point Bank of Scotland assumed any obligations relating to the Transferor Entities. The Transferor Entities will cease to exist on the day on which, in pursuance of a request made by or on behalf of Bank of Scotland, the registrar of companies strikes the Transferor Entities off the register. This series of transactions is referred to as the “**HBOS Group Reorganisation**”.

## RISK FACTORS

The Issuer and the LLP believe that the following factors may affect their ability to fulfil their respective obligations under the Covered Bonds issued under the Programme and the Covered Bond Guarantee. Most of these factors are contingencies which may or may not occur, and neither the Issuer nor the LLP are in a position to express a view on the likelihood of any such contingency occurring. In addition, risk factors which are specific to the Covered Bonds are also described below.

The Issuer and the LLP believe that the factors described below represent the material and principal risks inherent in investing in the Covered Bonds issued under the Programme, but the inability of the Issuer or the LLP to pay interest, principal or other amounts on or in connection with any Covered Bonds may occur for other reasons, and the Issuer and the LLP do not represent that the statements below regarding the risks of holding any Covered Bonds are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Offering Circular and reach their own views prior to making any investment decision.

*This section of the Offering Circular is split into three main sections – General Risk Factors, Risks Relating to Lloyds Banking Group plc and Risk Factors relating to the LLP.*

### 1. GENERAL RISK FACTORS

#### 1.1 Issuer and HBOS Group Guarantor liable to make payments when due on the Covered Bonds

The Issuer and the HBOS Group Guarantor are liable to make payments when due on the Covered Bonds. The obligations of the Issuer and the HBOS Group Guarantor under the Covered Bonds are direct, unsecured, unsubordinated and unconditional obligations, ranking *pari passu* with their respective other direct, unsecured, unconditional and unsubordinated obligations.

The LLP has no obligation to pay the Guaranteed Amounts payable under the Covered Bond Guarantee until the occurrence of an HBOS Event of Default, service by the Bond Trustee on the Issuer and the HBOS Group Guarantor of an HBOS Acceleration Notice and on the LLP of a written demand to pay under the Covered Bond Guarantee (a “**Notice to Pay**”) or, if earlier, following the occurrence of an LLP Event of Default and service by the Bond Trustee of an LLP Acceleration Notice. The occurrence of an HBOS Event of Default does not constitute an LLP Event of Default. However, failure by the LLP to pay amounts due under the Covered Bond Guarantee would constitute an LLP Event of Default which would entitle the Bond Trustee to accelerate the obligations of the Issuer under the Covered Bonds (if they have not already become due and payable) and the obligations of the LLP under the Covered Bond Guarantee and entitle the Security Trustee to enforce the Security.

#### 1.2 HBOS Group Guarantee may be withdrawn

The HBOS Group Guarantee may be withdrawn if the long-term unsecured, unguaranteed and unsubordinated debt obligations of the Issuer are rated by the Rating Agencies at least equal to the then ratings of the HBOS Group Guarantor (the “**Requisite Ratings**”) or a further guarantee is provided by another member of the HBOS Group which is on substantially similar terms to the HBOS Group Guarantee and the long-term unsecured, unguaranteed and unsubordinated debt obligations of such member providing such further guarantee has the Requisite Ratings.

In addition, the HBOS Group Guarantor may withdraw as a HBOS Group Guarantor if, at the time, the Issuer has the Requisite Ratings or, if that is not the case, if another member of the HBOS Group which provides a further guarantee on terms substantially similar to those of the HBOS Group Guarantee has the Requisite Ratings at the relevant time.

### **1.3 Obligations under the Covered Bonds**

The Covered Bonds will not represent an obligation or be the responsibility of the Bond Trustee, the Security Trustee or any other party to the Programme, their officers, members, directors, employees, security holders or incorporators, other than the Issuer and the Guarantors. The Issuer and the Guarantors will be liable solely in their corporate capacity for their obligations in respect of the Covered Bonds and such obligations will not be the obligations of their respective officers, members, directors, employees, security holders or incorporators.

### **1.4 Covered Bonds issued under the Programme**

Covered Bonds issued under the Programme will either be fungible with an existing Series of Covered Bonds or have different terms from an existing Series of Covered Bonds (in which case they will constitute a new Series). All Covered Bonds issued from time to time will rank *pari passu* with each other in all respects and will share equally in the security granted by the LLP under the Deed of Charge. If an HBOS Event of Default occurs, all Covered Bonds of all Series will accelerate at the same time as against the Issuer and HBOS Group Guarantor (following service of an HBOS Acceleration Notice) but (following service on the LLP of a Notice to Pay) will be subject to, and entitled to, payments made on the due dates thereof by the LLP under the Covered Bond Guarantee. If an LLP Event of Default occurs, all Covered Bonds of each Series will accelerate at the same time against the Issuer and the HBOS Group Guarantor (if not already accelerated following an HBOS Event of Default) and all corresponding obligations of the LLP under the Covered Bond Guarantee will accelerate at the same time as against the LLP (following service of an LLP Acceleration Notice). In order to ensure that any further issue of Covered Bonds under the Programme does not adversely affect existing Covered Bondholders:

- the Issuer will be obliged to apply the proceeds of any issue of Covered Bonds to make a Term Advance to the LLP. The LLP will use the proceeds of such Term Advance:
  - (a) to purchase Loans and their Related Security, from the Seller in accordance with the terms of the Mortgage Sale Agreement; and/or
  - (b) to invest in Substitution Assets in an amount not exceeding the prescribed limit to the extent required to meet the requirements of Regulations 23 and 24(1)(a) of the RCB Regulations and the Asset Coverage Test; and/or
  - (c) (subject to complying with the Asset Coverage Test (as described below)) to make a Capital Distribution to a Member; and/or
  - (d) if an existing Series or Tranche, or part of an existing Series or Tranche, of Covered Bonds is being refinanced (by the issue of a further Series or Tranche of Covered Bonds), to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or
  - (e) to make a deposit of all or part of the proceeds in the GIC Account (including, without limitation, to fund the Reserve Fund to an amount not exceeding the prescribed limit); and

- the Asset Coverage Test will be required to be met both before and immediately after any further issue of Covered Bonds; and
- on or prior to the date of issue of any further Covered Bonds, the Issuer will be obliged to obtain a Rating Agency Confirmation from each Rating Agency.

### **1.5 Security Trustee's powers may affect the interests of the Covered Bondholders**

In the exercise of its powers, trusts, authorities and discretions, the Deed of Charge requires the Security Trustee to consider the interests of each of the Secured Creditors. In the event that with respect to the exercise of any of its powers, trusts, authorities or discretions the Security Trustee determines in its absolute discretion that any of the Secured Creditors (other than the Covered Bondholders) would be materially prejudiced thereby or any such Secured Creditor informs the Security Trustee in writing that it would be materially prejudiced thereby, the Security Trustee shall only exercise the same with the written consent of such Secured Creditor(s) and provided that the Security Trustee is satisfied that such exercise will not be materially prejudicial to the interests of the Covered Bondholders.

If, in connection with the exercise of its powers, trusts, authorities or discretions, the Security Trustee is of the opinion that the interests of the holders of the Covered Bonds of any one or more Series would be materially prejudiced thereby, the Security Trustee shall not exercise such power, trust, authority or discretion without the approval of such Covered Bondholders by Extraordinary Resolution or by a written resolution of such Covered Bondholders of not less than fifty per cent. of the Principal Amount Outstanding of Covered Bonds of the relevant Series then outstanding.

### **1.6 Ratings of the Covered Bonds**

The ratings assigned to the Covered Bonds address the likelihood of full and timely payment to Covered Bondholders of all payments of interest on each Interest Payment Date and the Final Maturity Date. The ratings also address the likelihood of timely payment of principal in relation to the Hard Bullet Covered Bonds on the Final Maturity Date thereof but may only address the likelihood of ultimate payment of principal in relation to other types of Covered Bonds. The expected ratings of the Covered Bonds are set out in the relevant Final Terms for each Series of Covered Bonds. Any Rating Agency may lower its rating or withdraw its rating if, in the sole judgment of the Rating Agency, the credit quality of the Covered Bonds has declined or is in question. In addition, at any time any Rating Agency may revise its relevant rating methodology with the result that, amongst other things, any rating assigned to the Covered Bonds may be lowered. In this regard, we note that both S&P and Fitch have recently proposed changes to their covered bond rating methodologies. If implemented, such proposed changes may result in negative rating pressure in respect of the Covered Bonds. If any rating assigned to the Covered Bonds is lowered or withdrawn, the market value of the Covered Bonds may be reduced. A security rating is not a recommendation to buy, sell or hold Securities and may be subject to revision (as noted above), suspension or withdrawal at any time. A credit rating may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Covered Bonds. A credit rating is not a recommendation to buy, sell or hold securities.

### **1.7 The Security Trustee may agree to modifications to the Transaction Documents without the Secured Creditors' prior consent**

Pursuant to the terms of the Deed of Charge, the Security Trustee may, without the consent or sanction of the Secured Creditors, concur with any person in making or sanctioning any modifications to the Transaction Documents to which the Security Trustee is a party:

- provided that the Security Trustee is of the opinion that such modification will not be materially prejudicial to the interests of any of the Secured Creditors or, if it is not of that opinion in relation to any Secured Creditor or any Secured Creditor has informed the Security Trustee in writing that such modification will be materially prejudicial to its interests, such Secured Creditor has given its written consent to such modification; or
- which in the opinion of the Security Trustee are made to correct a manifest error or an error established as such to the satisfaction of the Security Trustee or are of a formal, minor or technical nature or are made to comply with mandatory provisions of law.

**1.8 The Bond Trustee may agree to modifications to the Transaction Documents without the Covered Bondholders’ or other Secured Creditors’ prior consent**

Pursuant to the terms of the Trust Deed, the Bond Trustee may, without the consent or sanction of any of the Covered Bondholders or any of the other Secured Creditors (other than the Security Trustee (where applicable)), concur with any person in making or sanctioning any modifications to the Transaction Documents:

- provided that the Bond Trustee is of the opinion that such modification will not be materially prejudicial to the interests of any of the Secured Creditors or, if it is not of that opinion in relation to any Secured Creditor or any Secured Creditor has informed the Bond Trustee in writing that such modification will be materially prejudicial to its interests, such Secured Creditor has given its written consent to such modification; or
- which in the opinion of the Bond Trustee are made to correct a manifest error or an error established as such to the satisfaction of the Bond Trustee or are of a formal, minor or technical nature or are made to comply with mandatory provisions of law,

provided that, prior to the Bond Trustee agreeing to any such modification, waiver or authorisation, the Issuer must send written confirmation to the Bond Trustee:

- (i) that such modification, waiver or authorisation, as applicable, would not result in a breach of the RCB Regulations, FSA’s Regulated Covered Bonds Sourcebook (“**RCB Sourcebook**”) or result in the Issuer, the Programme and/or any Covered Bonds issued under the Programme ceasing to be registered under the RCB Regulations; and
- (ii) that either: (a) such modification, waiver or authorisation would not require the FSA to be notified in accordance with Regulation 20 of the RCB Regulations; or (b) if such modification, waiver or authorisation would require the FSA to be notified in accordance with Regulation 20 of the RCB Regulations, the Issuer has provided all information required to be provided to the FSA and the FSA has given its consent to such proposed modification, waiver, authorisation or determination.

## **1.9 Certain decisions of Covered Bondholders taken at Programme level**

Any Extraordinary Resolution to direct the Bond Trustee to serve an HBOS Acceleration Notice following an HBOS Event of Default, or to direct the Bond Trustee to serve an LLP Acceleration Notice following an LLP Event of Default and any direction to the Bond Trustee or Security Trustee to take any enforcement action must be passed at a single meeting of the holders of all Covered Bonds of all Series then outstanding.

## **1.10 European Monetary Union**

If the United Kingdom joins the European Monetary Union prior to the maturity of the Covered Bonds, there is no assurance that this would not adversely affect the realisable value of the Portfolio or any part thereof or, pending such realisation (or if the Portfolio or any part thereof cannot be sold), the ability of the LLP to make payments under the Covered Bond Guarantee with respect to the Covered Bonds.

It is possible that, prior to the maturity of the Covered Bonds, the United Kingdom may become a participating member state in the European economic and monetary union and that the euro may become the lawful currency of the United Kingdom. In that event, (a) all amounts payable in respect of any Covered Bonds denominated in pounds sterling may become payable in euro; (b) the law may allow or require the Covered Bonds to be redenominated into euro and additional measures to be taken in respect of such Covered Bonds; and (c) there may no longer be available published or displayed rates for deposits in pounds sterling used to determine the rates of interest on such Covered Bonds or there may be changes in the way those rates are calculated, quoted and published or displayed. The introduction of the euro could also be accompanied by a volatile interest rate environment which could adversely affect a Borrower's ability to repay its Loan as well as adversely affect investors. It cannot be said with certainty what effect, if any, adoption of the euro by the United Kingdom will have on investors in the Covered Bonds.

## **1.11 Changes of law**

The structure of the issue of the Covered Bonds and the ratings which are to be assigned to them are based on English law and, in relation to the Scottish Loans, Scots law in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible change to English law or Scots law or administrative practice in the United Kingdom after the date of this Offering Circular.

## **1.12 Insolvency Act 2000**

Significant changes to the United Kingdom insolvency regime have been enacted since 2000, including the Insolvency Act 2000, the relevant provisions of which came into force on 1 January 2003. The Insolvency Act 2000 allows certain "small" companies to seek protection from their creditors for a period of 28 days for the purposes of putting together a company voluntary arrangement with the option for creditors to extend the moratorium for a further two months. Prior to 1 October 2005, there was some doubt as to whether the moratorium provisions of the Insolvency Act 2000 applied to limited liability partnerships (such as the LLP). However, on 1 October 2005, the Limited Liability Partnerships (Amendment) Regulations 2005 made clear that the moratorium provisions apply to limited liability partnerships subject to certain modifications.

A "small" company is defined as one which satisfies two or more of the following criteria: (i) its turnover is not more than £6.5 million, (ii) its balance sheet total is not more than £3.26 million and (iii) the number of employees is not more than 50. It appears that the same definitions would apply in respect of a limited liability partnership. The position as to whether or not a company is a



“small” company may change from time to time and consequently no assurance can be given that the Issuer or the LLP will not, at any given time, be determined to be a “small” company. The United Kingdom Secretary of State for Business, Innovation & Skills (formerly the Secretary of State for Business, Enterprise and Regulatory Reform) may by regulation modify the eligibility requirements for “small” companies and can make different provisions for different cases. No assurance can be given that any such modification or different provisions will not be detrimental to the interests of Covered Bondholders.

Certain special purpose companies in relation to capital markets transactions are excluded from the optional moratorium provisions. Such exclusions include (a) a company which, at the time of filing for a moratorium, is a party to an agreement which is or forms part of a “capital market arrangement” (as defined in paragraph 4D of Schedule A1 to the Insolvency Act 1986 (the “**Insolvency Act**”)) under which a party has incurred, or when the agreement was entered into was expected to incur, a debt of at least £10 million and which involves the issue of “capital market investment” (also defined but generally a rated, listed or traded bond) and (b) a company which, at the time of filing for a moratorium, has incurred a liability (including a present, future or contingent liability and a liability payable wholly or partly in a foreign currency) of at least £10 million. While both the Issuer and the LLP are expected to fall within one of the exceptions there is no guidance as to how the legislation will be interpreted and the Secretary of State for Business, Innovation & Skills may by regulation modify the exceptions. No assurance can be given that any modification of the exceptions will not be detrimental to the interests of Covered Bondholders. Correspondingly, if the Issuer is determined to be a “small” company and determined not to fall within one of the exceptions, then certain actions in respect of the Issuer may, for a period, be prohibited by the imposition of a moratorium.

If the LLP is determined to be a “small” limited liability partnership and determined not to fall within one of the exceptions (by reason of modification of the exceptions or otherwise), then the enforcement of the Security by the Security Trustee may, for a period, be prohibited by the imposition of a moratorium.

### **1.13 English law security and insolvency considerations**

The LLP has entered into the Deed of Charge pursuant to which it has granted the Security in respect of its obligations under the Guarantee (as to which, see *Transaction Documents – Deed of Charge*). In certain circumstances, including the occurrence of certain insolvency events in respect of the LLP, the ability to realise the Security may be delayed and/or the value of the Security impaired. While the transaction structure is designed to minimise the likelihood of the LLP becoming insolvent, there can be no assurance that the LLP will not become insolvent and/or the subject of insolvency proceedings and/or that the Covered Bondholders would not be adversely affected by the application of insolvency laws (including English insolvency laws and, if applicable, Scottish insolvency laws).

There is uncertainty as to the validity and/or enforceability of a provision which (based on contractual and/or trust principles) subordinates certain payment rights of a creditor to the payment rights of other creditors of its counterparty upon the occurrence of insolvency proceedings relating to that creditor. In particular, recent cases have focused on provisions involving the subordination of a swap counterparty's payment rights in respect of certain termination payments upon the occurrence of insolvency proceedings or other default on the part of such counterparty.

In this regard, the English Court of Appeal has recently affirmed the decision of the English High Court that such a subordination provision is valid under English law. This decision may be subject to a further appeal to the UK Supreme Court.

However, contrary to the determination of the English courts, the US Bankruptcy Court recently held that such a subordination provision is unenforceable under US bankruptcy law and that any action to enforce such provision would violate the automatic stay which applies under such law in the case of a US bankruptcy of the counterparty. The implications of this conflicting judgment are not yet known and certain issues remain subject to a pending status conference among the parties to the dispute. Like the recent English decision, the US decision may be subject to appeal.

If a creditor of the issuing entity (such as a swap counterparty) or a related entity becomes subject to insolvency proceedings in any jurisdiction outside England and Wales, and it is owed a payment by the issuing entity, a question arises as to whether the insolvent creditor or any insolvency official appointed in respect of that creditor could successfully challenge the validity and/or enforceability of subordination provisions in the English law governed transaction documents. In this regard, there is a risk that such subordination provisions would not be upheld under US bankruptcy law and, more generally, there can be no assurance that such subordination provisions would be upheld under the insolvency laws of any relevant jurisdiction outside England and Wales. If such provisions are not upheld, it is unclear whether and to what extent the relevant proceedings and corresponding findings would be recognised by either the English courts or the Scottish courts. While the English courts and the Scottish courts have been supportive of subordination arrangements generally thus far, there can be no assurance that this position would be unaffected in the context of co-operation between courts in a cross-border insolvency case.

In addition, it should be noted that, to the extent that the assets of the LLP are subject only to a floating charge (including any fixed charge recharacterised by the courts as a floating charge), in certain circumstances under the provisions of section 176A of the Insolvency Act 1986, certain floating charge realisations which would otherwise be available to satisfy the claims of Secured Creditors under the Deed of Charge may be used to satisfy any claims of unsecured creditors. While certain of the covenants given by the LLP in the Transaction Documents are intended to ensure it has no significant creditors other than the Secured Creditors under the Deed of Charge, it will be a matter of fact as to whether the LLP has any other such creditors at any time. There can be no assurance that the Covered Bondholders will not be adversely affected by any such reduction in floating charge realisations upon the enforcement of the Security.

Pursuant to the modifications made by the RCB Regulations to, amongst other things, the Insolvency Act 1986, the provisions set out above in respect of section 176A of the Insolvency Act 1986 will not apply with respect to the LLP and its floating charge assets.

#### **1.14 UK regulated covered bond regime**

On 11 November 2008, the Issuer was admitted by the FSA to the register of issuers and the Programme (and all Covered Bonds previously issued under the Programme) was admitted by the FSA to the register of regulated covered bonds under the RCB Regulations.

While the legislative framework contemplated by the RCB Regulations accommodates certain aspects of previous UK covered bond structures (such as that contemplated in respect of the Covered Bonds issued prior to 11 November 2008 under the Programme), changes are required to such structures to meet the requirements of the RCB Regulations and RCB Sourcebook. Covered Bondholders should be aware that significant amendments have been made to certain provisions of the Programme (including certain provisions of the Transaction Documents) as a result of the RCB Regulations. In particular, under the terms of the Transaction Documents as amended, following the realisation of the Security and/or the commencement of winding-up proceedings in respect of the LLP, all funds available to the LLP will be paid and applied in accordance with the Post-Enforcement Priority of Payments (subject to those matters described in *Expenses of the insolvency officeholders* below). In addition, the RCB Regulations and the RCB Sourcebook impose certain new ongoing

obligations and liabilities on both the Issuer and the LLP. In this regard, the LLP is required to (amongst other things) following the insolvency of the Issuer, make arrangements for the maintenance and administration of the asset pool such that certain asset capability and quality related requirements are met.

The FSA may take certain actions in respect of the Issuer and/or the LLP for failure to comply with the RCB Regulations and to the RCB Sourcebook. Such actions include directing the winding-up of the LLP, removing the Issuer from the register of issuers with the result that the Issuer may not make any further issue under the Programme (but pursuant to the RCB Regulations a regulated covered bond may not be removed from the register of regulated covered bonds prior to the expiry of the whole period of validity of the relevant bond), directing the Issuer and/or the LLP to take specified steps for the purposes of complying with the RCB Regulations and/or imposing a financial penalty of such amount as it considers appropriate in respect of the Issuer or the LLP. Moreover, as the body which regulates the financial services industry in the UK, the FSA may take certain actions in respect of issuers using its general powers under the UK regulatory regime (including restricting an issuer's ability to transfer further assets to the asset pool). There is a risk that any such enforcement actions by the FSA may reduce the amounts available to pay Covered Bondholders. However, pursuant to Condition 10(a)(ii), non-compliance by the Issuer with any obligation to provide notices to the FSA under the RCB Regulations and/or the RCB Sourcebook will not constitute an HBOS Event of Default. Nonetheless, any such non-compliance may impact the Issuer's registration with the FSA which may negatively impact the Covered Bonds.

With respect to the risks referred to above, see also *Cashflows* and *Description of the UK Regulated Covered Bonds Regime* below for further details.

### **1.15 Expenses of insolvency officeholders**

Under the RCB Regulations, following the realisation of any asset pool security and/or a winding-up of the LLP, certain costs and expenses are payable out of the fixed and floating charge assets of the LLP in priority to the claims of other Secured Creditors (including the Covered Bondholders). Such costs and expenses are also payable out of the floating charge assets of the LLP (but it would appear not out of the fixed charge assets) in priority to the claims of the Secured Creditors in an administration of the LLP. Such costs and expenses include costs incurred by an insolvency officeholder (including an administrative receiver, liquidator or administrator) in relation to certain senior service providers, and hedge counterparties and also general expenses incurred in the corresponding insolvency proceedings in respect of the LLP (which could include any corporation tax charges). This is a departure from the general position under English law which provides that in general the expenses of any administration or winding up rank ahead of unsecured debts and the claims of any floating chargeholder but below the claims of any fixed chargeholder.

It is intended that the LLP should be a bankruptcy-remote entity and a provision has been included in the Deed of Charge such that, in certain post-enforcement scenarios, each Secured Creditor agrees in effect that (amongst other things) if it receives certain subordinated amounts in respect of any secured liabilities owed to it other than in accordance with the Post-Enforcement Priority of Payments (referred to under *Cashflows* below) then such amounts will be held on trust for the Security Trustee and paid over to the Security Trustee immediately upon receipt so that such amounts may be applied in accordance with that priority of payments. Notwithstanding such provision, there is a risk that in certain circumstances the relevant provisions of the RCB Regulations will result in a reduction in the amounts available to pay Covered Bondholders. In particular, it is not possible to bind third parties (such as HMRC) in relation to such subordination provisions.

See also the investment consideration described here below under *Liquidation Expenses*.

## **1.16 Covered Bonds not guaranteed by UK Government**

On 8 October 2008, the UK Government announced the introduction of a new credit guarantee scheme pursuant to which the UK Government will make available to eligible institutions for an interim period a guarantee of new short and medium term debt issuance to assist in refinancing maturing, wholesale funding obligations as they fall due. The UK Government has indicated that certain debt instruments including UK covered bonds are not covered by the guarantee provided under the scheme and, as such, for the avoidance of doubt, the obligations of the Issuer in respect of the Covered Bonds are not guaranteed by the UK Government. In addition, any investment in the Covered Bonds does not have the status of a bank deposit in the United Kingdom and is not within the scope of the UK Financial Services Compensation Scheme.

In addition, on 22 April 2009, the UK Government announced the introduction of a new asset-backed securities guarantee scheme (the “**ABS Guarantee Scheme**”) pursuant to which the UK Government will make available to eligible institutions for an interim period a guarantee (covering either credit or liquidity) of certain asset-backed securities backed by eligible residential mortgage assets. The ABS Guarantee Scheme applies only to asset-backed securities and not UK covered bonds and, as such, for the avoidance of doubt, the obligations of the Issuer in respect of the Covered Bonds are not guaranteed by the UK Government.

## **1.17 Integral multiples of less than €50,000**

Although Covered Bonds which are admitted to trading on a regulated market in the European Economic Area or offered to the public in a member state of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive are required to have a minimum denomination of €50,000 (or, where the specified currency is not euro, its equivalent in the specified currency) (the “**Minimum Specified Denomination**”), it is possible that the Covered Bonds may be traded in the clearing systems in amounts in excess of €50,000 (or its equivalent in alternate currencies) that are not integral multiples of €50,000 (or its equivalent in alternate currencies). In relation to any issue of Covered Bonds that have a denomination consisting of the Minimum Specified Denomination plus a higher integral multiple of another smaller amount, it is possible that the Covered Bonds may be traded in amounts in excess of €50,000 (or its equivalent) that are not integral multiples of €50,000 (or its equivalent). In such a case a Covered Bondholder, who, as a result of trading such amounts, holds a principal amount of less than the Minimum Specified Denomination may not receive definitive Covered Bonds in respect of such holding (should definitive Covered Bonds be printed) and may need to purchase a principal amount of Covered Bonds such that its holding is at least the Minimum Specified Denomination.

If definitive Covered Bonds are issued, Covered Bondholders should be aware that definitive Covered Bonds that have a denomination that is not an integral multiple of the Minimum Specified Denomination may be illiquid and difficult to trade.

## **1.18 Factors which are material for the purpose of assessing the market risks associated with Covered Bonds issued under the Programme**

### *1.18.1 The Covered Bonds may not be a suitable investment for all investors*

Each potential investor in the Covered Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the Covered Bonds, the merits and risks of investing in the Covered Bonds and the information contained or incorporated by reference in this Offering Circular or any applicable supplement;

- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Covered Bonds and the impact the Covered Bonds will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Covered Bonds, including Covered Bonds with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;
- (iv) understand thoroughly the terms of the Covered Bonds and be familiar with the behaviour of any relevant indices and financial markets; and
- (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Covered Bonds are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Covered Bonds which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Covered Bonds will perform under changing conditions, the resulting effects on the value of the Covered Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

#### *1.18.2 Covered Bonds not in physical form*

Unless the Bearer Global Covered Bonds or the Registered Global Covered Bonds are exchanged for Bearer Definitive Covered Bonds or Registered Definitive Covered Bonds, respectively, which exchange will only occur in the limited circumstances set out under *Form of the Covered Bonds – Bearer Covered Bonds* and *Form of the Covered Bonds – Registered Covered Bonds* below, the beneficial ownership of the Covered Bonds will be recorded in book-entry form only with Euroclear and Clearstream, Luxembourg and/or DTC. The fact that the Covered Bonds are not represented in physical form could, among other things:

- result in payment delays on the Covered Bonds because distributions on the Covered Bonds will be sent by or on behalf of the Issuer to Euroclear, Clearstream, Luxembourg or DTC instead of directly to Covered Bondholders;
- make it difficult for Covered Bondholders to pledge the Covered Bonds as security if Covered Bonds in physical form are required or necessary for such purposes; and
- hinder the ability of Covered Bondholders to resell the Covered Bonds because some investors may be unwilling to buy Covered Bonds that are not in physical form.

#### *1.18.3 Risks related to the structure of a particular issue of Covered Bonds*

A wide range of Covered Bonds may be issued under the Programme. A number of these Covered Bonds may have features which contain particular risks for potential investors. Set out below is a description of the most common such features:

#### *1.18.3.1 Covered Bonds subject to optional redemption by the Issuer*

An optional redemption feature of Covered Bonds is likely to limit their market value. During any period when the Issuer may elect to redeem Covered Bonds, the market value of those Covered Bonds generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

The Issuer may be expected to redeem Covered Bonds when its cost of borrowing is lower than the interest rate on the Covered Bonds. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Covered Bonds being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

#### *1.18.3.2 Covered Bonds subject to Redemption for Taxation reasons*

Unless in the case of any particular Tranche or Series of Covered Bonds the relevant Final Terms specify otherwise, in the event that the Issuer would be obliged to increase the amounts payable in respect of any Covered Bonds due to any withholding or deduction for or on account of any present or future taxes, duties, or other charges of whatever nature imposed or levied by or on behalf of the United Kingdom or any authority therein or thereof having power to tax, the Issuer may redeem all outstanding Covered Bonds in accordance with the Terms and Conditions.

#### *1.18.4 Index Linked Covered Bonds and Dual Currency Covered Bonds*

The Issuer may issue Covered Bonds with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a “**Relevant Factor**”). In addition, the Issuer may issue Covered Bonds with principal or interest payable in one or more currencies which may be different from the currency in which the Covered Bonds are denominated. Potential investors should be aware that:

- (i) the market price of such Covered Bonds may be volatile;
- (ii) they may receive no interest;
- (iii) payment of principal or interest may occur at a different time or in a different currency from that expected;
- (iv) they may lose all or a substantial portion of their principal;
- (v) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (vi) if a Relevant Factor is applied to Covered Bonds in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

The historical experience of an index should not be viewed as an indication of the future performance of such index during the term of any Index Linked Covered Bonds. Accordingly, an investor should consult its own financial, tax and legal advisers about the risk entailed by an

investment in any Index Linked Covered Bonds and the suitability of such Covered Bonds in light of their particular circumstances.

#### *1.18.5 Partly-paid Covered Bonds*

The Issuer may issue Covered Bonds where the issue price is payable in more than one instalment. Failure to pay any subsequent instalment could result in an investor losing all of his investment.

#### *1.18.6 Variable rate Covered Bonds with a multiplier or other leverage factor*

Covered Bonds with variable interest rates can be volatile investments. If they are structured to include multipliers or other leverage factors, or caps or floors, or any combination of those features or other similar related features, their market values may be even more volatile than those for securities that do not include those features.

#### *1.18.7 Inverse Floating Rate Covered Bonds*

Inverse Floating Rate Covered Bonds have an interest rate equal to a fixed rate minus a rate based upon a reference rate such as LIBOR. The market values of those Covered Bonds typically are more volatile than market values of other conventional floating rate debt securities based on the same reference rate (and with otherwise comparable terms). Inverse Floating Rate Covered Bonds are more volatile because an increase in the reference rate not only decreases the interest rate of the Covered Bonds, but may also reflect an increase in prevailing interest rates, which further adversely affects the market value of these Covered Bonds.

#### *1.18.8 Fixed/Floating Rate Covered Bonds*

Fixed/Floating Rate Covered Bonds may bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Where the Issuer has the right to effect such a conversion, this will affect the secondary market and the market value of the Covered Bonds since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate in such circumstances, the spread on the Fixed/Floating Rate Covered Bonds may be less favourable than then prevailing spreads on comparable Floating Rate Covered Bonds tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Covered Bonds. If the Issuer converts from a floating rate to a fixed rate in such circumstances, the fixed rate may be lower than then prevailing rates on its Covered Bonds.

#### *1.18.9 Covered Bonds issued at a substantial discount or premium*

The market values of securities issued at a substantial discount or premium from their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of the securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

#### *1.18.10 Risks related to Covered Bonds generally*

Set out below is a brief description of certain risks relating to the Covered Bonds generally:

#### *1.18.10.1 Modification, waivers and substitution*

The conditions of the Covered Bonds contain provisions for calling meetings of Covered Bondholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Covered Bondholders including Covered Bondholders who did not attend and vote at the relevant meeting and Covered Bondholders who voted in a manner contrary to the majority.

The conditions of the Covered Bonds also provide that the Bond Trustee may, without the consent of Covered Bondholders, agree to (i) any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of Covered Bonds or (ii) determine at its discretion whether certain events of default shall not be treated as such or (iii) the substitution of the HBOS Group Guarantor as principal debtor under any Covered Bonds in place of the Issuer, in the circumstances described in Condition 15 of the conditions of the Covered Bonds.

#### *1.18.10.2 EU Savings Directive*

Under EC Council Directive 2003/48/EC (the “**Directive**”) on the taxation of savings income, each Member State of the European Economic Area is required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria may instead operate a withholding system in relation to such payments, deducting tax at rates rising over time to 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-European Union countries to the exchange of information relating to such payments.

A number of non-European Union countries and certain dependent and associated territories have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

If a payment were to be made or collected through a Member State which has opted for a withholding system, or through another country that has adopted similar measures, and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Covered Bond as a result of the imposition of such withholding tax. However, the Issuer is required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive.

On 15 September 2008, the European Commission issued a report to the Council of the European Union on the operation of the Directive, which included the Commission's advice on the need for changes to the Directive. On 13 November 2008, the European Commission published a more detailed proposal for amendments to the Directive, which included a number of suggested changes. The European Parliament approved amendments to this proposal on 24 April 2009. If any of those proposed changes are made in relation to the Directive, they may amend or broaden the scope of the requirements described above.



### *1.18.10.3 Trading in the clearing systems*

In relation to issue of any Covered Bonds which have a minimum denomination and are tradeable in the clearing systems in amounts above such minimum denomination which are smaller than that minimum denomination, should definitive Covered Bonds be required to be issued, a holder who does not have an integral multiple of the minimum denomination in his account with the relevant clearing system at the relevant time may not receive all of his entitlement in the form of definitive Covered Bonds unless and until such time as his holding becomes an integral multiple of the minimum denomination.

### *1.18.11 Risks related to the market generally*

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

### *1.18.12 The secondary market generally*

Covered Bonds may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid and may not continue for the life of the Covered Bonds. Therefore, investors may not be able to sell their Covered Bonds easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. This is particularly the case for Covered Bonds that are especially sensitive to interest rate, currency or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Covered Bonds generally would have a more limited secondary market and more price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of Covered Bonds.

### *1.18.13 Liquidity in the secondary market may adversely affect the market value of the Covered Bonds*

As at the date of this Offering Circular, the secondary market for mortgage-backed securities is experiencing disruptions resulting from reduced investor demand for such securities. This has had a materially adverse impact on the market value of mortgage-backed securities and resulted in the secondary market for mortgage-backed securities experiencing very limited liquidity. Structured investment vehicles, hedge funds, issuers of collateralised debt obligations and other similar entities that are currently experiencing funding difficulties have been forced to sell mortgage-backed securities into the secondary market. The price of credit protection on mortgage-backed securities through credit derivatives has risen materially. Limited liquidity in the secondary market may continue to have an adverse effect on the market value of mortgage-backed securities, especially those securities that are more sensitive to prepayment, credit or interest rate risk and those securities that have been structured to meet the requirements of limited categories of investors. Consequently, whilst these market conditions continue to persist, an investor in Covered Bonds may not be able to sell or acquire credit protection on its Covered Bonds readily and market values of Covered Bonds are likely to fluctuate. Any of these fluctuations may be significant and could result in significant losses to Covered Bondholders.

It is not known for how long the market conditions will continue or whether they will worsen. Further deterioration in wholesale funding markets may have an adverse effect on all UK financial services institutions including the Issuer. During the second half of 2007, the wholesale funding markets (including the international debt capital markets) experienced, and continue to experience, significant disruptions.

In addition, the current liquidity crisis has stalled the primary market for a number of financial products including covered bonds and mortgage-backed securities. While it is possible that the current liquidity crisis may soon alleviate for certain sectors of the global credit markets, there can be no assurance that the market for covered bonds and mortgage-backed securities will recover at the same time or to the same degree as such other recovering global credit market sectors.

As a result of the current liquidity crisis, there exist significant additional risks to the Issuer and the investors which may affect the returns on the Covered Bonds to investors.

#### *1.18.14 Exchange rate risks and exchange controls*

The Issuer will pay principal and interest on the Covered Bonds and the Guarantors will make any payments under the HBOS Group Guarantee and Covered Bond Guarantee in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Covered Bonds, (2) the Investor's Currency-equivalent value of the principal payable on the Covered Bonds and (3) the Investor's Currency-equivalent market value of the Covered Bonds.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

#### *1.18.15 Interest rate risks*

Investment in Fixed Rate Covered Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Covered Bonds.

#### *1.18.16 Risks relating to the Basel Framework*

Following the issue of proposals from the Basel Committee on Banking Supervision for reform of the 1988 Capital Accord, a framework has been developed by the Basel Committee on Banking Supervision which places enhanced emphasis on market discipline and sensitivity to risk. A comprehensive version of the text of the framework was published in June 2006 under the title "International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version)" (the "**Framework**"). The Framework is not self-implementing and, accordingly, implementation dates in participating countries are dependent on the relevant national implementation process in those countries.

In July 2009, the Basel Committee finalised certain revisions to the Framework, including changes intended to enhance certain securitisation requirements (e.g. increased risk weights for "resecuritisation" exposures). In addition, the European Parliament has approved certain amendments to the Capital Requirements Directive 2006/49/EC (the CRD) (including investment restrictions and due diligence requirements in respect of securitisation exposures) and the European Commission has put forward further securitisation related amendments to the European Parliament and the Council of Ministers for consideration (including increased capital charges for relevant trading book exposures and for resecuritisation exposures). As and when implemented, the Framework (and any relevant changes to it or to any relevant implementing measures) may affect the risk-weighting of the Covered Bonds for investors who are subject to capital adequacy requirements that follow the Framework.

Consequently, investors should consult their own advisers as to the implications for them of the application of the Framework and any relevant implementing measures.

#### *1.18.17 Legal investment considerations may restrict certain investments*

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) Covered Bonds are legal investments for it, (2) Covered Bonds can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Covered Bonds. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Covered Bonds under any applicable risk-based capital or similar rules.

#### *1.18.18 Recent mortgage loan market developments*

In late 2006 the sub-prime mortgage loan market in the United States commenced a period characterised by a large number of borrower defaults. Prior to the commencement of such period, a significant volume of sub prime mortgage loans had been securitised and, in turn, sub-prime mortgage backed securities had been sold to various investment funds. As a result of the deterioration of the U.S. sub-prime mortgage loan market, funds and institutions that invested in U.S. sub-prime mortgage-backed securities began experiencing significant losses which has triggered a series of events that have resulted in a severe liquidity crisis in the global credit markets since the summer of 2007.

There exist significant additional risks for the Issuer, the LLP and investors as a result of the current liquidity crisis. Those risks include, among others, (i) the likelihood that the Issuer and the LLP will find it harder to sell any of its assets in the secondary market, (ii) the possibility that, on or after the Issue Date, the price at which assets can be sold by the Issuer will have deteriorated from their effective purchase price and (iii) the increased illiquidity of mortgage-backed securities as there is currently limited liquidity in the secondary markets. These additional risks may affect the returns on the Covered Bonds to investors and/or the ability of investors to realise their investment in the Covered Bonds prior to their stated maturity.

The impact of the liquidity crisis on the primary market may additionally adversely affect the servicing flexibility of the Servicer in relation to the Portfolio and, ultimately the returns on the Covered Bonds to investors.

### **1.19 Conflicts of Interest**

Conflicts of interest may arise during the life of the Programme as a result of various factors involving certain transaction parties. For example, such potential conflicts may arise because members of Lloyds Banking Group act in several capacities under the Transaction Documents although the relevant rights and obligations under the Transaction Documents are not contractually conflicting and are independent from one another. Also during the course of their business activities, the transaction parties and/or any respective affiliates may operate, service, acquire or sell properties, or finance loans secured by properties, which are in the same markets as the Loans. In such cases, the interest of any of those parties or their affiliates or the interest of other parties for whom they perform servicing functions may differ from, and compete with, the interests of the Issuer or of the holders of the Covered Bonds.

## **1.20 The yield to maturity of the Covered Bonds may be adversely affected by redemptions by the Issuer**

The yield to maturity of each class of Covered Bonds will depend mostly on: (i) the amount and timing of the repayment of principal on the Covered Bonds, and (ii) the price paid by the Covered Bondholders of each class. The yield to maturity of the Covered Bonds may be adversely affected by a higher or lower than anticipated rate of redemption on the Covered Bonds.

## **2. RISKS RELATING TO LLOYDS BANKING GROUP PLC**

On 16 January 2009 Lloyds TSB Group plc acquired 100 per cent. of the ordinary share capital of HBOS plc and changed its name to Lloyds Banking Group plc. On 1 January 2010, Lloyds Banking Group plc transferred 100 per cent. of the ordinary share capital of HBOS plc to Lloyds TSB Bank plc. In this Offering Circular, references to “**Lloyds Banking Group**” are to Lloyds Banking Group plc and its subsidiary undertakings from time to time, references to “**Lloyds TSB Group**” are to Lloyds Banking Group plc and its subsidiary undertakings from time to time but excluding the HBOS Group and references to “**BOS Group**” are to Bank of Scotland plc and its subsidiary undertakings from time to time.

Set out below are certain risk factors relating to (i) the BOS Group, (ii) the HBOS Group and (iii) the HBOS Group (including the BOS Group) as part of Lloyds Banking Group that are relevant to the financial position and performance of the HBOS Group (including the Issuer and the HBOS Group Guarantor). These factors could affect the future results of Lloyds Banking Group (including the Issuer and the HBOS Group Guarantor) and cause them to be materially different from expected results. The factors discussed below should not be regarded as a complete and comprehensive statement of all the potential risks and uncertainties which the businesses of Lloyds Banking Group (including the Issuer and the HBOS Group Guarantor) face.

### **2.1 Risks relating to the BOS Group**

*2.1.1 The BOS Group’s businesses are subject to inherent risks arising from general and sector-specific economic conditions in the UK and other markets in which the BOS Group operates. Adverse developments, such as the severe dislocation in the global financial markets, recession, and further deterioration of general economic conditions, particularly in the UK, have already adversely affected the BOS Group’s earnings and profits and could continue to cause its earnings and profitability to decline. In addition, any credit rating downgrades of sovereigns, particularly the United Kingdom, Spain and Republic of Ireland (or a perception that downgrades may occur) may severely destabilise the markets and could have a material adverse effect on the BOS Group’s operating results, financial condition and prospects.*

The BOS Group’s businesses are subject to inherent risks arising from general and sector-specific economic conditions in the markets in which the BOS Group operates, particularly the United Kingdom, in which the BOS Group’s earnings are predominantly generated. Over approximately the past 2 years, the global economy and the global financial system have been experiencing a period of significant turbulence and uncertainty. The very severe dislocation of the financial markets around the world, that began in August 2007 and has substantially worsened since September 2008, triggered widespread problems at many large global and UK commercial banks, investment banks, insurance companies and other financial and related institutions. This dislocation has severely impacted general levels of liquidity, the availability of credit and the terms on which credit is available. This crisis in the financial markets led the UK Government and other governments to inject liquidity into the financial system and to require (and participate in) recapitalisation of the banking sector to reduce the risk of failure of certain large institutions and provide confidence to the market.

Despite this intervention, the volatility and market disruption in the banking sector has continued albeit with some easing in the second half of 2009. This market dislocation has also been accompanied by recessionary conditions and trends in many economies throughout the world, including the United Kingdom. The global economy has been in a severe recession, possibly the worst since World War II, although indications are that the UK has now emerged from its 18 month recession. The widespread and severe deterioration in the UK and virtually all other economies throughout the world, including, but not limited to, business and consumer confidence, unemployment trends, the state of the housing market, the commercial real estate sector, equity markets, bond markets, foreign exchange markets, commodity markets, counterparty risk, inflation, the availability and cost of credit, lower transaction volumes in key markets, the liquidity of the global financial markets and market interest rates, has already and could continue to reduce the level of demand for, and supply of, the BOS Group's products and services, lead to lower asset and other realisations and increased negative fair value adjustments and impairments of investments and other assets and materially and adversely impact its operating results, financial condition and prospects. While recent economic figures show a number of countries exiting recession, forecasts are that the recovery will be at a modest pace and is likely to be protracted. Any "double dip" recession causing further significant deterioration in the UK and other economies in which the BOS Group operates could have a material adverse impact on the future results of operations of the BOS Group. Moreover, any return to economic growth may be modest and is likely to be insufficient to prevent unemployment rising further. The rate at which deterioration of the global and UK economies has occurred has proven very difficult to predict and this will apply to any further deterioration or any recovery.

Additionally, the profitability of the BOS Group's businesses could be affected by market factors such as increased unemployment which may continue even following a return to economic growth in the markets in which the BOS Group operates. Significantly higher unemployment in the UK and elsewhere, reduced corporate profitability, reduced personal non-salary income levels, increased corporate insolvency rates, increased personal insolvency rates, increased tenant defaults and/or increased interest rates may reduce borrowers' ability to repay loans and may cause prices of residential or commercial real estate or other asset prices to fall further, thereby reducing the collateral value on many of the BOS Group's loans. This, in turn, would cause increased impairments in the event of default. Poor general economic conditions, lack of market liquidity and lack of transparency of asset structures have depressed asset valuations for the BOS Group and could continue to do so if there is a further deterioration in general economic conditions.

The BOS Group has significant exposures, particularly by way of loans, in a number of overseas jurisdictions, notably Ireland, Spain, Australia and the United States, and is therefore subject to a variety of risks relating to the performance of these economies as well.

The BOS Group's businesses are subject to risks arising from the current UK macroeconomic environment, high and increasing levels of UK government debt and uncertainty around the outcome of the forthcoming UK general election (including the possibility of a minority or coalition administration which may be unable to take decisive fiscal and other measures to reduce government debt levels resulting in heightened market uncertainty). Further, any downgrade of the UK sovereign credit rating or the perception that such a downgrade may occur may severely destabilise the markets and have a material adverse effect on the BOS Group's operating results, financial condition and prospects. This might also include impact on the BOS Group's own credit ratings, borrowing costs and ability to fund itself.

A UK sovereign downgrade or the perception that such a downgrade may occur would be likely to have a material effect in depressing consumer confidence, restricting the availability, and increasing the cost, of funding for individuals and companies, further depressing economic activity, increasing unemployment, reducing asset prices and consequently increasing the risk of a "double-dip" recession.

These risks are exacerbated by concerns over the levels of the public debt of, and the weakness of the economies in, Italy, the Republic of Ireland, Greece, Portugal, and Spain in particular. Further instability in these countries or others within the Eurozone might lead to contagion, which may have a material adverse effect on the BOS Group's operating results, financial condition and prospects.

The exact nature of the risks faced by the BOS Group is difficult to predict and guard against in view of (i) the severity of the global financial crisis, (ii) difficulties in predicting whether the recovery will be sustained and at what rate, and (iii) the fact that many of the related risks to the business are totally, or in part, outside the control of the BOS Group.

*2.1.2 The BOS Group's businesses are inherently subject to the risk of market fluctuations, which could materially adversely affect its operating results, financial condition and prospects.*

The BOS Group's businesses are inherently subject to risks in financial markets and in the wider economy, including changes in, and increased volatility of, interest rates, inflation rates, credit spreads, foreign exchange rates, commodity, equity, bond and property prices, and the risk that its customers act in a manner which is inconsistent with business, pricing and hedging assumptions.

Market movements have had and will have an impact on the BOS Group in a number of key areas. For example, adverse market movements have had and would have an adverse effect, which could be material, upon the financial condition of the pension schemes of the HBOS Group of which the BOS Group is a participating employer. Banking and trading activities that are undertaken by the BOS Group are subject to interest rate risk, foreign exchange risk, inflation risk and credit spread risk. For example, changes in interest rate levels, yield curves and spreads affect the interest rate margin realised between lending and borrowing costs. Since August 2007, there has been a period of unprecedented high and volatile interbank lending margins over official rates (to the extent banks have been willing to lend at all), which has exacerbated these risks. The margins over official rates have recently reduced to historically more normal levels but volatility and increases in margins may return. Competitive pressures on fixed rates or product terms in existing loans and deposits sometimes restrict the BOS Group in its ability to change interest rates applying to customers in response to changes in official and wholesale market rates.

For a discussion of market risks affecting the insurance businesses of the HBOS Group see "*Risk Factors – Risks relating to the HBOS Group other than those relating to the Issuer – The HBOS Group's insurance businesses and employee pension schemes are subject to risks relating to insurance claim rates, pension scheme benefit payment levels and changes in insurance customer and employee pension scheme member behaviour.*"

Changes in foreign exchange rates affect the value of assets and liabilities denominated in foreign currencies and such changes and the degree of volatility with respect thereto may affect earnings reported by the BOS Group. In the BOS Group's international businesses, earnings and net assets are denominated in local currency, which will fluctuate with exchange rates in pounds sterling terms. It is difficult to predict with any accuracy changes in economic or market conditions, and such changes could have a material adverse effect on the BOS Group's operating results, financial condition and prospects.

*2.1.3 The BOS Group's businesses are conducted in highly competitive environments and the BOS Group's financial performance depends upon management's ability to respond effectively to competitive pressures.*

The markets for UK financial services, and the other markets within which the BOS Group operates, are highly competitive, and management expects such competition to intensify in response to competitor behaviour, consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors. Moreover, UK Government and/or European intervention in the banking sector may impact the competitive position of the BOS Group relative to its international competitors which may be subject to different forms of government intervention, thus potentially putting the BOS Group at a competitive disadvantage to local banks in such jurisdictions. Any combination of these factors could result in a reduction in profit. The BOS Group's financial performance and its ability to capture additional market share depends significantly upon the competitive environment and management's response to it.

The BOS Group's financial performance may be materially and adversely affected by competition, including declining lending margins or competition for savings driving up funding costs which cannot be recovered from borrowers.

A key part of the BOS Group's strategy involves building strong customer relationships in order to win a bigger share of its customers' financial services spend. If the BOS Group is not successful in retaining and strengthening customer relationships it will not be able to deliver on this strategy, and may lose market share, incur losses on some or all of its activities or fail to attract new and retain existing deposits, which could have a material adverse effect on its business, financial condition and results of operations.

*2.1.4 Market conditions have resulted, and are expected to result in the future, in material changes to the estimated fair values of financial assets of the BOS Group. Negative fair value adjustments have had, and may continue to have in the future, a further material adverse effect on the BOS Group's operating results, financial condition and prospects.*

Financial markets have been subject to significant stress conditions resulting in steep falls in perceived or actual financial asset values, particularly due to the severe dislocation in the global financial markets.

The BOS Group has material exposures to securities and other investments, including, but not limited to, asset-backed securities, structured investments and private equity investments, that are recorded at fair value and are therefore exposed to further negative fair value adjustments, particularly in view of market dislocation and the fragility of the economic recovery. Although the board of Directors of Lloyds Banking Group plc (the "**Board**") believes that overall impairments for Lloyds Banking Group have peaked, asset valuations in future periods, reflecting prevailing market conditions, may result in further negative changes in the fair values of the BOS Group's financial assets and these may also translate into increased impairments. In addition, the value ultimately realised by the BOS Group for its securities and other investments may be lower than the current fair value. Any of these factors could require the BOS Group to record further negative fair value adjustments, which may have a material adverse effect on its operating results, financial condition or prospects.

The BOS Group has made asset redesignations as permitted by recent amendments to IAS 39 ("Financial Instruments: Recognition and Measurement"). The effect of such redesignations has been, and would be, that any effect on the income statement of movements in the fair value of such redesignated assets that have occurred since 1 July 2008, in the case of assets redesignated prior to 1 November 2008, or may occur in the future, may not be recognised until such time as the assets become impaired or are disposed of.

In addition, to the extent that fair values are determined using financial valuation models, the data used by such models may not be available or may become unavailable due to changes in market

conditions, particularly for illiquid assets, and particularly in times of substantial instability. In such circumstances, the BOS Group's valuation methodologies require it to make assumptions, judgements and estimates in order to establish fair value. These valuation models are complex and the assumptions used are difficult to make and are inherently uncertain, particularly in light of the uncertainty resulting from the current and ongoing crisis in the global financial markets, and any consequential impairments or write-downs could have a material adverse effect on the BOS Group's operating results, financial condition and prospects.

*2.1.5 The BOS Group's businesses are subject to inherent risks concerning borrower and counterparty credit quality which have affected and are expected to continue to affect the recoverability and value of assets on the BOS Group's balance sheet.*

The BOS Group (as a part of Lloyds Banking Group which is one of the UK's largest lenders with substantial business and operations overseas) has exposures to many different products and counterparties, and the credit quality of its exposures can have a significant impact on its earnings. The BOS Group makes both secured and unsecured loans to retail and corporate customers and the BOS Group's businesses are subject to inherent risks regarding the credit quality of, the recovery of loans to and amounts due from, customers and market counterparties. Adverse changes in the credit quality of the BOS Group's UK and/or international borrowers and counterparties, or in their behaviour, would be expected to reduce the value of the BOS Group's assets, and materially increase the BOS Group's write-downs and allowances for impairment losses. The BOS Group has a direct exposure to self-certification and sub-prime mortgages in the UK and is subject to the inherent risk of these types of mortgages and also has exposure to high risk buy-to-let mortgages.

The BOS Group estimates and establishes reserves for credit risks and potential credit losses inherent in its credit exposure. This process, which is critical to its results and financial condition, requires difficult, subjective and complex judgements, including forecasts of how these economic conditions might impair the ability of its borrowers to repay their loans. As is the case with any such assessments, there is always a risk that the BOS Group will fail to identify the proper factors or that it will fail to estimate accurately the impact of factors that it identifies.

As part of Lloyds Banking Group, the BOS Group's wholesale portfolio has significant sectoral concentrations (for example in real estate, leveraged lending, asset-backed securities and floating rate notes issued by financial institutions), resulting in high levels of credit risk.

At the time of the acquisition of HBOS plc by Lloyds Banking Group plc (the "**Acquisition**"), the average rating of the HBOS Group's corporate lending portfolio was significantly weaker than that of the heritage Lloyds TSB Group, and this continues to be the case. HBOS had substantial lending to mid-sized and private companies, a greater exposure than the heritage Lloyds TSB Group to leveraged finance and subordinated loans, as well as significant exposure to the commercial real estate sector, including hotels and residential property developers, which has been particularly adversely affected by the recessionary environment. These concentrations in cyclically weak sectors, as well as exposure at various levels of the capital structure, mean that the HBOS Group's wholesale business is potentially exposed to high and volatile levels of impairments.

It should be noted that the heritage HBOS portfolio in Ireland is heavily exposed to the commercial and residential real estate sectors, which have been negatively impacted by the current economic recession, the portfolio in Australia has material exposure to real estate and leveraged lending, and in the United States there are notable exposures to sectors such as gaming and real estate which are cyclically weak and have been negatively impacted by the economic recession. As in the UK, the heritage HBOS portfolio overseas is also particularly exposed to a small number of long-term customer relationships and these single name concentrations place the BOS Group at risk of loss should default occur.



UK house prices have declined significantly, albeit modest increases have been evident in recent months, reflecting a correction of severely inflated asset values, triggered by the economic downturn and lower availability of credit. Economic or other factors may lead to further contraction in the mortgage market and further decreases in housing prices. Many borrowers in the UK borrow on short-term fixed or discounted floating rates and when such rates expire the continued reduced supply and stricter terms of mortgages, together with the potential for higher mortgage rates, could lead to higher default and delinquency rates. The BOS Group provides mortgages to buy-to-let investors where increasing unemployment, an excess supply of rental property or falls in rental demand could also impact the borrowers' income and ability to service the loans. If interest rates rise, or the current economic recovery falters, causing further decreases in house prices and/or increases in unemployment, the BOS Group's retail portfolios could generate substantial impairment losses which could materially affect its operations, financial condition and prospects. Furthermore, the BOS Group has direct exposure to self-certification and sub-prime mortgages in the UK and is therefore subject to the risks inherent in this type of mortgage lending in the event of decreases in house prices, increases in unemployment or a reduction in borrowers' incomes and the risk that the BOS Group has incorrectly assessed the credit quality or willingness to pay of borrowers as a result of incomplete or inaccurate disclosure by those borrowers. At present, mortgage default and delinquency rates are cushioned by unprecedented low rates of interest which have improved customer affordability, and this has created the risk of increased defaults and delinquency rates as the economy recovers from the recession and interest rates start to rise.

Although the Board believes that overall impairments for the BOS Group have peaked, there is a risk of further increases in the impairment charges for some businesses and there remain ongoing concerns with regard to the outlook for the Irish economy in particular. Moreover, there remains a risk that further material impairments in the BOS Group's portfolios could come to light, particularly in the event of any further significant deterioration in the economic environment although the performance of some of the BOS Group's exposures might deteriorate further even in the absence of further economic decline, particularly in Ireland. Any such unforeseen material further impairments could have a material and adverse effect on the BOS Group's operations, financial condition and prospects.

#### *2.1.6 Concentration of credit and market risk could increase the potential for significant losses.*

The BOS Group has exposure to concentration risk where its business activities focus particularly on a similar type of customer or product or geographic location, including the UK market, which could be adversely affected by changes in economic conditions. Additionally, the HBOS Group's prior strategy of supporting UK entrepreneurs together with its joint venture model and its focus on commercial property lending has given rise to significant single name and risk capital exposure. Given the BOS Group's high concentrations of property exposure, further decreases in residential or commercial property values and/or further tenant defaults are likely to lead to higher impairment losses, which could materially affect its operations, financial condition and prospects.

The BOS Group's efforts to diversify or hedge its credit portfolio against concentration risks may not be successful and any concentration of credit risk could increase the potential for significant losses in its credit portfolio. In addition, the disruption in the liquidity or transparency of the financial markets may result in the BOS Group's inability to sell or syndicate securities, loans or other instruments or positions held, thereby leading to increased concentrations of such positions. These concentrations could expose the BOS Group to losses if the mark-to-market value of the securities, loans or other instruments or positions declines causing the BOS Group to take write-downs. Moreover, the inability to reduce the BOS Group's positions not only increases the market and credit risks associated with such positions, but also increases the level of risk-weighted assets on the BOS Group's balance sheet, thereby increasing its capital requirements and funding costs, all of which

could adversely affect the BOS Group's operating results, financial condition and prospects. Market conditions at present mean that it is difficult to achieve sales to ameliorate these concentrations.

*2.1.7 If the perceived creditworthiness of market counterparties does not improve or continues to deteriorate, the BOS Group may be forced to record further credit valuation adjustments on securities insured or guaranteed by such parties, which could have a material adverse effect on the BOS Group's results of operations, financial condition and prospects.*

The BOS Group has credit exposure to market counterparties through securities insured or guaranteed by such parties and credit protection bought from such parties with respect to certain over-the-counter derivative contracts, mainly credit default swaps ("CDSs") which are carried at fair value. The fair value of these underlying CDSs and other securities, and the BOS Group's exposure to the risk of default by the underlying counterparties, depend on the valuation and the perceived credit risk of the instrument insured or guaranteed or against which protection has been bought. Market counterparties have been adversely affected by their exposure to residential mortgage-linked products, and their perceived creditworthiness has deteriorated significantly since 2007. They may continue to be substantially adversely impacted by such or other events. Their creditworthiness may further deteriorate as a consequence of the deterioration of the value of underlying assets. Although the BOS Group seeks to limit and manage direct exposure to market counterparties, indirect exposure may exist through other financial arrangements and counterparties. If the financial condition of market counterparties or their perceived creditworthiness deteriorates further, the BOS Group may record further credit valuation adjustments on the underlying instruments insured by such parties in addition to those already recorded. Any primary or indirect exposure to the financial condition or creditworthiness of these counterparties could have a material adverse impact on the results of operations, financial condition and prospects of the BOS Group.

*2.1.8 The BOS Group's borrowing costs and access to the capital markets depend significantly on the Issuer's credit ratings and those of HBOS plc, Lloyds Banking Group plc and Lloyds TSB Bank plc, and any deterioration could materially adversely affect the BOS Group's results of operations, financial condition and prospects.*

As at 10 March 2010, the long-term credit ratings for the HBOS Group Guarantor were A1 from Moody's, A from S&P and AA- (AA minus) from Fitch Ratings Ltd; and the long-term credit ratings for the Issuer were Aa3 from Moody's, A+ (A plus) from S&P and AA- (AA minus) from Fitch Ratings Ltd. As at 10 March 2010, the long-term credit ratings for Lloyds Banking Group plc were A1 from Moody's, A from S&P and AA- (AA minus) from Fitch and the long-term credit ratings for Lloyds TSB Bank plc were Aa3 from Moody's, A+ (A plus) from S&P and AA- (AA minus) from Fitch.

As at 10 March 2010, the HBOS Group Guarantor had short term ratings of P-1 from Moody's, A-1 from S&P and F1+ from Fitch and the Issuer had short term ratings of P-1 from Moody's, A-1 from S&P and F1+ from Fitch. Lloyds Banking Group plc also had short-term ratings of A-1 from S&P and F1+ from Fitch. Lloyds TSB Bank plc had short term ratings of P-1 from Moody's, A-1 from S&P and F1+ from Fitch.

Reduction in the credit ratings of the BOS Group or deterioration in the capital market's perception of the BOS Group's financial resilience, could significantly increase its borrowing costs, limit its access to the capital markets and trigger additional collateral requirements in derivative contracts and other secured funding arrangements. Therefore, any further reduction in credit ratings or deterioration of market perception could materially adversely affect the BOS Group's access to liquidity and competitive position, increase its funding costs and, hence, have a material adverse effect on the BOS Group's business, financial position and results of operations. These material adverse effects could also follow from a reduction in the credit ratings of the Issuer, HBOS plc,

Lloyds Banking Group plc or Lloyds TSB Bank plc. See *Risk Factors – General Risk Factors – Ratings of the Covered Bonds*.

*2.1.9 Businesses of Lloyds Banking Group (which includes the HBOS Group and the BOS Group which rely upon Lloyds TSB Bank plc as a key funding source) are subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits or the access to global wholesale money markets continues to be limited or becomes more limited. Lloyds Banking Group and its businesses continue to be reliant on various government liquidity schemes and since certain of these schemes are not expected to be renewed or extended Lloyds Banking Group and its businesses will face refinancing risk as transactions under these schemes mature.*

The businesses of Lloyds Banking Group are subject to risks concerning liquidity, which are inherent in banking operations. If access to liquidity is constrained for a prolonged period of time, this could affect the profitability of Lloyds Banking Group and its businesses. Lloyds TSB Bank plc is the primary funding source for the banking subsidiaries of Lloyds Banking Group including HBOS Group and BOS Group. Whilst Lloyds Banking Group and its businesses expect to have sufficient access to liquidity to meet its funding requirements even in a stressed scenario, under extreme and unforeseen circumstances a prolonged and severe restriction on Lloyds Banking Group's and its businesses' access to liquidity (including government and central bank funding and liquidity support) could affect Lloyds Banking Group's and its businesses' ability to meet their financial obligations as they fall due or to fulfil their commitments to lend and in such extreme circumstances Lloyds Banking Group and its businesses may not be in a position to continue to operate without additional funding support, which they may be unable to access, which could have a material impact on Lloyds Banking Group's and its businesses' solvency. These risks can be exacerbated by many enterprise-specific factors, including an over reliance on a particular source of funding (including, for example, securitisations, covered bonds, foreign markets and short-term and overnight money markets), changes in credit ratings, or market-wide phenomena such as market dislocation and major disasters. There is also a risk that corporate and institutional counterparties may look to reduce aggregate credit exposures to Lloyds Banking Group or to all banks, which could increase Lloyds Banking Group's and its businesses' cost of funding and limit access to liquidity. In addition, the funding structure employed by Lloyds Banking Group and its businesses may prove to be inefficient, giving rise to a level of funding cost that is not sustainable in the long run. The funding needs of Lloyds Banking Group and its businesses will increase to the extent that customers, including conduit vehicles of Lloyds Banking Group, draw down under existing credit arrangements and such increases in funding needs may be material. In order to continue to meet its funding obligations and to maintain or grow its businesses generally, Lloyds Banking Group and its businesses rely on customer savings and transmission balances, as well as ongoing access to the global wholesale funding markets, central bank liquidity facilities (for example, Bank of England, European Central Bank and Federal Reserve Bank of New York) and the UK Government Credit Guarantee Scheme. The ability of Lloyds Banking Group and its businesses to access wholesale and retail funding sources on satisfactory economic terms is subject to a variety of factors, including a number of factors outside of its control, such as liquidity constraints, general market conditions, regulatory requirements, the encouraged or mandated repatriation of deposits by foreign wholesale or central bank depositors and loss of confidence in the UK banking system, any of which could affect Lloyds Banking Group's and its businesses' profitability or, in the longer term under extreme circumstances, their ability to meet their financial obligations as they fall due.

Medium-term growth in the BOS Group's lending activities will depend, in part, on the availability of retail funding on appropriate terms, for which there is increasing competition. See "*Risk Factors – Risks Relating to the BOS Group – The BOS Group's businesses are conducted in highly competitive environments and the BOS Group's financial performance depends upon management's ability to respond effectively to competitive pressures*" for a discussion of the

competitive nature of the banking industry and competitive pressures that could have a negative impact on the availability of customer deposits and retail funding. This reliance has increased in the recent past given the difficulties in accessing wholesale funding. Increases in the cost of such funding will impact on the BOS Group's margins and affect profit, and a lack of availability of such retail deposit funding could impact on the BOS Group's future growth.

The ongoing availability of retail deposit funding is dependent on a variety of factors outside the BOS Group's control, such as general economic conditions and market volatility, the confidence of retail depositors in the economy in general and in Lloyds Banking Group in particular, the financial services industry specifically and the availability and extent of deposit guarantees. These or other factors could lead to a reduction in the BOS Group's ability to access retail deposit funding on appropriate terms in the future.

Any loss in consumer confidence in the banking businesses of Lloyds Banking Group could significantly increase the amount of retail deposit withdrawals in a short space of time and this may have an adverse effect on Lloyds Banking Group's profitability. Should Lloyds Banking Group experience an unusually high and unforeseen level of withdrawals, in such extreme circumstances Lloyds Banking Group may not be in a position to continue to operate without additional funding support, which it may be unable to access, which could have a material impact on Lloyds Banking Group's solvency.

Whilst Lloyds Banking Group expects to have sufficient access to liquidity to meet its funding requirements and those of its banking subsidiaries even in a stressed scenario, under extreme and unforeseen circumstances a prolonged and severe restriction on Lloyds Banking Group plc's and Lloyds TSB Bank plc's access to liquidity (including government and central bank funding and liquidity support) could prevent Lloyds Banking Group and its banking subsidiaries from meeting regulatory minimum liquidity requirements.

In addition, if the current difficulties in the wholesale funding markets are not resolved or central bank provision of liquidity to the financial markets is abruptly curtailed, it is likely that wholesale funding will prove even more difficult to obtain. Such liquidity constraints could affect Lloyds Banking Group's profitability. Whilst Lloyds Banking Group expects to have sufficient access to liquidity to meet its funding requirements even in a stressed scenario, under extreme and unforeseen circumstances a prolonged and severe restriction on Lloyds Banking Group's access to these traditional sources of liquidity could have a material adverse effect on Lloyds Banking Group's business, financial position and results of operations, and in such extreme circumstances Lloyds Banking Group may not be in a position to continue to operate without additional funding support, which it may be unable to access and which, in turn, could have a material impact on Lloyds Banking Group's solvency.

Whilst various governments, including the UK Government and central banks, have taken substantial measures to ease the crisis in liquidity, (for example, the UK Credit Guarantee Scheme), there can be no assurance that these measures will succeed in materially improving the liquidity position of major UK banks, including Lloyds Banking Group in the longer term. In addition, the availability and the terms on which any such measures will continue to be made available to Lloyds Banking Group in the longer term are uncertain. Lloyds Banking Group does not have influence over the policy making behind such measures. Further, there can be no assurance that these conditions will not lead to an increase in the overall concentration risk and cost of funding of Lloyds Banking Group. Lloyds Banking Group has substantially relied on the Bank of England liquidity facilities as well as the UK Government funding scheme.

Lloyds Banking Group does not expect that there will be any extension or renewal of the Special Liquidity Scheme (which was closed for new transactions in January 2009) or the Credit Guarantee Scheme (which was closed for new issuance in February 2010). Accordingly, Lloyds

Banking Group will face a refinancing concentration during 2011 and 2012 associated with the maturity of the Special Liquidity Scheme transactions and Credit Guarantee Scheme issuance undertaken by Lloyds Banking Group prior to the closure of those schemes. While Lloyds Banking Group expects that the impact of this refinancing concentration can be mitigated by a combination of alternative funding over the course of the next two years and reductions in Lloyds Banking Group's net wholesale funding requirement over the same period, there can be no assurance that these mitigation efforts will be successful. Under the GAPS Withdrawal Deed, Lloyds Banking Group has agreed to develop with the FSA a medium term funding plan aimed at reducing dependence on short term funding, to be regularly reviewed by the FSA and the Bank of England. If Lloyds Banking Group's funding plan is not successful in mitigating the impact of this refinancing concentration in 2011, Lloyds Banking Group could at that time face serious liquidity constraints, which would have a material adverse impact on its solvency.

At the time of the Acquisition, the HBOS Group had a funding profile that involved the need to refinance a higher volume of maturing wholesale funding than that of the heritage Lloyds TSB Group. As this continues to be the case, the funding profile of Lloyds Banking Group involves substantially higher refinancing risk than the funding profile of the heritage Lloyds TSB Group on a stand-alone basis. The HBOS Group (including the BOS Group) will also continue to be dependent on its credit ratings and those of Lloyds Banking Group in order to be able to attract wholesale investors into its debt issuance programmes; should the ratings fall, the cost of refinancing will increase and it may not be possible to refinance borrowings as they mature on favourable terms. Such increased refinancing risk, in isolation or in concert with the related liquidity risks noted above, could have a material adverse effect on the HBOS Group's profitability and, in the longer term under extreme and unforeseen circumstances, its ability to meet its financial obligations as they fall due.

*2.1.10 The BOS Group has been and could continue to be negatively affected by the soundness and/or the perceived soundness of other financial institutions, which could result in significant systemic liquidity problems, losses or defaults by other financial institutions and counterparties, and which could materially adversely affect the BOS Group's results of operations, financial condition and prospects.*

Against the backdrop of the lack of liquidity and the recent high cost of funds relative to official rates in the interbank lending market, which was unprecedented in recent history, the BOS Group is subject to the risk of deterioration of the commercial soundness and/or perceived soundness of other financial services institutions within and outside the United Kingdom. Financial services institutions that deal with each other are interrelated as a result of trading, investment, clearing, counterparty and other relationships. This risk is sometimes referred to as 'systemic risk' and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with whom the BOS Group interacts on a daily basis, all of which could have an adverse effect on the BOS Group's ability to raise new funding.

The BOS Group routinely executes a high volume of transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients, resulting in a significant credit concentration. The BOS Group is exposed to counterparty risk as a result of recent financial institution failures and nationalisations and will continue to be exposed to the risk of loss if counterparty financial institutions fail or are otherwise unable to meet their obligations. A default by, or even concerns about the financial resilience of, one or more financial services institutions could lead to further significant systemic liquidity problems, or losses or defaults by other financial institutions, which could have a material and adverse effect on the BOS Group's results of operations, financial condition and prospects.

*2.1.11 Risks Relating to the Banking Act 2009*

Under the Banking Act 2009 (the “**Banking Act**”), substantial powers have been granted to HM Treasury, the Bank of England and the FSA (together with HM Treasury and the Bank of England, the “**Authorities**”) under the special resolution regime (the “**SRR**”). These powers enable the Authorities to deal with and stabilise UK-incorporated institutions with permission to accept deposits pursuant to Part IV of the Financial Services and Markets Act 2000 (“**FSMA**”) (each a “**relevant entity**”) that are failing or are likely to fail to satisfy the threshold conditions (within the meaning of section 41 of the FSMA). The SRR consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity, or the shares or other securities of the relevant entity, to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a “bridge bank” wholly-owned by the Bank of England; and (iii) taking the relevant entity into temporary public ownership. HM Treasury may also take a parent company of a relevant entity into temporary public ownership where certain conditions are met. The Banking Act also provides for two new insolvency procedures for relevant entities (bank administration and bank insolvency).

Although Lloyds Banking Group currently meets all capital requirements, if the position of a relevant entity within Lloyds Banking Group (including the Issuer) was to decline so dramatically that it was considered to be failing, or likely to fail, to meet threshold authorisation conditions in the FSMA, it could become subject to the exercise of powers by the Authorities under the SRR.

In general, the Banking Act requires the Authorities to have regard to specified objectives in exercising the powers provided for by the Banking Act. One of the objectives (which is required to be balanced as appropriate with the other specified objectives) refers to the protection and enhancement of the stability of the financial systems of the United Kingdom. The Banking Act includes provisions related to compensation in respect of transfer instruments and orders made under it. In general, there is considerable uncertainty about the scope of the powers afforded to the Authorities under the Banking Act and how the Authorities may choose to exercise them. The following risk factors set out some of the possible consequences for the Issuer of the exercise of those powers under the SRR.

*2.1.12 The Issuer may become subject to the SRR, or the HBOS Group Guarantor (as holding company of the Issuer) may be taken into temporary public ownership, either prior to or after the point at which insolvency proceedings could be commenced in respect of the relevant entity if the Issuer fails to satisfy the threshold conditions set out in Schedule 6 to the FSMA and the relevant conditions of the Banking Act are met.*

The stabilisation powers may only be exercised if the FSA is satisfied that a relevant entity (such as the Issuer) (a) is failing, or is likely to fail, to satisfy the threshold conditions set out in Schedule 6 to the FSMA required to retain its FSA authorisation to accept deposits; and (b) having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilising options) action will be taken that will enable the relevant entity to satisfy those threshold conditions. In such circumstances and where certain further conditions are satisfied, (i) the Bank of England or HM Treasury could exercise the stabilisation powers in relation to the Issuer; or (ii) as a last resort HM Treasury may take a parent undertaking (such as the HBOS Group Guarantor) of a relevant entity into temporary public ownership irrespective of the financial condition of such parent undertaking. It is therefore possible that one of the stabilisation options could be exercised prior to the point at which any application for an insolvency or administration order with respect to the relevant entity could be made.

*2.1.13 Various actions may be taken in relation to any securities issued by the Issuer (including the Covered Bonds) without the consent of the holders thereof.*

If the Issuer is made subject to the SRR, HM Treasury may take various actions in relation to any securities issued by the Issuer (including the Covered Bonds) without the consent of the holders thereof, including (among other things):

- (a) transferring securities (including the Covered Bonds) free from any restrictions on transfer and free from any trust, liability or encumbrance;
- (b) delisting securities (including the Covered Bonds);
- (c) converting securities (including the Covered Bonds) into another form or class (for example, from debt securities into equity securities); or
- (d) prescribing that the transfer of securities (including the Covered Bonds) takes place free from any trust.

Accordingly, there can be no assurance that the taking of any such actions would not adversely affect:

- (a) the rights of the Covered Bondholders;
- (b) the price or value of their investment; and
- (c) the ability of the Issuer, or any other relevant party, to satisfy its obligations under the issued securities (including the Covered Bonds) or Transaction Documents.

Where the stabilisation powers are exercised, HM Treasury must make statutory provision for a scheme or other arrangements for determining the compensation, if any, due to those affected by an exercise of the powers. However, there can be no assurance that any compensation would be recovered promptly or that it would be equal to any loss actually incurred.

*2.1.14 If the HBOS Group Guarantor is taken into temporary public ownership or if the Issuer is made subject to the SRR, contractual arrangements between the Issuer, its group companies, and/or the bridge bank or private sector purchaser may be created, modified or cancelled.*

If the HBOS Group Guarantor is taken into temporary public ownership or if the Issuer is made subject to the SRR and a transfer of all or part of the Issuer's business or shares to another entity were effected, the transfer order or instrument may directly affect the Issuer and/or its group companies (including the HBOS Group Guarantor and the LLP) and commercial counterparties by creating, modifying or cancelling their contractual arrangements with a view to ensuring the provision of such services and facilities as are required to enable the bridge bank or private sector purchaser to operate the transferred business (or any part of it) effectively. For example, the transfer order or instrument may (among other things) (i) require the Issuer or its group companies (including the LLP) to support and co-operate with the bridge bank or private sector purchaser, for example by providing services and facilities; (ii) cancel or modify contracts or arrangements between the Issuer or the transferred business and a group company (including the HBOS Group Guarantor and the LLP); or (iii) impose additional obligations on the Issuer or its group companies including the HBOS Group Guarantor or the LLP under new or existing contracts. There can be no assurance that the taking of any such actions would not adversely affect the ability of the Issuer, the HBOS Group Guarantor or the LLP to satisfy each of its obligations to the Covered Bondholders, under the Covered Bonds or under the Transaction Documents.

*2.1.15 If the HBOS Group Guarantor is taken into temporary public ownership or if the Issuer is made subject to the SRR, a subsequent partial transfer of the HBOS Group Guarantor's or the Issuer's business may result in a concentration of risk.*

If the HBOS Group Guarantor is taken into temporary public ownership or if the Issuer is made subject to the SRR and a partial transfer of such entity's business to another entity were effected, the quality of the assets and the quantum of the liabilities not transferred and remaining with the HBOS Group Guarantor or the Issuer, as the case may be, may result in a deterioration in the creditworthiness of such entity and increase the risk that the HBOS Group Guarantor or, as the case may be, the Issuer may eventually become subject to administration or insolvency proceedings pursuant to the Banking Act or the Insolvency Act 1986.

Where the stabilisation powers are exercised, HM Treasury must make statutory provision (for example, in accordance with the Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations 2009) for a scheme or other arrangements for determining the compensation, if any, due to those affected by an exercise of the powers. As noted above, however, there can be no assurance that any compensation would be recovered promptly nor that it would be equal to any loss actually incurred.

*2.1.16 If the Issuer is made subject to the SRR, there may be additional consequences under the Covered Bonds and the Transaction Documents.*

If an instrument or order were to be made under the Banking Act in respect of the Issuer, such order may (amongst other things) affect the ability of such entity to satisfy its obligations under the Transaction Documents and/or result in (i) (as noted above) the transfer of the Covered Bondholders' entitlements in respect of the Covered Bonds or the conversion of the Covered Bonds from "one form or class to another" (the scope of which is not clear) and/or (ii) modifications to the Terms and Conditions of the Covered Bonds and/or the Transaction Documents. In particular, modifications may be made pursuant to powers permitting certain trust arrangements to be removed or modified and/or via powers which permit a transfer instrument or order to disapply certain widely defined "default event provisions" which might otherwise be triggered by the transfer. These default event provisions could include certain trigger events included in the Transaction Documents in respect of the Issuer, including trigger events in respect of perfection of legal title to the Mortgage Loans, the HBOS Events of Default, acceleration and mandatory early redemption. Moreover, other than in the context of certain partial property transfers, modifications may be made to contractual arrangements between the relevant institution and certain group companies (such as the HBOS Group Guarantor and the LLP). If an instrument or order were to be made under the Banking Act in respect of the Issuer, such action may affect various other aspects of the transaction, including resulting in modifications to the Transaction Documents. For example, a transfer instrument or order made in respect of the Issuer may disapply certain remedial actions which the Issuer would otherwise be required to take in the event of a transfer or certain related events and, more generally, the ability of such entity to perform its obligations under the Transaction Documents. As a result, the making of an instrument or order in respect of the Issuer may affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee and/or the ability of the Issuer to meet its obligations in respect of the Covered Bonds and/or the ability of the HBOS Group Guarantor to meet its obligations under the HBOS Group Guarantee. While there is provision for compensation under the Banking Act under certain circumstances, as noted above, there can be no assurance that Covered Bondholders would recover compensation promptly and equal to any loss actually incurred.

The Authorities are also empowered by order to amend the law (other than the Banking Act and related statutory instruments) for the purpose of enabling the powers under the SRR to be used effectively. An order may make provision which has retrospective effect.



At present, the Authorities have not made an instrument or order under the Banking Act in respect of any of the entities referred to above and there has been no indication that it will make any such instrument or order, but there can be no assurance that this will not change and/or that Covered Bondholders will not be adversely affected by any such instrument or order if made.

*2.1.17 The BOS Group's businesses are subject to substantial regulation, and to regulatory and governmental oversight. Adverse regulatory developments or changes in government policy could have a significant material adverse effect on the BOS Group's operating results, financial condition and prospects.*

The BOS Group conducts its businesses subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK and the other markets where it operates. This is particularly the case in the current market environment, which is witnessing increased levels of government and regulatory intervention in the banking sector, which the BOS Group expects to continue for the foreseeable future. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of Lloyds Banking Group and could materially adversely affect the BOS Group's business.

Areas where changes could have an adverse impact include, but are not limited to:

- the monetary, interest rate and other policies of central banks and regulatory authorities;
- general changes in government or regulatory policy, or changes in regulatory regimes that may significantly influence investor decisions in particular markets in which the BOS Group operates, may change the structure of those markets and the products offered or may increase the costs of doing business in those markets;
- changes to prudential regulatory rules relating to capital adequacy and liquidity frameworks;
- external bodies applying or interpreting standards or laws differently to those applied by the BOS Group historically;
- changes in competition and pricing environments;
- further developments in requirements relating to financial reporting, corporate governance, conduct of business and employee compensation;
- expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; and
- other unfavourable political, military or diplomatic developments producing social instability or legal uncertainty which, in turn, may affect demand for the BOS Group's products and services.

In particular, the July 2009 White Paper and the Financial Services Bill (presented to Parliament in November 2009) both contain a wide range of legislative proposals. Some proposals (how to offset moral hazard problems and the impact of changes to the capital and liquidity schemes) were discussed in the second Turner Review published in October 2009 and, more recently, in the Basel Committee on Banking Supervision consultation papers released in December 2009. Although many of the proposals in these papers are subject to further discussion and the achievement of a wider international consensus, see *"Risk Factors — Risks relating to the HBOS Group (including the BOS Group) as part of Lloyds Banking Group — Future legislative and regulatory changes could force*

*Lloyds Banking Group to comply with certain operational restrictions, take steps to raise further capital, or divest assets” for a further discussion of liquidity proposals which are expected to proceed in advance of any international consensus. There is a risk that if the Government chooses to proceed with certain of its proposals more quickly than anticipated, this could adversely affect the competitive position of UK banks, including Lloyds Banking Group.*

In addition, under the Banking Act, substantial powers over Lloyds Banking Group’s business, including the ability to take control of Lloyds Banking Group’s business, have been granted to HM Treasury or the Bank of England. In the longer term, if the position of a relevant entity in Lloyds Banking Group were to decline so dramatically that it was considered to be failing, or likely to fail, to meet threshold authorisation conditions in the FSMA, it could become subject to the exercise of powers by HM Treasury or the Bank of England under the special resolution regime (the “**SRR**”). There can be no assurance that, if economic conditions deteriorate significantly in the future and/or if the financial position of Lloyds Banking Group deteriorates significantly in the future, further UK Government or other intervention will not take place, including pursuant to the Banking Act. For a discussion of the Banking Act see “*Risks Relating to the Banking Act 2009*” and “*Regulation and Supervision — Other Relevant Legislation and Regulation — UK Government*” herein.

In the United Kingdom and elsewhere, there is also increased political and regulatory scrutiny of the banking industry and, in particular, retail banking. Increased regulatory intervention may lead to requests from regulators to carry out wide ranging reviews of past sales and/or sales practices. In the United Kingdom, the Competition Commission, the FSA and the OFT have recently carried out, or are currently conducting, several inquiries. In recent years, regulators have increased their focus on consumer protection and there have been several issues in the UK financial services industry in which the FSA has intervened directly, including the sale of investment products, personal pensions and mortgage-related endowments. See “*Regulation and Supervision*” herein. Under the GAPS Withdrawal Deed, Lloyds Banking Group has, among other things, agreed to implement any measures relating to personal current accounts agreed between the OFT and the UK banking industry.

In light of the ongoing market uncertainty, the BOS Group expects to face increased regulation and political and regulatory scrutiny of the financial services industry. The UK Government, the FSA or other regulators in the United Kingdom or overseas may intervene further in relation to the areas of industry risk already identified, or in new areas, which could adversely affect the BOS Group.

In addition, the HBOS Group (including the BOS Group) faces increased political and regulatory scrutiny as a result of the Acquisition. Such scrutiny may focus on, or include review of, the historical or future operations of the HBOS Group as well as the characteristics of the enlarged Lloyds Banking Group and future operation of the markets concerned. Regulatory reviews and investigations may result in enforcement actions and public sanction, which could expose Lloyds Banking Group to an increased risk of litigation in addition to financial penalties and/or the deployment of such regulatory tools as the relevant regulator deems appropriate in the circumstances. The outcome of any regulatory review, proceeding or complaint against Lloyds Banking Group or the heritage HBOS Group is inherently uncertain and difficult to predict particularly at the early stages and could have a material adverse effect on Lloyds Banking Group’s operations and/or financial condition, especially to the extent the scope of any such proceedings expands beyond its original focus. See “*Regulation and Supervision — Regulatory Approach of the FSA — FSA Supervisory Review into Historical HBOS Disclosures*” and “*Regulation and Supervision — Other Relevant Legislation and Regulation*” herein.

Such increased scrutiny may result in part from Lloyds Banking Group’s increased size and systemic importance following the Acquisition. For example, in clearing the Acquisition without a reference to the UK Competition Commission, the Secretary of State noted that there were some

competition concerns identified by the OFT in the markets for personal current accounts and mortgages in Great Britain and the market for SME banking in Scotland. The Secretary of State then asked the OFT to keep relevant markets under review in order to protect the interests of UK consumers and the British economy. Partly in response to this request, in April 2009 the OFT launched a consultation on its plans for keeping UK financial markets under review. At this time, the OFT has indicated its intention to focus its efforts in the financial services markets on the banking sector, including credit, leasing and debt recovery activities. Amongst other plans, it has announced its intention to launch a review of the unsecured consumer credit sector in 2009 which will address the offerings of suppliers, the role of intermediaries and the behaviour of and decisions made by consumers. The OFT has also reiterated that it will consider whether to refer any banking markets to the Competition Commission if it identifies any prevention, restriction or distortion of competition. On 29 July 2009, following consultation on its proposed plans, the OFT published a final plan for its activities in the financial services markets in 2009. The outcome of any reviews by the OFT or referrals to the Competition Commission could adversely affect Lloyds Banking Group as a whole (including the BOS Group).

Compliance with any changes in regulation or with any regulatory intervention resulting from political or regulatory scrutiny may significantly increase Lloyds Banking Group's costs, impede the efficiency of its internal business processes, limit its ability to pursue business opportunities, or diminish its reputation. Any of these consequences could have a material adverse effect on Lloyds Banking Group's (including the BOS Group's) operating results, financial condition and prospects.

*2.1.18 In the United Kingdom, firms within the BOS Group are responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.*

In the United Kingdom, the Financial Services Compensation Scheme ("FSCS") was established under the FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it. The FSCS is funded by levies on firms authorised by the FSA, including firms within the BOS Group. The recent arrangements put in place to protect the depositors of Bradford & Bingley and other failed deposit-taking institutions involving the FSCS are expected to result in a significant increase in the levies made by the FSCS on the industry. Lloyds Banking Group (including the BOS Group) has made a provision of £122 million in its 2008 accounts in respect of its current obligation to contribute its share of the management expenses levy and the estimated interest cost on the FSCS borrowings. Going forward, further provisions in respect of these costs are likely to be necessary until the borrowings are repaid. The ultimate cost to the industry, which will also include the cost of any compensation payments made by the FSCS and, if necessary, the cost of meeting any shortfall after recoveries on the borrowings entered into by the FSCS, remains uncertain, although it may be significant, and the associated costs to the BOS Group may have a material adverse effect on its results of operations and financial condition.

There is also uncertainty over how the FSCS arrangements will develop as a consequence of regulatory reform initiatives in the United Kingdom and internationally. The FSCS and the arrangements which support it are potentially subject to changes which could impose additional costs and expose the BOS Group to risks. For example, the FSA has proposed that UK deposit-taking institutions develop systems by 31 December 2010 to produce a Single Customer View ("SCV") providing an aggregated view of each customer's eligibility for compensation in the event of a failure. As this proposal proceeds, and depending on how the FSA requires firms to execute it, the SCV has the potential to divert management attention from competing priorities. In the event that the BOS Group fails to deliver such a project to the regulator's standards or timetables, there is the risk of public sanction, financial penalty and/or the deployment by the FSA of such other regulatory tools as it deems appropriate to the circumstances. Other potential changes to the FSCS arrangements with the

potential to require the BOS Group to incur additional costs or expose the BOS Group to risks may arise from ongoing discussions at the national and European Union levels around the future design of deposit protection schemes, including, but not limited to, potentially increasing the level of protection which is accorded to deposits and/or moving to pre-funding of compensation schemes. HM Treasury intends to carry out a consultation exercise before introducing any proposals relating to pre-funding of the FSCS.

*2.1.19 The BOS Group is exposed to various forms of legal and regulatory risk, including the risk of mis-selling financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice, any of which could have a material adverse effect on its results or its relations with its customers.*

The BOS Group is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. Primarily:

- certain aspects of the BOS Group’s business may be determined by the authorities, the Financial Ombudsman Service ( “FOS”) or the courts as not being conducted in accordance with applicable laws or regulations, or, in the case of FOS, with what is fair and reasonable in the Ombudsman’s opinion. For more information on additional constraints that may be imposed as a result of the European state aid clearance process, see also “*Risk Factors –Risks relating to the HBOS Group (including the BOS Group) as part of Lloyds Banking Group - Lloyds Banking Group is subject to European state aid obligations following the approval of its restructuring plan by the European Commission on 18 November 2009. The implementation of this restructuring plan may have consequences that are materially adverse to the interests of Lloyds Banking Group. Moreover, should a third party successfully challenge the European Commission’s decision to approve Lloyds Banking Group’s restructuring plan, or should Lloyds Banking Group require additional state aid in the future, further restructuring measures could be required and these may be materially adverse to the interests of Lloyds Banking Group and to those of the HBOS Group*”;
- the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such products by or attributed to a member of the BOS Group, resulting in disciplinary action or requirements to amend sales processes, withdraw products, or provide restitution to affected customers; all of which may require additional provisions;
- contractual obligations may either not be enforceable as intended or may be enforced against the BOS Group in an adverse way;
- the BOS Group holds accounts for a number of customers that might be or are subject to interest from various regulators and authorities including the Serious Fraud Office, those in the US and others. The BOS Group is not aware of any current investigation into the BOS Group as a result of any such enquiries but cannot exclude the possibility of the BOS Group’s conduct being reviewed as part of any such investigations;
- the intellectual property of the BOS Group (such as trade names) may not be adequately protected; and
- the BOS Group may be liable for damages to third parties harmed by the conduct of its business.

In addition, the BOS Group faces risk where legal or regulatory proceedings, complaints made by FOS or other complaints are brought against it in the UK High Court or elsewhere, or in jurisdictions outside the UK, including other European countries and the United States (which may include class action lawsuits). See Note 31 to the Issuer's 2008 Annual Report. For example, a major focus of US governmental policy relating to financial institutions in recent years has been combating money laundering and terrorist financing and enforcing compliance with US economic sanctions.

Failure to manage these risks adequately could impact the BOS Group adversely, both financially and reputationally, through an adverse impact on the BOS Group's brands.

*2.1.20 The BOS Group could fail to attract or retain senior management or other key employees.*

The BOS Group's success depends on the ability and experience of its senior management and other key employees. The loss of the services of certain key employees, particularly to competitors, could have a material adverse effect on the BOS Group's results of operations, financial condition and prospects. In addition, as the BOS Group's businesses develop, both in the UK and in other jurisdictions, future success will depend on the ability to attract and retain highly skilled and qualified personnel, which cannot be guaranteed, particularly in light of the increased regulatory intervention in financial institutions and management compensation arrangements coming under government prescription. For example, the BOS Group's remuneration arrangements are subject to the FSA's Rule and supporting Code on remuneration (which only apply to certain financial institutions), effective from 1 January 2010 for the 2009 performance year. In addition, in the GAPS Withdrawal Deed, Lloyds Banking Group has acknowledged to HM Treasury its commitment to the principle that, from 2010, it should be at the leading edge of implementing the G20 principles, the FSA code and any remuneration provisions accepted by the Government from the Walker Review, provided that this principle shall always allow Lloyds Banking Group to operate on a level playing field with its competitors. Furthermore, Lloyds Banking Group has agreed with HM Treasury the specific deferral and clawback terms which will apply to any bonuses in respect of the 2009 performance year and these may affect the BOS Group's ability to offer competitive remuneration arrangements.

Therefore, depending on the nature of the remuneration arrangements developed, staff retention and recruitment may become more difficult. The failure to attract or retain a sufficient number of appropriate personnel could significantly impede the financial plans, growth and other objectives of Lloyds Banking Group (including the BOS Group) and have an adverse effect on its business, financial position and results of operations.

In addition, failure to manage trade union relationships effectively may result in disruption to the business and its operations causing potential financial loss.

*2.1.21 Weaknesses or failures in the BOS Group's internal processes and procedures and other operational risks could materially adversely affect the BOS Group's results of operations, financial condition and prospects and could result in reputational damage.*

Operational risks, through inadequate or failed internal processes and/or systems (including financial reporting and risk monitoring processes) or from people-related or external events, including the risk of fraud and other criminal acts carried out against the BOS Group, are present in the BOS Group's businesses. The BOS Group's businesses are dependent on their ability to process and report accurately and efficiently a high volume of complex transactions across numerous and diverse products and services, in different currencies and subject to a number of different legal and regulatory regimes. Any weakness in such internal controls and processes could have a negative impact on the BOS Group's results or its ability to report adequately such results during the affected period.

Furthermore, damage to the BOS Group's reputation (including to customer confidence) arising from actual or perceived inadequacies, weaknesses or failures in BOS Group systems or processes could have a significant adverse impact on the BOS Group's businesses. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that either the Issuer or any relevant company within Lloyds Banking Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA (as the case may be).

*2.1.22 Terrorist acts, other acts of war, geopolitical, pandemic or other such events could have a material adverse impact on the BOS Group's results of operations, financial condition and prospects.*

Terrorist acts, other acts of war or hostility, geopolitical, pandemic or other such events and responses to those acts/events may create economic and political uncertainties, which could have a material adverse impact on UK and international economic conditions generally, and more specifically on the business and results of the BOS Group in ways that cannot necessarily be predicted.

*2.1.23 The BOS Group's financial statements are based in part on assumptions and estimates which, if wrong, could cause losses in the future.*

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to the BOS Group's results and financial position, based upon materiality and significant judgements and estimates, include impairment of financial assets, valuation of financial instruments, pensions, goodwill and taxation. If the judgements, estimates and assumptions used by the BOS Group in preparing its consolidated financial statements are subsequently found to be incorrect, there could be a material impact on the BOS Group's results of operations.

*2.1.24 Changes in taxation rates or law, or failure to manage the risks associated with such changes, or misinterpretation of the law, could materially and adversely affect the BOS Group's results of operations, financial condition and prospects.*

Tax risk is the risk associated with changes in taxation rates or law, or misinterpretation of the law. This could result in increased charges, financial loss including penalties, and reputational damage. Changes in taxation rates or law, or failure to manage these risks adequately could impact the BOS Group materially and adversely and could have a material negative impact on the BOS Group's performance.

**2.2 Risks relating to the HBOS Group other than those relating to the Issuer (HBOS Group is subject to all the risks set out in section 2.1 as well as these set out in section 2.2, as a consequence of HBOS being the HBOS Group Guarantor)**

*2.2.1 The HBOS Group's insurance businesses and employee pension schemes are subject to risks relating to insurance claim rates, pension scheme benefit payment levels and changes in insurance customer and employee pension scheme member behaviour.*

The life and pensions insurance businesses of the HBOS Group and its employee pension schemes are exposed to short-term and longer-term variability arising from uncertain longevity and

ill-health rates. Adverse developments in any of these factors will increase the size of the HBOS Group's insurance and employee pension scheme liabilities and may adversely affect the HBOS Group's financial condition and results of operations.

Customer behaviour in the life and pensions insurance business may result in increased propensity to cease contributing to or cancel insurance policies at a rate in excess of business assumptions. The consequent reduction in policy persistency and fee income has an adverse impact upon the profitability of the life and pensions business of the HBOS Group. The behaviour of employee pension scheme members affects the levels of benefits payable from the schemes. For example, the rate at which members cease employment affects the aggregate amount of benefits payable by the schemes. This rate may differ from applicable business assumptions. Adverse variances may increase the size of the HBOS Group's aggregate pension liabilities and may adversely affect the HBOS Group's financial condition and results of operations.

The general insurance businesses of the HBOS Group are exposed to the risk of uncertain insurance claim rates. For example, extreme weather conditions can result in high property damage claims, higher levels of theft can increase claims on property, contents and motor vehicle insurance and changes to unemployment levels can increase claims on loan protection insurance. These claims rates may differ from business assumptions and negative developments may adversely affect the HBOS Group's financial condition and results of operations.

UK banks recognise an insurance asset in their balance sheets representing the value of in-force business ("VIF") in respect of long-term life assurance contracts, being insurance contracts and investment contracts with discretionary participation features. This asset represents the present value of future profits expected to arise from the portfolio of in-force life assurance contracts. Adoption of this accounting treatment results in the earlier recognition of profit on new business, but subsequently a lower contribution from existing business, when compared to the recognition of profits on investment contracts under IAS 39 (Financial Instruments: Recognition and Measurement). Differences between actual and expected experience may have a significant impact on the value of the VIF asset, as changes in experience can result in significant changes to modelled future cash flows. The VIF asset is calculated based on best-estimate assumptions made by management, including mortality experience and persistency. If these assumptions prove incorrect, the VIF asset could be materially reduced, which in turn could have a material adverse effect on the HBOS Group's financial condition and results of operations.

Also, the HBOS Group's insurance assets are subject to the risk of market fluctuations. The insurance businesses of the HBOS Group face market risk arising, for example, from equity, bond and property markets in a number of ways depending upon the product and associated contract; for example, the annual management charges received in respect of investment and insurance contracts fluctuate, as do the values of the contracts, in line with the markets. Some of these risks are borne directly by the customer and some are borne by the insurance businesses. Some insurance contracts involve guarantees and options that have increased in value in the current adverse investment markets and may continue to do so. There is a risk that the insurance businesses will bear some of the cost of such guarantees and options. The insurance businesses also have capital directly invested in the markets that are exposed to market risk. The performance of the investment markets will thus have a direct impact upon the embedded value of insurance and investment contracts and the HBOS Group's operating results, financial condition and prospects. Adverse market conditions affect investor confidence, which in turn can result in lower sales and/or reduced persistency. Adverse persistency in the HBOS Group's insurance business is a risk to current and future earnings.

*2.2.2 HBOS plc is a holding company and, as a result, is dependent on dividends from its subsidiaries to meet its obligations including its obligations with respect to its debt securities*

HBOS plc is a non-operating holding company and as such the principal sources of its income are from operating subsidiaries who also hold the principal assets of the HBOS Group. As a separate legal entity, HBOS plc relies on remittance of their dividends and other funds in order to be able to pay obligations to debt holders as they fall due.

### **2.3 Risks relating to the HBOS Group (including the BOS Group) as part of Lloyds Banking Group (the BOS Group is subject to all the risks set out in the section below as a consequence of HBOS Group being acquired by Lloyds Banking Group)**

*2.3.1 HM Treasury is the largest shareholder of Lloyds Banking Group plc. Through its shareholding in, and other relationships with, Lloyds Banking Group plc, HM Treasury is in a position to exert significant influence over Lloyds Banking Group (including the BOS Group) and its business.*

HM Treasury currently holds approximately 41.3 per cent. of the ordinary share capital of Lloyds Banking Group plc. The two exchange offers announced by Lloyds Banking Group on 3 November 2009 (the “**Exchange Offers**”) involve the potential conversion of enhanced capital notes (the “**Enhanced Capital Notes**” or “**ECNs**”) which are being offered for exchange, into ordinary shares pursuant to their terms. It is not possible to calculate precisely the total dilutive effect any potential conversion of ECNs may have on HM Treasury’s ownership interest in Lloyds Banking Group plc but HM Treasury is expected to remain a significant shareholder in Lloyds Banking Group plc.

In the longer term, it may become necessary for Lloyds Banking Group to raise further capital or seek the support of the UK Government (as described in “*Risk Factors — Risks relating to the HBOS Group (including the BOS Group) as part of Lloyds Banking Group — Regulatory capital requirements and access to capital affect Lloyds Banking Group's Business*”). Any such capital raising or support from the UK Government could result in an increase in HM Treasury’s shareholding in Lloyds Banking Group plc.

No formal “relationship agreement” has been concluded between Lloyds Banking Group and the UK Government in respect of its shareholding in Lloyds Banking Group plc and no specific measures are in place to limit the level of control which may be exercised by HM Treasury. However, the relationship falls within the scope of the revised framework document between HM Treasury and UK Financial Investments Limited published on 13 July 2009. Nevertheless, there is a risk that HM Treasury might seek to exert influence over Lloyds Banking Group, and may disagree with the commercial decisions of Lloyds Banking Group, including over such matters as the implementation of synergies, commercial and consumer lending policies and management of Lloyds Banking Group’s assets and/or business. There is also a risk that, through its interests in Lloyds Banking Group plc, the UK Government and HM Treasury may be able to influence Lloyds Banking Group in other ways that would have a material adverse effect on Lloyds Banking Group’s business (including the business of the Issuer and the HBOS Group Guarantor) including, among other things, the election of directors, the appointment of senior management at Lloyds Banking Group plc, staff remuneration policies, lending policies and commitments, management of Lloyds Banking Group’s businesses (including those of the HBOS Group), including, in particular, management of Lloyds Banking Group’s assets such as its existing retail and corporate loan portfolios, significant corporate transactions and the issue of new ordinary shares. Shareholders may disagree as to whether an action opposed or supported by HM Treasury is in the best interests of Lloyds Banking Group generally. Furthermore, HM Treasury also has interests in other UK financial institutions, as well as an interest in the health of the UK banking industry and other industries generally, and those interests may not always be aligned with the commercial interests of Lloyds Banking Group (including those of the HBOS Group) or its shareholders.



*2.3.2 Lloyds Banking Group is subject to European state aid obligations following the approval of its restructuring plan by the European Commission on 18 November 2009. The implementation of this restructuring plan may have consequences that are materially adverse to the interests of Lloyds Banking Group. Moreover, should a third party successfully challenge the European Commission's decision to approve Lloyds Banking Group's restructuring plan, or should Lloyds Banking Group require additional state aid in the future, further restructuring measures could be required and these may be materially adverse to the interests of Lloyds Banking Group and to those of the HBOS Group.*

As a result of Lloyds Banking Group's placing and open offer in November 2008 and Lloyds Banking Group's participation in the Credit Guarantee Scheme, which was announced on 8 October 2008, Lloyds Banking Group was required to cooperate with HM Treasury to submit a restructuring plan to the European Commission setting out Lloyds Banking Group's plans to restructure and return to a position of viability in which it no longer relies on state aid.

On 18 November 2009 the European Commission approved Lloyds Banking Group's restructuring plan. The principal elements of the plan are set out in this document at "Recent Developments - Capital Restructuring" and address competition distortions from all elements of state aid that Lloyds Banking Group has received, including HM Treasury's participation in the placing and compensatory open offer in June 2009 and the rights issue in November 2009 (the "**Rights Issue**"), as well as any commercial benefit received by Lloyds Banking Group following its announcement in March 2009 of the intention it held at that time to participate in GAPS. The approval also covers Lloyds Banking Group's ongoing participation in HM Treasury's Credit Guarantee Scheme at current levels up to June 2010. Lloyds Banking Group plc has agreed with HM Treasury in the deed of withdrawal relating to Lloyds Banking Group plc's withdrawal from GAPS (the "**GAPS Withdrawal Deed**") that it will comply with the terms of the European Commission's decision.

It is possible that a third party could challenge the decision of the College of Commissioners to approve the restructuring plan in the European Courts. Lloyds Banking Group does not believe that any such challenge would be likely to succeed, but if it were to succeed the Commission would need to reconsider its decision, which could result in more extensive remedies being applied including the disposal of a significantly larger proportion of Lloyds Banking Group's assets and/or a significantly more stringent divestment timetable or more onerous behavioural restrictions than those contemplated in the approved restructuring plan.

Lloyds Banking Group will also be subject to a variety of risks as a result of implementing the approved restructuring plan. There is no assurance that the price that Lloyds Banking Group receives for any assets sold pursuant to the restructuring plan will be at a level Lloyds Banking Group considers adequate or which it could obtain in circumstances in which Lloyds Banking Group was not required to sell such assets in order to implement a state aid restructuring plan or if such sale were not subject to the restrictions contained in the terms thereof. In particular, should Lloyds Banking Group fail to complete the disposal of the retail banking business that Lloyds Banking Group is required to divest within four years, a divestiture trustee would be appointed to conduct the sale, with a mandate to complete the disposal with no minimum price (including at a negative price). In implementing the plan, Lloyds Banking Group will lose existing customers, deposits and other assets (both directly through the sale and potentially through damage to the rest of Lloyds Banking Group's business arising from implementing the restructuring plan) and the potential for realising additional associated revenues and margins that it otherwise might have achieved in the absence of such disposals. Such implementation may also result in disruption to the retained business, impacting on customers and separation costs which could potentially be substantial.

The effect of implementing the approved restructuring plan may be the emergence of one or more new viable competitors in the UK banking market or a material strengthening of one or more of Lloyds Banking Group's competitors in that market. There can be no assurance that Lloyds Banking

Group will be able to continue to compete as effectively (whether against existing or new or strengthened competitors) and maintain or improve its revenues and margins in the resulting competitive environment, which could adversely affect Lloyds Banking Group's results of operations and financial condition and its business generally. If any or all of the risks described in this paragraph, or any other currently unforeseen risks, materialise, there could be a negative impact, which could be material, on Lloyds Banking Group's business, operations and competitive position.

Should Lloyds Banking Group require any further state aid that was not covered in the European Commission's approval decision of 18 November 2009, this may require Lloyds Banking Group to commit to further restructuring measures. Any such measures could be materially adverse to the interests of Lloyds Banking Group.

*2.3.3 Future legislative and regulatory changes could force Lloyds Banking Group to comply with certain operational restrictions, take steps to raise further capital or divest assets.*

In July 2009, the UK Government issued a White Paper (the "**White Paper**") which builds on and responds to the previously published Turner Review (March 2009) and Bank of England Financial Stability Report (June 2009), both of which contained proposals for reform of the structure and regulation of the UK banking system. Proposals in the White Paper include: enhanced regulatory powers for the FSA; introducing pre-funding for the UK's deposit guarantee scheme by 2012; requiring banks to develop and maintain detailed plans for winding down (or resolution); and more stringent capital and liquidity requirements for systemically significant firms. The Government's stated aim in linking capital requirements to the size and complexity of systemically significant firms, is that, "The capital requirements in place for systemically significant institutions would need to be sufficient to change incentives of banks to over-indulge in risky activities throughout the economic cycle. This should encourage them to reduce or at least better understand the riskier activities they undertake (for example, proprietary trading) and reduce the moral hazard problem by removing the incentive for firms to become systemically significant."

A second Turner Review discussion paper (October 2009) developed issues highlighted for further discussion in the March review, specifically how to offset the moral hazard created by the existence of systemically important banks and the cumulative impact of changes to the capital and liquidity schemes. Key proposals include: using contingent capital which converts to equity when required; reducing the interconnectedness of large cross-border banks; restricting retail banks from engaging in proprietary trading activities; and emphasising the need to prioritise capital conservation and enhancement above employee bonus payments.

In November 2009 the draft Financial Services Bill was presented to Parliament. This bill consolidates some of the proposals presented in the White Paper, in addition to enhancing the FSA's disciplinary and enforcement powers. Specifically, the bill provides the FSA with the power to require authorised firms to prepare recovery and resolution plans and act in accordance with the FSA's remuneration rules. The proposals set out in the White Paper, Turner Reviews and draft legislation, if implemented, could have a significant impact on the operations, structure and costs of Lloyds Banking Group.

There is a risk that the regulation or legislation that may be developed over time to implement these proposals (including the Financial Services Bill) could force Lloyds Banking Group to divest core assets, withdraw from or not engage in some activities, and/or increase its capital. Such regulations or legislation, taken with the more regular and detailed reporting obligations which are expected to accompany regulatory reform, the development and maintenance of a wind down plan, and the move to pre-funding of the deposit protection scheme in the UK, would result in additional costs for Lloyds Banking Group, and such costs could be material. Such measures could have a material adverse effect on Lloyds Banking Group's results of operations, financial condition and prospects.

On 5 October 2009, the FSA published its new liquidity rules which significantly broaden the scope of the existing liquidity regime and are designed to enhance regulated firms' liquidity risk management practices. Procedures to comply with the FSA's liquidity proposals are already incorporated within Lloyds Banking Group's liquidity funding plans. These will result in more stringent requirements, which may lead to additional costs for Lloyds Banking Group. For a fuller discussion of liquidity risks affecting the BOS Group, see *"Risk Factors – Risks relating to the BOS Group - The BOS Group's businesses are subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits or the access to global wholesale money markets continues to be limited or becomes more limited. The BOS Group continues to be reliant on various governmental liquidity schemes and since certain of these schemes are not expected to be renewed or extended the BOS Group will face refinancing risk as transactions under these schemes mature."*

#### *2.3.4 Regulatory capital requirements and access to capital affect Lloyds Banking Group's business.*

Lloyds Banking Group is subject to extensive regulation and regulatory supervision in relation to the levels of capital in its business. Currently, Lloyds Banking Group meets and exceeds its regulatory capital requirements. Lloyds Banking Group expects to continue to meet both its regulatory capital requirements and the additional capital requirements imposed by the FSA Stress Test. However, the FSA could apply increasingly stringent stress case scenarios in determining the required capital ratios for Lloyds Banking Group and other banks, increase the minimum regulatory requirements imposed on Lloyds Banking Group, introduce liquidity restrictions, introduce new ratios and/or change the manner in which it applies existing regulatory requirements to recapitalised banks including those within Lloyds Banking Group. Specifically, in relation to the consultation papers issued by the Basel Committee on Banking Supervision ("Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring"), Lloyds Banking Group is participating in the industry-wide consultation and calibration exercises taking place through 2010. In order to meet additional regulatory capital requirements, Lloyds Banking Group may be forced to raise further capital. Bank of Scotland plc which is a subsidiary of Lloyds TSB Bank plc, relies upon Lloyds TSB Bank plc as the primary source of equity capital outside of retained profit. To the extent that Lloyds TSB Bank plc does not provide equity capital to Bank of Scotland plc this could impact Bank of Scotland plc's capital position.

Further, within Lloyds Banking Group, the heritage Lloyds TSB Group and HBOS Group businesses may have approaches to the Basel II modelling of regulatory capital requirements which may differ according to the assumptions used. As the two model methodologies are aligned over time this may result in changes to Lloyds Banking Group's combined reported level of regulatory capital.

Lloyds Banking Group's ability to maintain its targeted and regulatory capital ratios in the longer term could be affected by a number of factors, including net synergies and implementation costs following the Acquisition, and its level of risk-weighted assets, post-tax profit and fair value adjustments. In addition to the fair value adjustments, Lloyds Banking Group's core tier 1 capital ratio will be directly impacted by any shortfall in forecasted after-tax profit (which could result, most notably, from greater than anticipated asset impairments and/or adverse volatility relating to the insurance or lending businesses). Furthermore, under Basel II, capital requirements are inherently more sensitive to market movements than under previous regimes and capital requirements will increase if economic conditions or negative trends in the financial markets worsen.

If the regulatory capital requirements, liquidity restrictions or ratios applied to Lloyds Banking Group are increased in the future, any failure of Lloyds Banking Group to maintain such increased regulatory capital ratios could result in administrative actions or sanctions, which in turn may have a material adverse effect on Lloyds Banking Group's operating results, financial condition

and prospects. A shortage of available capital would also affect Lloyds Banking Group's ability to pay dividends, continue organic growth or pursue acquisitions or other strategic opportunities. In particular, changes in regulatory capital requirements imposed by Lloyds Banking Group's regulators could cause Lloyds Banking Group to defer the re-introduction of ordinary dividends or change its dividend policy.

Lloyds Banking Group's life assurance and general insurance businesses in the UK are subject to capital requirements prescribed by the FSA, and Lloyds Banking Group's life and general insurance companies outside the UK are subject to local regulatory capital requirements. In July 2007, the European Commission published a draft proposal for primary legislation to define broad "framework" principles for Solvency II, a fundamental review of the capital adequacy regime for the European insurance industry. Solvency II aims to establish a revised set of EU-wide capital requirements where the required regulatory capital will be dependent upon the risk profile of the entities, together with risk management standards, that will replace the current Solvency I requirements. Solvency II is still in development, but there is a risk that the final regime could increase the amount of regulatory capital Lloyds Banking Group's life assurance and general insurance businesses are required to hold, thus decreasing the amount of capital available for other uses.

*2.3.5 Lloyds Banking Group plc has agreed to certain undertakings with HM Treasury in relation to the operation of its business (including the HBOS Group's business) in connection with the placing and open offers by Lloyds Banking Group plc in November 2008 and May 2009, in connection with Lloyds Banking Group's participation in the Credit Guarantee Scheme and as part of its formerly proposed participation in GAPS. The implications of some of these undertakings remain unclear and they could have a material adverse effect on Lloyds Banking Group's (including the HBOS Group's) results of operations, financial condition and prospects. Lloyds Banking Group also agreed to certain other commitments in the GAPS Withdrawal Deed.*

In connection with HM Treasury's participation in the placing and open offers in November 2008 and May 2009, Lloyds Banking Group's participation in the Credit Guarantee Scheme and as part of its possible participation in GAPS, Lloyds Banking Group plc provided certain undertakings aimed at ensuring that the acquisition by HM Treasury of Lloyds Banking Group plc's shares and the participation of Lloyds Banking Group in the UK Government funding scheme as part of its support for the banking industry is consistent with the European state aid clearance. The state aid rules aim to prevent companies from being given an artificial or unfair competitive advantage as a result of governmental assistance. It is Lloyds Banking Group's understanding that the undertakings are also aimed at supporting certain objectives of HM Treasury in providing assistance to the UK banking industry. These undertakings include (i) supporting UK Government policy in relation to mortgage lending and lending to businesses through to the end of February 2011, (ii) regulating the remuneration of management and other employees and (iii) regulating the rate of growth of Lloyds Banking Group's balance sheet. There is a risk that these undertakings or any further requirements introduced by HM Treasury could have a materially adverse effect on the operations of Lloyds Banking Group (including the HBOS Group).

On 6 March 2009, in connection with Lloyds Banking Group's then proposed participation in GAPS, Lloyds Banking Group plc entered into a commitment to increase lending by £14 billion in the 12 months commencing 1 March 2009 to support UK businesses (£11 billion) and homeowners (£3 billion). As part of withdrawing from GAPS, Lloyds Banking Group has agreed in the GAPS Withdrawal Deed to reaffirm its overall lending commitments and to maintain in the 12 months commencing 1 March 2010 similar levels of lending as in the 12 months commencing 1 March 2009, subject to adjustment of the lending commitments by agreement with the UK Government to reflect circumstances at the start of the 12 month period commencing 1 March 2010. Negotiations are ongoing with the UK Government to agree the precise terms of the commitment in respect of the year commencing 1 March 2010, in line with the requirements. This additional lending in 2009 and 2010 is

expected to be subject to Lloyds Banking Group's prevailing commercial terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, Lloyds Banking Group's standard credit and other acceptance criteria. This commitment could, however, limit the operational flexibility of Lloyds Banking Group (including the HBOS Group).

*2.3.6 Lloyds Banking Group may fail to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or may incur unanticipated costs associated with, the Acquisition. As a consequence, Lloyds Banking Group's (including the HBOS Group's) results of operations, financial condition and prospects may suffer.*

The continued integration of the HBOS Group into Lloyds Banking Group is complex, expensive and presents a number of challenges for the management of each of Lloyds Banking Group plc, the Issuer, the HBOS Group Guarantor and their respective staff and potentially their respective customers. Lloyds Banking Group (including the HBOS Group) believes that it will achieve its reported anticipated cost synergies as well as other operating efficiencies and business growth opportunities, revenue benefits and other benefits from the Acquisition. However, these expected business growth opportunities, revenue benefits, cost synergies and other operational efficiencies and other benefits may not develop, including because the assumptions upon which Lloyds Banking Group determined the Acquisition consideration may prove to be incorrect. For example, the expected cost synergies were calculated by Lloyds Banking Group on the basis of the existing and projected cost and operating structures of Lloyds Banking Group and its estimate of the existing and projected cost and operating structures of the HBOS Group. Statements of estimated synergies and other effectiveness and calculations of the costs of achieving them relate to future actions and circumstances which, by their nature, involve risks, uncertainties, contingencies and other factors. As a result, the synergies and other efficiencies referred to may not be achieved, or those achieved may be materially different from those estimated.

Lloyds Banking Group may also face a number of other risks with respect to the Acquisition including retaining key employees; redeploying resources in different areas of operations to improve efficiency; unifying financial reporting and internal control procedures, minimising the diversion of management attention from ongoing business concerns, overcoming integration challenges (particularly as the management of the HBOS Group and Lloyds Banking Group may be unfamiliar with some aspects of each others' business and operations), and addressing possible differences between the business culture, risk management, compliance systems and processes, controls, procedures, systems, accounting practices and implementation of accounting standards in respect of the HBOS Group and Lloyds Banking Group.

Under any of these circumstances, the business growth opportunities, revenue benefits, cost synergies and other benefits anticipated by Lloyds Banking Group as a whole (including the HBOS Group) to result from the Acquisition may not be achieved as expected, or at all, or may be delayed. To the extent that Lloyds Banking Group incurs higher integration costs or achieves lower revenue benefits or fewer cost savings than expected, its operating results, financial condition and prospects may suffer.

*2.3.7 HM Treasury's acquisition of its shareholding in Lloyds Banking Group plc, the Acquisition, any further increase in HM Treasury's shareholding in Lloyds Banking Group plc, or the aggregation of HM Treasury's interests with that of certain other shareholders could lead to Lloyds Banking Group suffering adverse tax consequences.*

Certain Lloyds Banking Group companies have material tax losses and reliefs which they anticipate carrying forward to reduce tax payable in the future. If HM Treasury's acquisition of its shareholding in Lloyds Banking Group plc, the Acquisition, any further increase in HM Treasury's shareholding in Lloyds Banking Group plc or the aggregation of HM Treasury's interests with that of

other shareholders holding 5 per cent. or more, is coupled with the occurrence of certain specified events in relation to Lloyds Banking Group companies with such losses or reliefs (including a major change in the nature or conduct of a trade carried on by such a Lloyds Banking Group company or an increase in capital of such a Lloyds Banking Group company with an investment business), there would, in the case of legacy HBOS Group companies, and could, in the case of legacy Lloyds TSB Group companies, be restrictions on the ability to utilise these losses and reliefs. The Rights Issue, the Exchange Offers or the conversion of the Enhanced Capital Notes may result in certain shareholders holding 5 per cent. or more of Lloyds Banking Group plc. Restrictions on the ability to utilise losses and reliefs could affect the post-tax profitability and capital position of Lloyds Banking Group.

Lloyds Banking Group plc considers that it will be able to conduct its business, and the business of Lloyds Banking Group, in a manner which avoids the occurrence of these specified events. However, the ability to do so cannot be predicted with any certainty at the date of this document.

### **3. RISK FACTORS RELATING TO THE LLP**

#### **3.1 LLP only obliged to pay Guaranteed Amounts when the same are Due for Payment**

Following service of an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor, a Notice to Pay will be served by the Bond Trustee on the LLP. Following service of a Notice to Pay on the LLP, under the terms of the Covered Bond Guarantee the LLP will be obliged to pay Guaranteed Amounts as and when the same are Due for Payment on each Scheduled Payment Date. In these circumstances, the LLP will not be obliged to pay any other amounts which become payable for any other reason.

Payments by the LLP will be made subject to any applicable withholding or deduction and the LLP will not be obliged to pay any additional amounts as a consequence. The LLP will not be obliged to make any payments in respect of broken funding indemnities, penalties, premiums, default interest or interest on interest which may accrue on or in respect of the Covered Bonds.

If the LLP fails to make a payment when due under the Covered Bond Guarantee or any other LLP Event of Default occurs, then the Bond Trustee may accelerate the Covered Bonds (if not already accelerated) by service of an LLP Acceleration Notice, whereupon the Bond Trustee will have a claim under the Covered Bond Guarantee for the Early Redemption Amount of each Covered Bond, together with accrued interest and all other amounts then due under the Covered Bonds, although in such circumstances the LLP will not be obliged to gross up in respect of any withholding which may be required in respect of any payment. Following service of an LLP Acceleration Notice and/or the commencement of winding-up proceedings against the LLP, the Security Trustee may enforce the Security over the Charged Property. The proceeds of enforcement and realisation of the Security shall be applied by the Security Trustee in accordance with the Post-Enforcement Priority of Payments in the Deed of Charge, and Covered Bondholders will receive amounts from the LLP on an accelerated basis.

#### **3.2 Excess Proceeds received by the Bond Trustee**

Following the occurrence of an HBOS Event of Default, the Bond Trustee may receive moneys from the Issuer, the HBOS Group Guarantor or any administrator, administrative receiver, receiver, liquidator or other similar official appointed in relation to the Issuer or the HBOS Group Guarantor (the “**Excess Proceeds**”). The Excess Proceeds shall be paid by the Bond Trustee on behalf of the Covered Bondholders of the relevant Series to the LLP for its own account, as soon as practicable, and shall be held by the LLP in the GIC Account and the Excess Proceeds shall thereafter form part of the Security and shall be used by the LLP in the same manner as all other moneys from time to time standing to the credit of the GIC Account. Any Excess Proceeds received by the Bond Trustee shall discharge the obligations of the Issuer in respect of the Covered Bonds, Receipts and Coupons and the obligations of the HBOS Group Guarantor under the HBOS Group Guarantee. However, the obligations of the LLP under the Covered Bond Guarantee are unconditional and irrevocable and the receipt by the Bond Trustee of any Excess Proceeds shall not reduce or discharge any such obligations.

By subscribing for Covered Bond(s), each Covered Bondholder shall be deemed to have irrevocably directed the Bond Trustee to pay the Excess Proceeds to the LLP in the manner as described above.

### **3.3 Finite resources available to the LLP to make payments due under the Covered Bond Guarantee**

Following the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice on the Issuer and HBOS Group Guarantor, all amounts payable under the Covered Bonds will be accelerated by the Bond Trustee as against the Issuer and the HBOS Group Guarantor following which a Notice to Pay will be served by the Bond Trustee on the LLP. The LLP’s ability to meet its obligations under the Covered Bond Guarantee will depend on the realisable value of Selected Loans and their Related Security in the Portfolio, the amount of Revenue Receipts and Principal Receipts generated by the Portfolio and the timing thereof, amounts received from the Swap Providers, realisable value of other assets of the LLP, including Substitution Assets and Authorised Investments and the receipt by it of credit balances and interest on credit balances on the GIC Account and the other LLP Accounts. The LLP will not have any other source of funds available to meet its obligations under the Covered Bond Guarantee.

If an LLP Event of Default occurs and the Security created by or pursuant to the Deed of Charge is enforced, the Charged Property may not be sufficient to meet the claims of all the Secured Creditors, including the Covered Bondholders.

If, following enforcement of the Security constituted by or pursuant to the Deed of Charge, the Secured Creditors have not received the full amount due to them pursuant to the terms of the Transaction Documents, then they may still have an unsecured claim against the Issuer and the HBOS Group Guarantor for the shortfall. There is no guarantee that the Issuer and the HBOS Group Guarantor will have sufficient funds to pay that shortfall.

Covered Bondholders should note that the Asset Coverage Test has been structured to ensure that the Adjusted Aggregate Loan Amount is greater than the aggregate Principal Amount Outstanding of the Covered Bonds for so long as Covered Bonds remain outstanding, which should reduce the risk of there ever being a shortfall (although there is no assurance of this) (see *Summary of the Principal Documents – LLP Deed – Asset Coverage Test and Credit Structure – Asset Coverage Test*).

The Asset Coverage Test and the Yield Shortfall Test have in the aggregate been structured to ensure that the Asset Pool is sufficient to pay amounts due on the Covered Bonds and senior ranking expenses which will include costs relating to the maintenance, administration and winding-up of the

Asset Pool whilst the Covered Bonds are outstanding. However, no assurance can be given that the Asset Pool will yield sufficient amounts for such purpose.

“**Asset Pool**” means all assets of the LLP from time to time including but not limited to the Portfolio, any Substitution Assets, any Authorised Investments, the rights of the LLP in the Transaction Documents, the LLP Accounts and all amounts standing to the credit thereto and any other assets referred to in Regulation 3(1) (*Asset Pool*) of the RCB Regulations, provided that all such assets are recorded as comprising the asset pool under the RCB Regulations.

### **3.4 Reliance of the LLP on third parties**

The LLP has entered into agreements with a number of third parties, which have agreed to perform services for the LLP. In particular, but without limitation, the Original Servicer has been (and New Servicers may be) appointed to service Loans in the Portfolio sold to the LLP and the Cash Manager has been appointed to monitor compliance with the Asset Coverage Test and the Amortisation Test and to provide cash management services to the LLP. In the event that any of those parties fails to perform its obligations under the relevant agreement to which it is a party, the realisable value of the Portfolio or any part thereof or pending such realisation (if the Portfolio or any part thereof cannot be sold) the ability of the LLP to make payments under the Covered Bond Guarantee may be affected. For instance, if a Servicer has failed to administer the Loans adequately, this may lead to higher incidences of non-payment or default by Borrowers. The LLP is also reliant on the Swap Providers to provide it with the funds matching its obligations under the Intercompany Loan Agreement and the Covered Bond Guarantee, as described in the following two risk factors.

If a Servicer Event of Default occurs pursuant to the terms of a Servicing Agreement, then the LLP and/or the Security Trustee will be entitled to terminate the appointment of the relevant Servicer and appoint a New Servicer in its place. There can be no assurance that a substitute servicer with sufficient experience of administering mortgages of residential properties would be found who would be willing and able to service the Loans, as a New Servicer, on the terms of the Servicing Agreement. In addition, as described below, any substitute servicer may be required to be authorised under the Financial Services and Markets Act 2000, as amended (the “**FSMA**”). The ability of a substitute servicer to perform fully the required services would depend, among other things, on the information, software and records available at the time of the appointment. Any delay or inability to appoint a substitute servicer may affect the realisable value of the Portfolio or any part thereof, and/or the ability of the LLP to make payments under the Covered Bond Guarantee. However, if a Servicer ceases to be assigned a long-term unsecured, unguaranteed and unsubordinated debt obligation rating by Moody’s of at least Baa3 or by Standard & Poor’s of at least BBB- or by Fitch of at least BBB-, it will use reasonable efforts to enter into a master servicing agreement with a third party.

None of the Servicers have, or will have, (as applicable) any obligation to advance payments that Borrowers fail to make in a timely fashion. Covered Bondholders will have no right to consent to or approve of any actions taken by a Servicer under a Servicing Agreement.

Neither the Security Trustee nor the Bond Trustee is obliged in any circumstances to act as a Servicer or to monitor the performance by any Servicer of its obligations.

### **3.5 Reliance on Swap Providers**

To provide a hedge against possible variances in the rates of interest payable on the Loans in the Portfolio (which may, for instance, include variable rates of interest, discounted rates of interest, fixed rates of interest or rates of interest which track a base rate) and the rate of interest payable on the outstanding Term Advances, the LLP has entered into the Original Interest Rate Swap Agreement with the Original Interest Rate Swap Provider and, if any New Seller accedes to the Programme, the



LLP will enter into a New Interest Rate Swap Agreement with the New Interest Rate Swap Provider. In addition, to provide a hedge (following service on the LLP of a Notice to Pay) against interest rate, currency and/or other risks in respect of amounts received by the LLP under the Loans and the Interest Rate Swaps and amounts paid by the LLP under the Covered Bond Guarantee in respect of the Covered Bonds, the LLP will enter into the Covered Bond Swap Agreements (together with the Interest Swap Agreements, the “**Swap Agreements**” and each a “**Swap Agreement**”) with the Covered Bond Swap Provider (together with the Interest Swap Providers, the “**Swap Providers**” and each a “**Swap Provider**”).

If the LLP fails to make timely payments of amounts due under any Swap Agreement, then it will have defaulted under that swap. A Swap Provider is only obliged to make payments to the LLP as long as the LLP complies with its payment obligations under the relevant Swap Agreement. If the Swap Provider is not obliged to make payments or if it defaults in its obligations to make payments of amounts in the relevant currency equal to the full amount to be paid to the LLP on the payment date under the Swap Agreements, the LLP will be exposed to changes in the relevant currency exchange rates to sterling and to any changes in the relevant rates of interest. Unless a replacement swap is entered into, the LLP may have insufficient funds to make payments under the Covered Bond Guarantee.

If a Swap terminates, then the LLP may be obliged to make a termination payment to the relevant Swap Provider. There can be no assurance that the LLP will have sufficient funds available to make a termination payment under the relevant Swap Agreement, nor can there be any assurance that the LLP will be able to enter into a replacement swap agreement, or if one is entered into, that the credit rating of the replacement swap counterparty will be sufficiently high to prevent a downgrade of the then current ratings of the Covered Bonds by the Rating Agencies.

If the LLP is obliged to pay a termination payment under any Swap Agreement, such termination payment will rank ahead of amounts due on the Covered Bonds (in respect of the Interest Rate Swaps) and *pari passu* with amounts due on the Covered Bonds (in respect of the Covered Bond Swaps), except where default by, or downgrade of, the relevant Swap Provider has caused the relevant Swap to terminate. The obligation to pay a termination payment may adversely affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

### **3.6 Differences in timings of obligations of the LLP and the Covered Bond Swap Provider under the Covered Bond Swaps**

With respect to the Covered Bond Swaps, the LLP will pay a monthly amount, on each LLP Payment Date (following an HBOS Event of Default and service of a Notice to Pay on the LLP), to the Covered Bond Swap Provider based on one-month sterling deposits. The Covered Bond Swap Provider will not be obliged to make corresponding swap payments to the LLP under a Covered Bond Swap for up to twelve months until amounts are Due for Payment by the LLP under the Covered Bond Guarantee. If the Covered Bond Swap Provider does not meet its payment obligations to the LLP under the relevant Covered Bond Swap and the Covered Bond Swap Provider does not make a termination payment that has become due from it to the LLP, the LLP may have a larger shortfall in funds with which to make payments under the Covered Bond Guarantee with respect to the Covered Bonds than if the Covered Bond Swap Provider’s payment obligations coincided with the LLP’s payment obligations under the Covered Bond Guarantee. Hence, the difference in timing between the obligations of the LLP and the Covered Bond Swap Provider under the Covered Bond Swaps may affect the LLP’s ability to make payments under the Covered Bond Guarantee with respect to the Covered Bonds.

### **3.7 Change of counterparties**

The parties to the Transaction Documents who receive and hold monies pursuant to the terms of such documents (such as the Account Bank) are required to satisfy certain criteria in order that they can continue to receive and hold monies.

These criteria include requirements imposed by the FSA under the FSMA and requirements in relation to the short-term, unguaranteed and unsecured ratings ascribed to such party by S&P, Fitch and Moody's. If the party concerned ceases to satisfy the applicable criteria, including the ratings criteria detailed above, then the rights and obligations of that party (including the right or obligation to receive monies on behalf of the LLP) may be required to be transferred to another entity which does satisfy the applicable criteria. In these circumstances, the terms agreed with the replacement entity may not be as favourable as those agreed with the original party pursuant to the Transaction Documents.

In addition, should the applicable criteria cease to be satisfied, then the parties to the relevant Transaction Document may agree to amend or waive certain of the terms of such document, including the applicable criteria, in order to avoid the need for a replacement entity to be appointed. The consent of Covered Bondholders may not be required in relation to such amendments and/or waivers.

### **3.8 Limited description of the Portfolio**

Covered Bondholders will not receive detailed statistics or information in relation to the Loans in the Portfolio because it is expected that the constitution of the Portfolio may constantly change due to, for instance:

- the Sellers selling Loans and their Related Security (or new types of Loans and their Related Security) to the LLP;
- New Sellers acceding to the Transaction and selling Loans and their Related Security (or new types of Loans and their Related Security) to the LLP; and
- each Seller repurchasing Loans and their Related Security pursuant to its obligations under, or its right of pre-emption under, the Mortgage Sale Agreement.

However, each Loan will be required to meet the Eligibility Criteria and the Representations and Warranties set out in the Mortgage Sale Agreement – see *Summary of the Principal Documents – Mortgage Sale Agreement – Sale by Sellers of Loans and Related Security* (although the Eligibility Criteria and Representations and Warranties may change in certain circumstances – see *The Security Trustee may agree to modifications to the Transaction Documents without the Secured Creditors' prior consent* above). In addition, the Asset Coverage Test is intended to ensure that the Adjusted Aggregate Loan Amount is an amount equal to or in excess of the aggregate Principal Amount Outstanding of the Covered Bonds for so long as Covered Bonds remain outstanding and the Cash Manager will provide monthly reports that will set out certain information in relation to the Asset Coverage Test.

### **3.9 Scottish and Northern Irish Loans**

It should be noted that Loans and their Related Security governed by Scots law and relating to Scottish properties were included in the Portfolio on the First Transfer Date and may also be sold to the LLP in the future. It is also intended to add Loans and their Related Security governed by Northern Irish law and relating to Northern Irish properties in the future. The consent of Covered

Bondholders will not be obtained in relation to any changes required to the Transaction Documents in order to include Northern Irish loans in the Portfolio.

### **3.10 Fixed charges may take effect under English law as floating charges**

Pursuant to the terms of the Deed of Charge, the LLP has purported to grant fixed charges over, amongst other things, its interests in the English Loans and their Related Security, the Substitution Assets and its rights and benefits in the LLP Accounts and all Authorised Investments purchased from time to time.

The law in England and Wales relating to the characterisation of fixed charges is unsettled. The fixed charges purported to be granted by the LLP may take effect under English law as floating charges only, if, for example, it is determined that the Security Trustee does not exert sufficient control over the Charged Property for the security to be said to “fix” over those assets. If the charges take effect as floating charges instead of fixed charges, then the claims of the Security Trustee will be subject to the matters which are given priority over a floating charge by law, including (*inter alia*) prior charges, certain subsequent charges, the prescribed part referred to above, the expenses of any administration, the claims of preferential creditors and, following the changes made by the Companies Act 2006, the expenses of any winding-up.

The Enterprise Act 2002 abolished the preferential status of certain Crown debts (including the claims of the United Kingdom tax authorities). However, certain employee claims (in respect of contributions to pension schemes and wages) still have preferential status. In this regard, it should be noted that the LLP has agreed in the Transaction Documents not to have any employees. In addition, any administrative receiver, administrator or liquidator appointed in respect of the LLP will be required to set aside the prescribed percentage or percentages of the floating charge realisations (as described above, under the *Enterprise Act 2002*) in respect of the floating charges contained in the Deed of Charge.

For further information on the effect of the Enterprise Act 2002 coming into effect, see *Changes of law – Enterprise Act 2002* above.

### **3.11 Liquidation Expenses**

On 6 April 2008, a provision in the Insolvency Act 1986 came into force which effectively reversed by statute the House of Lords’ decision in the case of *Leyland Daf* in 2004. Accordingly, it is now the case that in general the costs and expenses of a liquidation (including certain tax charges) will be payable out of floating charge assets in priority to the claims of the floating chargeholder. In respect of certain litigation expenses of the liquidator only, this is subject to approval of the amount of such expenses by the floating chargeholder (or, in certain circumstances, the court) pursuant to provisions set out in the Insolvency Rules 1986.

It appears that the provisions referred to above apply in respect of limited liability partnerships. On this basis and as a result of the changes described above, upon the enforcement of the floating charge security granted by the LLP, floating charge realisations which would otherwise be available to satisfy the claims of Secured Creditors under the Deed of Charge may be reduced by at least a significant proportion of any liquidation expenses. There can be no assurance that the Covered Bondholders will not be adversely affected by such a reduction in floating charge realisations.

See also the investment consideration described above under *Expenses of insolvency officeholders*.

### **3.12 Maintenance of Portfolio**

*Asset Coverage Test:* Pursuant to the terms of the Mortgage Sale Agreement, each Seller will agree to use all reasonable efforts to transfer Loans and their Related Security to the LLP in order to ensure that the Portfolio is in compliance with the Asset Coverage Test. In consideration thereof, the relevant Seller will receive a combination of (i) a cash payment paid by the LLP and/or (ii) the relevant Seller will be treated as having made a Capital Contribution to the LLP (in an amount up to the difference between the Current Balance of the Loans sold by the relevant Seller to the LLP as at the relevant Transfer Date and the cash payment (if any) paid by the LLP for such Loans) and (iii) Deferred Consideration.

Alternatively, the Members of the LLP (other than the Liquidation Member) may make a Cash Capital Contribution to the LLP pursuant to the LLP Deed in order to ensure that the LLP is in compliance with the Asset Coverage Test. If a breach of the Asset Coverage Test occurs which is not cured on the next Calculation Date, this would constitute an HBOS Event of Default. There is no specific recourse by the LLP to the Sellers in respect of the failure to sell Loans and their Related Security to the LLP nor is there any specific recourse to the Members if they do not make Cash Capital Contributions to the LLP.

*Amortisation Test:* Pursuant to the LLP Deed, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date following service of a Notice to Pay on the LLP but prior to the service of an LLP Acceleration Notice and/or the realisation of the Security and/or the commencement of winding-up proceedings against the LLP, the Amortisation Test Aggregate Loan Amount is in an amount at least equal to the aggregate Principal Amount Outstanding under the Covered Bonds. The Amortisation Test is intended to ensure that the assets of the LLP do not fall below a certain threshold to ensure that the assets of the LLP are sufficient to meet its obligations under the Covered Bond Guarantee.

If the collateral value of the Portfolio has not been maintained in accordance with the terms of the Asset Coverage Test or the Amortisation Test, then that may affect the realisable value of the Portfolio or any part thereof (both before and after the occurrence of an LLP Event of Default) and/or the ability of the LLP to make payments under the Covered Bond Guarantee.

Prior to the occurrence of an HBOS Event of Default, the Asset Monitor will test the calculations performed by the Cash Manager in respect of the Asset Coverage Test once each year on the Calculation Date immediately preceding each anniversary of the Programme Date and more frequently in certain circumstances. Following the occurrence of an HBOS Event of Default, the Asset Monitor will be required to test the calculations performed by the Cash Manager in respect of the Amortisation Test. See further – *Summary of Principal Documents – Asset Monitor Agreement*.

The Security Trustee shall not be responsible for monitoring compliance with, nor the monitoring of, the Asset Coverage Test, the Pre-Maturity Liquidity Test or the Amortisation Test or any other test, or supervising the performance by any other party of its obligations under any Transaction Document.

### **3.13 Sale of Selected Loans and their Related Security prior to maturity of Hard Bullet Covered Bonds where the Pre-Maturity Test is breached or following the occurrence of an HBOS Event of Default**

If the Pre-Maturity Test is breached, the LLP is obliged to sell Selected Loans and their Related Security (selected on a random basis) to seek to generate sufficient cash to enable the LLP to pay the final redemption amount on any Hard Bullet Covered Bond should the Issuer or HBOS Group Guarantor fail to pay. If a Notice to Pay is served on the LLP, then the LLP will be obliged to sell

Selected Loans and their Related Security (selected on a random basis) in order to make payments to the LLP's creditors including to make payments under the Covered Bond Guarantee (see *Summary of the Principal Documents – LLP Deed – Sale of Selected Loans and their Related Security following an HBOS Event of Default*).

There is no guarantee that a buyer will be found to acquire Selected Loans and their Related Security at the times required and there can be no guarantee or assurance as to the price which may be obtainable. This may affect payments under the Covered Bond Guarantee.

### **3.14 Realisation of Charged Property following the occurrence of an LLP Event of Default and Service of an LLP Acceleration Notice and/or following the commencement of winding-up proceedings against the LLP**

If an LLP Event of Default occurs and an LLP Acceleration Notice is served on the LLP and/or winding-up proceedings are commenced against the LLP, then the Security Trustee will be entitled to enforce the Security created under and pursuant to the Deed of Charge and the proceeds from the realisation of the Charged Property (together with all other amounts standing to the credit of the LLP Accounts) will be applied by the Security Trustee towards payment of all secured obligations in accordance with the Post-Enforcement Priority of Payments described in *Cashflows* below.

There is no guarantee that the proceeds of realisation of the Charged Property will be in an amount sufficient to repay all amounts due to the Secured Creditors (including the Covered Bondholders) under the Transaction Documents.

If an LLP Acceleration Notice is served on the LLP, then the Covered Bonds may be repaid sooner or later than expected or not at all.

### **3.15 Factors that may affect the realisable value of the Portfolio or any part thereof or the ability of the LLP to make payments under the Covered Bond Guarantee**

Following the occurrence of an HBOS Event of Default and the service on the LLP of a Notice to Pay, the realisable value of Selected Loans and their Related Security comprised in the Portfolio may be reduced (which may affect the ability of the LLP to make payments under the Covered Bond Guarantee) by:

- no representations or warranties being given by the LLP or (unless otherwise agreed with the relevant Seller) the Sellers;
- default by Borrowers of amounts due on their Loans;
- changes to the lending criteria of the Sellers;
- the Loans of New Sellers being included in the Portfolio;
- sale of Selected Loans and their Related Security;
- reliance of the LLP on third parties;
- the impact of the Pensions Act 2004;
- the LLP not having legal title to the Loans in the Portfolio;
- set-off risks in relation to some types of Loans in the Portfolio;

- limited recourse to the Sellers;
- certain regulatory considerations that could lead to some of the Loans or their Related Security being unenforceable, cancellable or subject to set-off, or some of their terms being unenforceable; and
- decisions of the Ombudsman, which could lead to some terms of the Loans being varied.

Each of these factors is considered in more detail below. However, it should be noted that the Asset Coverage Test, the Amortisation Test and the Eligibility Criteria are intended to ensure that there will be an adequate amount of Loans in the Portfolio and moneys standing to the credit of the GIC Account to enable the LLP to repay the Covered Bonds following an HBOS Event of Default and service of a Notice to Pay on the LLP and accordingly it is expected (but there is no assurance) that Selected Loans and their Related Security could be realised for sufficient values to enable the LLP to meet its obligations under the Covered Bond Guarantee.

### ***3.15.1 No warranties to be given by the LLP or the Sellers if Selected Loans and their Related Security are to be sold***

Following a breach of the Pre-Maturity Test (see *Credit Structure – Pre-Maturity Liquidity* below) and/or the occurrence of an HBOS Event of Default, the LLP will be obliged to sell Selected Loans and their Related Security to third party purchasers, subject to a right of pre-emption enjoyed by the Sellers pursuant to the terms of the Mortgage Sale Agreement (see *Summary of the Principal Documents – LLP Deed – Method of Sale of Selected Loans and their Related Security*). In respect of any sale of Selected Loans and their Related Security to third parties, however, the LLP will not be permitted to give warranties or indemnities in respect of those Selected Loans and their Related Security (unless expressly permitted to do so by the Security Trustee). There is no assurance that the Sellers would give any warranties or representations in respect of the Selected Loans and their Related Security. Any Representations or Warranties previously given by the Sellers in respect of the Loans in the Portfolio may not have value for a third party purchaser if the Sellers are then insolvent. Accordingly, there is a risk that the realisable value of the Selected Loans and their Related Security could be adversely affected by the lack of representations and warranties which in turn could adversely affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

### ***3.15.2 Default by Borrowers in paying amounts due on their Loans***

Borrowers may default on their obligations due under the Loans. Defaults may occur for a variety of reasons. The Loans are affected by credit, liquidity and interest rate risks. Various factors influence mortgage delinquency rates, prepayment rates, repossession frequency and the ultimate payment of interest and principal, such as changes in the national or international economic climate, regional economic or housing conditions, changes in tax laws, interest rates, inflation, the availability of financing, yields on alternative investments, political developments and government policies. Although interest rates are at a historic low, this may change in the future and an increase in interest rates may adversely affect the Borrowers' ability to pay interest or repay principal on their Loans. Other factors in Borrowers' individual, personal or financial circumstances may affect the ability of Borrowers to repay the Loans. Unemployment, loss of earnings, illness, divorce and other similar factors may lead to an increase in delinquencies by and bankruptcies of Borrowers, and could ultimately have an adverse impact on the ability of Borrowers to repay the Loans. In addition, the ability of a Borrower to sell a property given as security for a Loan at a price sufficient to repay the amounts outstanding under that Loan will depend upon a number of factors, including the availability of buyers for that property, the value of that property and property values in general at the time.

Over the last few years and as a result of, among other things, fluctuations in the Bank of England base rate, there has been a cycle of rising and falling mortgage interest rates, resulting in borrowers with a mortgage loan subject to a variable rate of interest or with a mortgage loan for which the related interest rate adjusts following an initial fixed rate or low introductory rate, as applicable, being exposed to increased monthly payments as and when the related mortgage interest rate adjusts upward (or, in the case of a mortgage loan with an initial fixed rate or low introductory rate, at the end of the relevant fixed or introductory period). Future increases in borrowers' required monthly payments, which (in the case of a mortgage loan with an initial fixed rate or low introductory rate) may be compounded by any further increase in the related mortgage interest rate during the relevant fixed or introductory period, may ultimately result in higher delinquency rates and losses in the future.

Borrowers seeking to avoid these increased monthly payments by refinancing their mortgage loans may no longer be able to find available replacement loans at comparably low interest rates. The recent declines in housing prices may also leave borrowers with insufficient equity in their homes to permit them to refinance. These events, alone or in combination, may contribute to higher delinquency rates and losses.

Prior to the occurrence of an HBOS Event of Default or an LLP Event of Default and following receipt of a Defaulted Loans Notice (as defined below) each Seller has agreed or will agree, as applicable, to repurchase each Defaulted Loan sold by it to the LLP for an amount equal to the Current Balance of the relevant Loan plus expenses. Defaulted Loans that are not repurchased will be omitted from any calculation of the Asset Coverage Test.

### ***3.15.3 Homeowner Mortgage Support Scheme***

On 3 December 2008, the UK Government released a preliminary announcement on the Homeowner Mortgage Support Scheme (the "HMSS"). Further details on the HMSS were published on 10 December 2008. The final scheme documentation was published on 21 April 2009 at which time, the Issuer announced its intention to participate in the HMSS. The terms of the HMSS provide that, subject to certain conditions, eligible mortgage borrowers experiencing a temporary loss of income will be allowed to defer up to 70 per cent. of interest payments for up to two years, with a percentage of the deferred interest payments being guaranteed by the UK Government in certain circumstances should the borrower default. The participation by the Issuer in the HMSS may have an adverse effect on the collection of interest loans, the timing of enforcement of the Mortgages and accordingly on the Issuer's financial condition.

### ***3.15.4 Changes to the Lending Criteria of the Sellers***

Each of the Loans originated by each Seller will have been originated in accordance with its Lending Criteria at the time of origination. It is expected that each Seller's Lending Criteria will generally consider type of property, term of loan, age of applicant, the loan-to-value ratio, mortgage indemnity guarantee policies, high loan-to-value fees, status of applicants and credit history. In the event of the sale or transfer of any Loans and Related Security (sold by any Seller) to the LLP, each Seller will warrant only that such Loans and Related Security were originated in accordance with such Seller's Lending Criteria applicable at the time of origination. Each Seller retains the right to revise its Lending Criteria from time to time. If the Lending Criteria change in a manner that affects the creditworthiness of the Loans, that may lead to increased defaults by Borrowers and may affect the realisable value of the Portfolio, or part thereof, and the ability of the LLP to make payments under the Covered Bond Guarantee. As noted above, however, Defaulted Loans that are not repurchased by the relevant Seller thereof will be excluded from the calculation of the Asset Coverage Test.

### **3.15.5 *The Loans of New Sellers may be included in the Portfolio***

New Sellers may sell Loans and their Related Security to the LLP. However, this would only be permitted if the conditions precedent relating to New Sellers acceding to the Transaction (more fully described under *Summary of the Principal Documents – Mortgage Sale Agreement – Original Seller and New Sellers*, below) are met.

Any Loans originated by a New Seller will have been originated in accordance with the Lending Criteria of the New Seller, which may differ from the Lending Criteria of Loans originated by the Original Seller. If the Lending Criteria differ in a way that affects the creditworthiness of the Loans, that may lead to increased defaults by Borrowers and may affect the realisable value of the Portfolio or any part thereof or the ability of the LLP to make payments under the Covered Bond Guarantee. As noted above, however, Defaulted Loans that are not repurchased by the relevant Seller thereof will be excluded from the calculation of the Asset Coverage Test.

### **3.15.6 *The LLP does not have legal title to the Loans in the Portfolio on the relevant Transfer Date***

The sale by the Sellers to the LLP of English Loans and their Related Security has taken or will take effect by way of an equitable assignment. The sale by the Sellers to the LLP of Scottish Loans and their Related Security has been or will be given effect by way of Scottish Declarations of Trust under which the beneficial interest in the Scottish Loans and their Related Security has been or will be transferred to the LLP. As a result, legal title to English Loans and their Related Security and Scottish Loans and their Related Security will remain with the relevant Seller. Subject to any contrary provisions which may be made pursuant to the continuity sections of the Banking Act 2009 (as to which see “*Risk Factors – Risks Relating to the Banking Act 2009*”), the LLP will have the right to demand that the relevant Seller give it legal title to the Loans and the Related Security in the circumstances described in *Summary of the Principal Documents – Mortgage Sale Agreement – Transfer of title to the Loans to the LLP* and until then the LLP will not give notice of the sale of the English Loans and their Related Security to any Borrower or apply to the Land Registry or the Central Land Charges Registry to register or record its equitable interest in the Loans and their Related Security or take any steps to perfect its title to the Scottish Loans and their Related Security.

Since the LLP has not obtained legal title to the Loans or their Related Security, the following risks exist:

- first, if the relevant Seller wrongly sells a Loan and its Related Security, which has already been sold to the LLP, to another person and that person acted in good faith and did not have notice of the interests of the LLP in the Loan and its Related Security, then she or he might obtain good title to the Loan and its Related Security, free from the interests of the LLP. If this occurred then the LLP would not have good title to the affected Loan and its Related Security and it would not be entitled to payments by a Borrower in respect of that Loan. However, the risk of third party claims obtaining priority to the interests of the LLP would be likely to be limited to circumstances arising from a breach by the relevant Seller of its contractual obligations or fraud, negligence or mistake on the part of the relevant Seller or the LLP or their respective personnel or agents;
- second, the rights of the LLP may be subject to the rights of the Borrowers against the relevant Seller, such as rights of set-off, which occur in relation to transactions or deposits made between Borrowers and the relevant Seller, and the rights of Borrowers to redeem their mortgages by repaying the Loans directly to the relevant Seller; and



- third, unless the LLP has perfected the assignment or assignation (as appropriate) of the Loans (which it is only entitled to do so in certain circumstances), the LLP would not be able to enforce any Borrower's obligations under any Loan or mortgage itself but would have to join the relevant Seller as a party to any legal proceedings.

If any of the risks described in the above three bullet points were to occur then the realisable value of the Portfolio or any part thereof and/or the ability of the LLP to make payments under the Covered Bond Guarantee may be affected.

Once notice has been given to the Borrowers of the assignment or assignation (as appropriate) of the Loans and their Related Security to the LLP, independent set-off rights which a Borrower has against a Seller (such as, for example, set-off rights associated with Borrowers holding deposits with Sellers) will crystallise and further rights of independent set-off would cease to accrue from that date and no new rights of independent set-off could be asserted following that notice. Set-off rights arising under "transaction set-off" (which are set-off claims arising out of a transaction connected with the Loan) will not be affected by that notice.

It should be noted, however, that the Asset Coverage Test seeks to take account of the potential set-off risk associated with Borrowers holding deposits with the Sellers (although there is no assurance that all such risks will be accounted for). Further, for so long as the LLP does not have legal title, each Seller will undertake for the benefit of the LLP and the Secured Creditors that it will lend its name to, and take such other steps as may be reasonably required by the LLP and/or the Security Trustee in relation to, any legal proceedings in respect of the Loans and their Related Security.

### ***3.15.7 Set-off risks in relation to some types of Loans may adversely affect the value of the Portfolio or any part thereof***

As described in the immediately preceding risk factor, the sale by each Seller to the LLP of English Loans has been or will be given effect by an equitable assignment, with each sale of Scottish Loans being given effect by a Scottish Declaration of Trust. As a result, legal title to both the English Loans and the Scottish Loans and their Related Security sold by Sellers to the LLP will remain with the relevant Seller. Therefore, the rights of the LLP may be subject to the direct rights of the Borrowers against the relevant Seller, including rights of set-off existing prior to notification to the Borrowers of the assignment or assignation (as appropriate) of the Loans. Some of the Loans in the Portfolio may have increased risks of set-off, because the relevant Seller is required to make payments under them to the Borrowers. For instance:

- under a Flexible Loan, the Borrower is permitted to make larger repayments than are due on a given payment date or draw further amounts under the Loan in some circumstances. Any drawings under Flexible Loans will be funded solely by the relevant Seller;
- under a delayed cashback loan, the Borrower is entitled to receive a payment from the relevant Seller as an incentive for entering into the Loan at a specified time following completion of the Loan. Any such payment will be funded solely by the relevant Seller.

In addition, the Original Seller offers a further advance product called Home Cash Reserve, which is a facility linked to a Borrower's mortgage whereby a Borrower may draw additional funds from time to time. A Borrower must have had a Halifax mortgage (prior to the Effective Date) or a Bank of Scotland mortgage (any time on or following the Effective Date) for a minimum of three months to qualify for the Home Cash Reserve. Where originated by the Original Seller before 31 October 2004, the total amount of the facility was not permitted to be less than £25,005. Borrowers must draw down amounts of at least £1,000 at a time. Funds drawn under the Home Cash Reserve are added to the mortgage loan. No redraw facility is available under the Home Cash Reserve.

None of the loans in the expected portfolio obliges the Original Seller to make further advances save for retentions and Home Cash Reserve withdrawals. However, some loans in the expected portfolio may have further advances made on them prior to their being sold to the mortgages trustee and new loans added to the portfolio in the future may have had further advances made on them prior to that time.

New products offered by the Sellers in the future may have similar characteristics involving payments due by the relevant Seller to the Borrower.

Set-off rights may occur if a Seller fails to make the payments due to the Borrower – for example, where the relevant Seller fails to advance to a Borrower a drawing under a Flexible Loan or a drawing under a Home Cash Reserve Loan which the Borrower is entitled to draw or if a Seller fails to pay to a Borrower any delayed cashback which the relevant Seller had agreed to pay to that Borrower after completion of the relevant Loan.

If the relevant Seller fails to make the payment due, then the relevant Borrower may set off the amount of any damages claim arising from that Seller's breach of contract against the relevant Seller's (and, as assignee of the Loans, the LLP's) claim for payment of principal and/or interest under the Loan as and when it becomes due. These set-off claims will constitute "transaction set-off" as described in the immediately preceding risk factor.

The amount of the damages claim in respect of a failure by the relevant Seller to make the payment due will, in many cases, be the cost to the Borrower of finding an alternative source of finance. The Borrower may obtain a Loan elsewhere in which case the damages would be equal to any difference in the borrowing costs together with any consequential losses, namely the associated costs of obtaining alternative funds (for example, legal fees and survey fees). If the Borrower is unable to obtain an alternative loan, he or she may have a claim in respect of other losses arising from the relevant Seller's breach of contract where there are special circumstances communicated by the Borrower to the Seller at the time the Loan was taken out.

In respect of a delayed cashback loan, the damages claim of the relevant Borrower is likely to be in an amount equal to the amount due under the delayed cashback loan together with interest and expenses and consequential losses (if any).

Further there may be circumstances in which:

- a Borrower may seek to argue that certain drawings under Flexible Loans and Home Cash Reserve Loans are unenforceable by virtue of non-compliance with the Consumer Credit Act 1974 (the "CCA"); or
- certain drawings may rank behind liens created by a Borrower after the date on which the Borrower entered into its mortgage with a Seller.

A Borrower may also attempt to set off against his or her mortgage payments an amount greater than the amount of his or her damages claim. In that case, the relevant Servicer will be entitled to take enforcement proceedings against the Borrower although the period of non-payment by the Borrower is likely to continue until a judgment or decree is obtained.

The exercise of set-off rights by Borrowers may adversely affect the realisable value of the Portfolio and/or the ability of the LLP to make payments under the Covered Bond Guarantee. The Asset Coverage Test seeks to take account of the set-off risk including any set-off risk relating to Flexible Loans in the Portfolio (although there is no assurance that such risks will be accounted for).

### **3.15.8 Limited recourse to the Sellers**

The LLP will not, and the Bond Trustee and the Security Trustee will not, undertake any investigations, searches or other actions on any Loan or its Related Security and will rely instead on the Representations and Warranties given in the Mortgage Sale Agreement by the relevant Sellers in respect of the Loans sold by them to the LLP.

If any Loan sold by a Seller does not materially comply with any of the Representations and Warranties made by that Seller as at the Transfer Date of that Loan, then the relevant Seller will be required to remedy the breach within 20 London Business Days of that Seller becoming aware of the same or of receipt by it of a notice from the LLP requiring the Seller to remedy the breach.

If the relevant Seller fails to remedy the breach of a Representation and Warranty within 20 London Business Days, then that Seller will be required to repurchase on or before the next following Calculation Date (or such other date that may be agreed between the LLP and the Seller) the relevant Loan or Loans under the relevant Mortgage Account and their Related Security at their Current Balance as of the date of repurchase together with expenses.

In addition, each Seller will be required to repurchase Defaulted Loans in the Portfolio sold by it to the LLP within 20 London Business Days of that Seller becoming aware of the Defaulted Loan in the Portfolio or of receipt by it of a notice from the LLP. The relevant Seller will be required to repurchase the relevant Loan or Loans under the relevant Mortgage Account and their Related Security at their Current Balance as at the date of repurchase together with expenses.

There can be no assurance that the relevant Seller will have the financial resources to repurchase the Loan or Loans under the relevant Mortgage Account and their Related Security. However, if the relevant Seller does not repurchase those Loans and their Related Security which are in breach of the Representations and Warranties or does not repurchase those Loans and their Related Security which are Defaulted Loans, then the Current Balance of those Loans will be excluded from the Calculation of the Asset Coverage Test. There is no further recourse to the Seller or the Issuer in respect of a breach of a Representation or Warranty or failure to buy back a Defaulted Loan. There is no other recourse to the assets of the Sellers if an HBOS Event of Default occurs or an LLP Event of Default occurs.

### **3.15.9 Certain Regulatory Considerations**

#### *3.15.9.1 Office of Fair Trading, Financial Services Authority and other regulatory authorities*

In the United Kingdom, the Office of Fair Trading (the “OFT”) is responsible for the issue of licences under, and the superintendence of the working and enforcement of, the CCA, related consumer credit regulations and other consumer protection legislation. The OFT may review businesses and operations, provide guidelines to follow and take actions when necessary with regard to the mortgage market in the United Kingdom (except to the extent the market is regulated by the FSA under the FSMA, as described below). The licensing regime under the CCA is different from, and where applicable, additional to, the regime for authorisation under the FSMA.

A credit agreement is regulated by the CCA where: (a) the borrower is or includes an “individual” as defined in the CCA; (b) if the credit agreement is made before the financial limit is removed (as described below), the amount of “credit” as defined in the CCA does not exceed the financial limit, which is £25,000 for credit agreements made on or after 1 May 1998, or lower amounts for credit agreements made before that date; and (c) the credit agreement is not an exempt agreement under the CCA (for example, it is intended that a Regulated Mortgage Contract under the FSMA is an exempt agreement under the CCA).

There is a risk that any credit agreement that is wholly or partly regulated by the CCA or treated as such has to comply with requirements under the CCA as to licensing of lenders and brokers, documentation and procedures of credit agreements, and (in so far as applicable) pre-contract disclosure. If it does not comply with those requirements, then to the extent that the credit agreement is regulated by the CCA or treated as such, it is unenforceable against the borrower: (a) without an order of the OFT, if the lender or any broker does not hold the required licence at the relevant time; (b) totally, if the credit agreement was made before 6 April 2007 and if the form to be signed by the borrower was not signed by the borrower personally or omits or mis-states a "prescribed term"; or (c) without a court order in other cases and, in exercising its discretion whether to make the order, the court would take into account any prejudice suffered by the borrower and any culpability of the lender.

Any credit agreement intended to be a Regulated Mortgage Contract under the FSMA, or unregulated, might instead be wholly or partly regulated by the CCA or treated as such because of technical rules on: (a) determining whether any credit under the CCA arises, or whether the applicable financial limit of the CCA is exceeded; (b) determining whether the credit agreement is an exempt agreement under the CCA; and (c) changes to credit agreements.

A court order under Section 126 of the CCA is necessary to enforce a land mortgage (including, in Scotland, a standard security) securing a credit agreement to the extent that the credit agreement is regulated by the CCA or treated as such. In dealing with such application, the court has the power, if it appears just to do so, to amend the credit agreement or to impose conditions upon its performance or to make a time order (for example, giving extra time for arrears to be cleared).

Under Section 75 of the CCA in certain circumstances: (a) the lender is liable to the borrower in relation to misrepresentation and breach of contract by a supplier in a transaction financed by the lender, where the related credit agreement is or is treated as entered into under pre-existing arrangements, or in contemplation of future arrangements, between the lender and the supplier; and (b) the lender has a statutory indemnity from the supplier against such liability, subject to any agreement between the lender and the supplier. The borrower may set off the amount of the claim against the lender against the amount owing by the borrower under the loan or under any other loan that the borrower has taken. Any such set-off may adversely affect the realisable value of the Loans in the Portfolio and accordingly the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

The Consumer Credit Act 2006 (the **CCA 2006**), which amends and updates the CCA, was enacted on 30 March 2006 and was fully implemented by 31 October 2008.

Under the CCA 2006, the "extortionate credit" regime is replaced by an "unfair relationship" test. The "unfair relationship" test applies to all existing and new credit agreements, except Regulated Mortgage Contracts under the FSMA. The new test applies to all existing credit agreements and new credit agreements except Regulated Mortgage Contracts. The new test explicitly imposes liability to repay the borrower on both the originator and any assignee, such as the LLP. In applying the new unfair relationship test, the courts will be able to consider a wider range of circumstances surrounding the transaction, including the creditor's conduct before and after making the agreement. There is no statutory definition of the word "unfair", as the intention is for the test to be flexible and subject to judicial discretion. However, the word "unfair" is not an unfamiliar term in United Kingdom legislation due to the UTCCR (as defined below).

The courts may, but are not obliged to, look solely to the CCA 2006 for guidance. The FSA's Principles for Businesses may also be relevant, and apply to the way contract terms are used in practice and not just the way they are drafted. Once the debtor alleges that an unfair relationship exists, then the burden of proof is on the creditor to prove the contrary.

An alternative dispute resolution scheme for consumer credit matters is run by the Ombudsman (as described below) and was established on 6 April 2007. The scheme is mandatory for all businesses licensed under the CCA. The OFT is given far broader powers under the CA 2006 from 6 April 2008. For example, it can apply civil penalties, has greater powers of investigation and can issue indefinite standard licences. For appeals against such decisions by the OFT, the CCA 2006 introduced an independent Consumer Credit Appeals Tribunal, whose functions were transferred to the First-Tier Tribunal under the Transfer of Functions of the Consumer Credit Appeals Tribunal Order 2009 on 1 September 2009.

The financial limit of £25,000 for CCA regulation is removed for credit agreements made on or after 6 April 2008, except for certain changes to credit agreements, and except for certain buy-to-let loans made before 31 October 2008. Buy-to-let loans made on or after 31 October 2008 are, irrespective of amount, exempt agreements under the CCA. Regulations define buy-to-let loans for these purposes as being credit agreements secured on land where less than 40 per cent. of the floor area of the secured property is used, or is intended to be used, as or in connection with a dwelling by the borrower or by a connected person. A court order under Section 126 of the CCA is, however, necessary to enforce a land mortgage (or, in Scotland, a standard security) securing a buy-to-let loan to the extent that the loan would, apart from this exemption, be regulated by the CCA or treated as such.

To the extent that the credit agreement is regulated by the CCA or treated as such, it is unenforceable for any period when the lender fails to comply with requirements as to default notices. From 1 October 2008: (a) the credit agreement is also unenforceable for any period when the lender fails to comply with further requirements as to annual statements and arrears notices; (b) the borrower will not be liable to pay interest or, in certain cases, default fees for any period when the lender fails to comply with further requirements as to post-contract disclosure; and (c) interest upon default fees will be restricted to nil until the 29<sup>th</sup> day after the day on which a prescribed notice is given and then to simple interest. Charges payable on any early repayment in full are restricted by a formula under the CCA, which applies to the extent that the credit agreement is regulated by the CCA or treated as such. A more restrictive formula applies to credit agreements made on or after 31 May 2005, and applies retrospectively to all existing credit agreements from 31 May 2007 or 31 May 2010 depending on their terms.

These changes to the CCA may adversely affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

The Sellers have interpreted certain technical rules under the CCA in a way common with many other lenders in the mortgage market. If such interpretation were held to be incorrect by a court or the Ombudsman, then a Loan, to the extent that it is regulated by the CCA or treated as such, would be unenforceable as described above. If such interpretation were challenged by a significant number of Borrowers, then this could lead to significant disruption and shortfall in the income of the LLP. Court decisions have been made on technical rules under the CCA against certain mortgage lenders, but such decisions are very few and are generally county court decisions not binding on other courts.

The Sellers have given or, as applicable, will give warranties to the LLP in the Mortgage Sale Agreement that, among other things, each Loan and its Related Security is enforceable (subject to certain exceptions). If a Loan or its Related Security does not comply with these warranties, and if the default cannot be or is not cured within 20 London business days, then the relevant Seller will be required to repurchase the Loans under the relevant mortgage account and their Related Security from the LLP.

In the United Kingdom, regulation of residential mortgage business by the FSA under the FSMA came into force on 31 October 2004, the date known as “**N(M)**”. Entering into, arranging or

advising in respect of and administering Regulated Mortgage Contracts, and agreeing to do any of these things, are (subject to applicable exemptions) regulated activities under the FSMA.

A credit agreement is a “**Regulated Mortgage Contract**” under the FSMA if, at the time it is entered into or varied on or after N(M): (a) the borrower is an individual or trustee; (b) the contract provides for the obligation of the borrower to repay to be secured by a first legal mortgage or, in Scotland, a first ranking standard security on land (other than timeshare accommodation) in the UK; and (c) at least 40 per cent. of that land is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person (broadly, the person’s spouse, near relative or a person with whom the borrower has a relationship which is characteristic of a spouse).

The main effects are that, on or after N(M), unless an exclusion or exemption applies: (a) each entity carrying on a regulated mortgage activity by way of business has to hold authorisation and permission from the FSA to carry on that activity; and (b) each financial promotion in respect of an agreement relating to qualifying credit has to be issued or approved by a person holding authorisation and permission from the FSA. It should be noted that the definition of “qualifying credit” is broader than that of a “regulated mortgage contract” and may include mortgage loans that are regulated by the CCA or treated as such or unregulated and under which the lender is a person (such as the Seller) who carries on the regulated activity of entering into a regulated mortgage contract. If requirements as to authorisation and permission of lenders and brokers or as to issue and approval of financial promotions are not complied with, a Regulated Mortgage Contract (or, in the case of failure to comply with the financial promotions requirements, the relevant mortgage loan that is “qualifying credit”) or other secured credit in question will be unenforceable against the borrower except with the approval of a court. An unauthorised person who administers a Regulated Mortgage Contract entered into on or after N(M) may commit a criminal offence, but this will not render the contract unenforceable against the borrower.

The Sellers are required to hold, and holds, authorisation and permission to enter into and to administer and, where applicable, to advise in respect of Regulated Mortgage Contracts. Subject to any exemption, brokers will be required to hold authorisation and permission to arrange and, where applicable, to advise in respect of Regulated Mortgage Contracts.

The LLP is not and does not propose to be an authorised person under the FSMA with respect to Regulated Mortgage Contracts and related activities. The LLP does not require authorisation in order to acquire legal or beneficial title to a Regulated Mortgage Contract. The LLP does not carry on the regulated activity of administering Regulated Mortgage Contracts by having them administered pursuant to an administration agreement by an entity having the required FSA authorisation and permission. If such administration agreement terminates, however, the LLP would have a period of not more than one month in which to arrange for mortgage administration to be carried out by a replacement servicer having the required FSA authorisation and permission. In addition, on and after N(M), no variation has been or will be made to the Loans and no Further Advance or Product Switch has been or will be made in relation to a Loan, where it would result in the LLP arranging or advising in respect of, administering or entering into, a Regulated Mortgage Contract, or agreeing to carry on any of those activities, if the LLP would be required to be authorised under the FSMA to do so.

There is a risk that any credit agreement intended to be a Regulated Mortgage Contract under the FSMA might instead be wholly or partly regulated by the CCA or treated as such, or unregulated, and any credit agreement intended to be regulated by the CCA or treated as such, or unregulated, might instead be a Regulated Mortgage Contract under the FSMA, because of technical rules on: (a) determining whether the credit agreement or any part of it falls within the definition of “Regulated Mortgage Contract”; and (b) changes to credit agreements.

The FSA's Mortgages and Home Finance: Conduct of Business Sourcebook (“**MCOB**”), which sets out the FSA's rules for regulated mortgage activities, came into force on 31 October 2004. These rules cover, *inter alia*, certain pre-origination matters such as financial promotion and pre-application illustrations, pre-contract and start-of-contract and post-contract disclosure, contract changes, charges, and arrears and repossessions. FSA rules for prudential and authorisation requirements for mortgage firms, and for extending the appointed representatives regime for mortgages, came into force on 31 October 2004.

A borrower who is a private person may be entitled to claim damages for loss suffered as a result of any contravention by an authorised person of an FSA rule, and may set off the amount of the claim against the amount owing by the borrower under the loan or any other loan that the borrower has taken (or exercise analogous rights in Scotland). Any such set-off may adversely affect the realisable value of the Loans in the Portfolio and accordingly the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

So as to avoid dual regulation, it is intended that Regulated Mortgage Contracts will not be regulated by the CCA, and the relevant regulations made in 2005 and 2008 under the FSMA are designed to clarify the position in this regard. This exemption only affects credit agreements made on or after N(M), and credit agreements made before N(M) but subsequently changed such that a new contract is entered into on or after N(M) and constitutes a separate Regulated Mortgage Contract. A court order under Section 126 of the CCA is, however, necessary to enforce a land mortgage (including, in Scotland, a standard security) securing a Regulated Mortgage Contract to the extent that the credit agreement would, apart from this exemption, be regulated by the CCA or be treated as such.

No assurance can be given that additional regulatory changes by the OFT, the FSA or any other regulatory authority will not arise with regard to the mortgage market in the United Kingdom generally, any Seller's particular sector in that market or specifically in relation to the Sellers. Any such action or developments or compliance costs may have a material adverse effect on the Sellers, the Issuer, the Servicers, the LLP and their respective businesses and operations. This may adversely affect the ability of the LLP to dispose of the Portfolio or any part thereof in a timely manner and/or the realisable value of the Portfolio or any part thereof, and accordingly affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee when due.

Prior to N(M), in the United Kingdom, self-regulation of mortgage business existed under the Mortgage Code (the “**CML Code**”) issued by the Council of Mortgage Lenders (the “**CML**”). The Original Seller subscribed to the CML Code and on and from N(M), as an authorised person, has been subject to the FSA requirements in the MCOB. Membership of the CML and compliance with the CML Code were voluntary. The CML Code set out minimum standards of good mortgage business practice, from marketing to lending procedures and dealing with borrowers experiencing financial difficulties. Since 30 April 1998 lender-subscribers to the CML Code could not accept mortgage business introduced by intermediaries who were not registered with (before 1 November 2000) the Mortgage Code Register of Intermediaries or (on and after 1 November 2000 until 31 October 2004) the Mortgage Code Compliance Board. Complaints relating to breach of the CML Code were dealt with by the relevant scheme, such as the Banking Ombudsman Scheme or the Mortgage Code Arbitration Scheme. The CML Code ceased to have effect on 31 October 2004 when the FSA assumed responsibility for the regulation of Regulated Mortgage Contracts.

In April 2008, the European Parliament and the Council adopted a second directive on consumer credit (Directive 2008/48/EC, the “**Consumer Credit Directive**”), which provides that, subject to exemptions, loans of at least €200 and not exceeding €75,000 between credit providers and consumers will be regulated. This directive will repeal and replace the first consumer credit directive and requires Member States to implement the directive by measures coming into force by 11 June 2010.

Loans secured by a land mortgage (including, in Scotland, a standard security) are, however, exempted from the Consumer Credit Directive and from the first consumer credit directive. The European Commission published a White Paper on mortgage credit in December 2007, setting out its tasks for 2008 to 2010 including, among other things, an assessment of the regulation of early repayment charges, pre-contract disclosure and interest rate restrictions. The European Commission has stated that, in its view, it is too early to decide on whether a mortgage directive would be appropriate.

Until the final text of any initiatives resulting from the White Paper process is decided and the details of the United Kingdom's implementation of the Consumer Credit Directive are finalised and the final text of any initiatives resulting from the Commission's further work are decided and implemented, it is not certain what effect the adoption and implementation of the Consumer Credit Directive or any initiatives resulting from the White Paper process would have on the Sellers, the Issuer, the Servicers, the LLP and their respective businesses and operations. This may adversely affect the ability of the LLP to dispose of the Portfolio or any part thereof in a timely manner and/or the realisable value of the Portfolio or any part thereof, and accordingly affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee when due.

#### *3.15.9.2 Distance Marketing*

The Financial Services (Distance Marketing) Regulations 2004 apply to, *inter alia*, credit agreements entered into on or after 31 October 2004 by means of distance communication (i.e. without any substantive simultaneous physical presence of the originator and the borrower). A Regulated Mortgage Contract under the FSMA, if originated by a UK lender from an establishment in the UK, will not be cancellable under these regulations but will be subject to related pre-contract disclosure requirements in MCOB. Certain other credit agreements will be cancellable under these regulations if the borrower does not receive prescribed information at the prescribed time, or in any event for certain unsecured lending. Where the credit agreement is cancellable under these regulations, the borrower may send notice of cancellation at any time before the end of the fourteenth day after the day on which the cancellable agreement is made, where all the prescribed information has been received, or, if later, the borrower receives the last of the prescribed information.

If the borrower cancels the credit agreement under these regulations then:

- (a) the borrower is liable to repay the principal and any other sums paid by the originator to the borrower under or in relation to the cancelled agreement, within 30 days beginning with the day of the borrower sending the notice of cancellation or, if later, the originator receiving notice of cancellation;
- (b) the borrower is liable to pay interest, or any early repayment charge or other charge for credit under the cancelled agreement, only if the borrower received certain prescribed information at the prescribed time and if other conditions are met; and
- (c) any security provided in relation to the contract is to be treated as never having had effect.



### *3.15.9.3 Unfair Terms in Consumer Contracts Regulations 1994 and 1999*

In the United Kingdom, the Unfair Terms in Consumer Contracts Regulations 1999 as amended (the “**1999 Regulations**”), together with (in so far as applicable) the Unfair Terms in Consumer Contracts Regulations 1994 (together with the 1999 Regulations, the “**UTCCR**”), apply to agreements made on or after 1 July 1995 and affect all or almost all of the Loans. The UTCCR provide that:

- a consumer may challenge a standard term in an agreement on the basis that it is “unfair” within the UTCCR and therefore not binding on the consumer (although the rest of the agreement will remain enforceable if it is capable of continuing in existence without the unfair term); and
- the OFT and any “qualifying body” within the 1999 Regulations (such as the FSA) may seek to enjoin (or in Scotland interdict) a business from relying on unfair terms.

The UTCCR will not generally affect terms which define the main subject matter of the contract, such as the borrower’s obligation to repay the principal (provided that these terms are written in plain and intelligible language and are drawn adequately to the consumer’s attention), but may affect terms that are not considered to define the main subject matter of the contract, such as the lender’s power to vary the interest rate, and certain terms imposing early repayment charges and mortgage exit administration fees.

For example, if a term permitting the lender to vary the interest rate (as the Original Seller is permitted to do) is found to be unfair, the borrower will not be liable to pay interest at the increased rate or, to the extent that the borrower has paid it, will be able, as against the lender, or any assignee such as the LLP, to claim repayment of the extra interest amounts paid or to set off the amount of the claim against the amount owing by the borrower under the loan or any other loan that the borrower has taken. Any such non-recovery, claim or set-off may adversely affect the realisable value of the Loans in the Portfolio and accordingly the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

The division of responsibilities between the OFT and the FSA for enforcing the UTCCR is set out in concordats made between them, most recently in November 2009. Generally, the FSA is responsible for enforcement of the UTCCR in Regulated Mortgage Contracts under the FSMA originated by lenders authorised by the FSA, and the OFT is responsible for enforcement of the UTCCR in other mortgage contracts.

In February 2000, the OFT issued a guidance note on what the OFT considers to be fair terms and unfair terms for interest variation in mortgage contracts. Where the interest variation term does not provide for precise and immediate tracking of an external rate outside the lender’s control, and if the borrower is locked in, for example by an early repayment charge that is considered to be a penalty, the term is likely to be regarded as unfair under the UTCCR unless the lender (i) notifies the affected borrower in writing at least 30 days before the rate change and (ii) permits the affected borrower to repay the whole loan during the next three months after the rate change without paying the early repayment charge. The Original Seller has reviewed the guidance note and has concluded that its compliance with it will have no material adverse effect on the Loans or its business. The guidance note has been withdrawn from the OFT website but may remain in effect as the OFT’s view and a factor that the FSA may take into account.

In May 2005, the FSA issued a statement of good practice on fairness of terms in consumer contracts, which is relevant to firms authorised and regulated by the FSA in relation to products and services within the FSA’s regulatory scope. This statement provides that, for locked-in borrowers, a

firm may consider drafting the contract to permit a change in the contract to be made only where any lock-in clause is not exercised. In the context of the OFT's investigation into credit card default charges, the OFT on 5 April 2006 publicly announced that the principles the OFT considers should be applied in assessing the fairness of credit card default charges shall apply (or are likely to apply) also to analogous default charges in other agreements, including those for mortgages.

In January 2007, the FSA issued a statement of good practice on mortgage exit administration fees. This statement provides that the lender should ensure that the fee represents in fact the cost of the administration services that the lender provides when a borrower exits the mortgage. The FSA issued a follow-up communication in November 2007 emphasising that this statement should not be interpreted narrowly and, where appropriate, firms should consider applying its principles to other charges. In August 2007, the FSA's Unfair Contract Terms Regulatory Guide came into force. This guide is designed to explain the FSA's policy on how it will use its powers under the 1999 Regulations.

The extremely broad and general wording of the UTCCR makes any assessment of the fairness of terms largely subjective and makes it difficult to predict whether or not a court would find a term to be unfair. It is therefore possible that any Loans which have been made or may be made to Borrowers that are covered by the UTCCR may contain unfair terms which may result in the possible unenforceability of the terms of such Loans.

In August 2002, the Law Commission for England and Wales and the Scottish Law Commission issued a joint consultation (LCCP No. 166/SLCDP 119) on proposals to rationalise the UK's Unfair Contract Terms Act 1977 and the 1999 Regulations into a single piece of legislation and a final report, together with a draft bill on unfair terms, was published in February 2005. It is not proposed that there should be any significant increase in the extent of controls over terms in consumer contracts. Some changes are proposed, however, such as that (a) a consumer may also challenge a negotiated term in an agreement on the basis that it is "unfair" and "unreasonable" within the legislation and therefore not binding on the consumer; and (b) in any challenge by a consumer (but not by the OFT or a qualifying body) of a standard term or a negotiated term, the burden of proof lies on the business to show that the term is fair and reasonable. It is too early to tell how the proposals, if enacted, would affect the Loans.

No assurance can be given that changes in the 1999 Regulations, if enacted, or changes to guidance on interest variation terms, if adopted, will not have a material adverse effect on the Sellers, the Issuer, the Servicers, the LLP and their respective businesses and operations. This may adversely affect the ability of the LLP to dispose of the Portfolio or any part thereof in a timely manner and/or the realisable value of the Portfolio or any part thereof, and accordingly affect the ability of the LLP to meet its obligations under the Covered Bond Guarantee when due.

#### *3.15.9.4 Unfair Commercial Practices Directive 2005*

In May 2005, the European Parliament and the Council adopted Directive 2005/29/EC on unfair business-to-consumer commercial practices (the "**Unfair Practices Directive**"). Generally, this directive applies full harmonisation, which means that Member States may not impose more stringent provisions in the fields to which full harmonisation applies. By way of exception, this directive permits Member States to impose more stringent provisions in the fields of financial services and immovable property, such as mortgage loans.

The Unfair Practices Directive provides that enforcement bodies may take administrative action or legal proceedings against a commercial practice on the basis that it is "unfair" within the directive. This directive is intended to protect only collective interests of consumers, and so is not intended to give any claim, defence or right of set-off to an individual consumer.

The Unfair Practices Directive required Member States to implement the directive by measures coming into force by 12 December 2007. The United Kingdom has implemented the directive by the Consumer Protection from Unfair Trading Regulations 2008 which came into force on 26 May 2008. In addition, the FSA has taken the directive into account in reviewing its relevant rules such as MCOB, and the OFT addresses commercial practices in administering licences under the CCA. The Unfair Practices Directive provides a transitional period until 12 June 2013 for applying full harmonisation in the fields to which it applies.

No assurance can be given that the UK implementation of the Unfair Practices Directive, including full harmonisation in the fields to which it applies, will not have a material adverse effect on the Loans and accordingly on the ability of the Issuer to make payments to the Covered Bondholders.

#### *3.15.9.5 Pre-Action Protocol for mortgage possession*

A new protocol for mortgage possession cases in England and Wales came into force on 19 November 2008, setting out the steps that judges will expect any lender to take before starting a claim. A number of mortgage lenders have confirmed that they will delay the initiation of repossession action for at least three months after a borrower, who is an owner-occupier, is in arrears. The application of such a moratorium may be subject to the wishes of the relevant borrower, and may not apply in cases of fraud. The protocol is addressed to residential mortgage lenders and may have more adverse effect in markets experiencing above average levels of possession claims.

#### *3.15.9.6 Financial Ombudsman Service*

Under the FSMA, the Financial Ombudsman Service is required to make decisions on, among other things, complaints relating to activities and transactions under its jurisdiction on the basis of what, in the Ombudsman's opinion, would be fair and reasonable in all circumstances of the case, taking into account, among other things, law and guidance. Transitional provisions exist by which certain complaints relating to breach of the CML Code occurring before N(M) may be dealt with by the Financial Ombudsman Service. Complaints brought before the Financial Ombudsman Service for consideration must be decided on a case-by-case basis, with reference to the particular facts of any individual case. Each case would first be adjudicated by an adjudicator. Either party to the case may appeal against the adjudication. In the event of an appeal, the case proceeds to a final decision by the Ombudsman.

As the Financial Ombudsman Service is required to make decisions on the basis of, among other things, the principles of fairness, and may order a money award to the borrower, it is not possible to predict how any future decision of the Financial Ombudsman Service would affect the realisable value of the Loans in the Portfolio and accordingly the ability of the LLP to meet its obligations under the Covered Bond Guarantee.

#### *3.15.9.7 Decisions of the Ombudsman could lead to some terms of the Loans being varied, which may adversely affect payments under the Covered Bond Guarantee*

In January 2002, the Ombudsman made a determination on Halifax's appeal to an earlier decision by an adjudicator at the Financial Ombudsman Service concerning a case involving HVR 1 and HVR 2 (a second Variable Base Rate that was made available to Borrowers by Halifax between 1 March 2001 and 1 February 2002). In March 2001, two joint Borrowers with a capped rate loan originated when Halifax offered only a single standard variable base rate contacted Halifax and requested that their loan be linked to HVR 2. Halifax informed the Borrowers that, because they were still in their product period, they could either transfer to HVR 2 when their product period expired or transfer to HVR 2 immediately and pay the applicable early repayment fee. The Borrowers complained to the Financial Ombudsman Service and, on 29 January 2002, on appeal by Halifax, the

Ombudsman determined in the Borrowers' favour and recommended that Halifax recalculate the Borrowers' mortgage by reference to HVR 2 from the date when Halifax should have granted their request in March 2001, refund any overpayments and pay £150 for any inconvenience caused. HVR 2 was withdrawn and ceased to be available to new Borrowers with effect from 1 February 2002.

The Ombudsman's decision only applies to the two Borrowers and their particular circumstances, though other Borrowers may also complain to the Ombudsman. In March 2002, Halifax announced that Borrowers under loans who were in similar circumstances and who had asked to be transferred to HVR 2 when it was available would be invited to make a Product Switch to HVR 2 and to obtain a refund for all overpayments of interest since the date they had asked to be transferred. For each of those loans, the Borrowers would also receive £150 for any inconvenience caused. The Borrowers under loans who requested to be transferred after HVR 2 was withdrawn and before the announcement in March 2002 were not offered a switch or a refund, though Halifax has given or will give each of these customers an *ex gratia* payment of £100.

Since then, the Ombudsman has, in similar cases, confirmed that affected Borrowers were only entitled to a refund of overpayments of interest from the date when they asked to be transferred to HVR 2 and not from the date when HVR 2 first became available, and also that affected Borrowers were not entitled to apply to be transferred to HVR 2 after it was withdrawn.

Bank of Scotland (as successor to Halifax's business pursuant to the HBOS Group Reorganisation Act 2006) does not believe that any decision of the Ombudsman to date or any other decision by any competent authority in the future (in respect of Halifax's two former variable base rates, HVR 1 and HVR 2) would affect the yield on the Loans in such a way as to have a material adverse effect on the ability of the LLP to meet its obligations under the Covered Bond Guarantee when due.

As regards other Borrowers, in the event that a decision (in respect of Halifax's Variable Base Rate) by the Ombudsman or any other competent authority finds that a Borrower's Loan should be linked to HVR 2, then that Borrower may set off the overpaid sum against the amount owing under his or her Loan if the Original Seller does not reimburse that Borrower. Any such non-recovery, claim or set-off ultimately may adversely affect the LLP's ability to make payments under the Covered Bond Guarantee.

### **3.16 Limited Liability Partnerships**

The LLP is a limited liability partnership. Limited liability partnerships, created by statute pursuant to the LLPA 2000, are bodies corporate and have unlimited capacity. A general description of limited liability partnerships is set out below under *Description of Limited Liability Partnerships*. This area of the law is relatively undeveloped. Accordingly, there is a risk that as the law develops, new case law or new regulations made under or affecting the LLPA 2000 or relating to limited liability partnerships could adversely affect the ability of the LLP to perform its obligations under the Transaction Documents which could, in turn, adversely affect the interests of Covered Bondholders.

### **3.17 Pensions Act 2004**

Under the Pensions Act 2004 a person that is 'connected with' or an 'associate' of an employer under an occupational pension scheme can be subject to either a contribution notice or a financial support direction. As the LLP is a member of the HBOS Group, it may be treated as 'connected to' an employer under an occupational pension scheme which is within the HBOS Group.

A contribution notice could be served on the LLP if it was party to an act, or a deliberate failure to act and either (A), the main purpose or one of the main purposes of which was either (i) to

prevent the recovery of the whole or any part of a debt which was, or might become, due from the employer under Section 75 of the Pensions Act 1995 or (ii) to prevent such a debt becoming due, to compromise or otherwise settle such a debt, or to reduce the amount of such a debt which would otherwise become due or (B), in the opinion of the UK Pensions Regulator it has detrimentally affected in a material way the likelihood of accrued scheme benefits being received. A contribution notice can only be served where the Pensions Regulator considers it is reasonable to do so, having regard to a number of factors.

A financial support direction could be served on the LLP where the employer is either a service company or insufficiently resourced. An employer is insufficiently resourced if the value of its resources is less than 50 per cent. of the pensions scheme's deficit calculated on an annuity buy-out basis and there is a connected or associated person whose resources at least cover that difference. A financial support direction can only be served where the Pensions Regulator considers it is reasonable to do so, having regard to a number of factors.

If a contribution notice or financial support direction were to be served on the LLP this could adversely affect investors in the Covered Bonds.

### **3.18 Divestment by the Lloyds Banking Group of mortgages, which may otherwise have been transferred to the LLP as New Loans or Substitution Assets, as a result of the restructuring plan approved by the European commission on 18 November 2009**

As a result of the restructuring plan approved by the European commission on 18 November 2009, approximately 19 per cent. of the Lloyds Banking Group's mortgage assets are to be divested within approximately four years; however the mortgage assets of the Lloyds Banking Group to be divested cannot be determined with precision until nearer the date of sale. This divestment of mortgage assets, some of which may meet the Eligibility Criteria and which may have otherwise been available to be transferred to the LLP as New Loans, may reduce the pool of eligible mortgages available to meet the requirements of the programme. There can be no assurance that a sufficient number of mortgage assets which meet the Eligibility Criteria will be available to meet the replenishment needs of the LLP. In the event that the pool of mortgage assets available to be transferred as New Loans is reduced, to the extent that a shortfall results, any such shortfall would likely be met from the sale of Loans originated by another member of the Lloyds Banking Group to the LLP, subject to any necessary approval of such sale by the transaction parties, or alternatively cash or Substitution Assets (up to the permitted level). The retention of cash or purchase of Substitution Assets could affect the level of revenue receipts, which, together with a potentially limited supply of mortgage assets, may affect the ability of the LLP to make payments under the Covered Bond Guarantee.

## RECENT DEVELOPMENTS

### esure

On 11 February 2010, Lloyds Banking Group announced the sale of its 70 per cent. stake in esure to a management buyout vehicle to be called esure Group Holdings Ltd for a cash consideration slightly in excess of book value in the Lloyds Banking Group accounts (31 December 2008: £185 million).

### Group Reorganisation

On 1 January 2010, Lloyds Banking Group transferred its holding in HBOS to Lloyds TSB Bank plc (the "**Group Reorganisation**"). As a result of the Group Reorganisation, Lloyds TSB Bank plc has become the immediate parent of HBOS. Lloyds Banking Group will continue to own Lloyds TSB Bank plc directly but, as a result of the Group Reorganisation, will own HBOS indirectly, as Lloyds TSB Bank plc will be the immediate parent of HBOS. The capital ratios of Lloyds Banking Group will not change as a result of the Group Reorganisation. The Group Reorganisation has been approved by the FSA.

### Preference Share Exchanges

On 11 December 2009 Lloyds Banking Group plc announced that it had agreed to repurchase U.S.\$359,790,000 of its U.S.\$750,000,000 6.413 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.\$194,457,000 of its U.S.\$750,000,000 5.92 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.\$252,842,000 of its U.S.\$750,000,000 6.657 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares and U.S.\$451,542,000 of its U.S.\$1,000,000,000 6.267 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, which are held by a limited number of investors in the United States, for new U.S.\$1,258,631,000 8.00 per cent. Fixed to Floating Rate Undated Enhanced Capital Notes. The exchanges settled on 15 and 16 December 2009.

On 14 December 2009 Lloyds Banking Group plc announced that it had agree to repurchase U.S.\$15,400,000 of its U.S.\$750,000,000 6.413 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.\$183,610,000 of its U.S.\$750,000,000 5.92 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.\$62,808,000 of its U.S.\$750,000,000 6.657 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares and U.S.\$14,840,000 of its U.S.\$1,000,000,000 6.267 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, for new U.S.\$276,658,000 8.50 per cent. Undated Enhanced Capital Notes. The exchanges settled on 17 December 2009.

### Capital Restructuring

On 3 November 2009 Lloyds Banking Group plc announced proposals intended to meet its current and long-term capital requirements including a Rights Issue and two separate Exchange Offers (together, the "**Proposals**"). The Proposals, which were fully underwritten, were approved by shareholders on 26 November 2009. The Rights Issue, which raised £13.5 billion (£13 billion net of the expenses of the Proposals) was completed on 14 December 2009 with 95.3 per cent. of shares placed with shareholders. The remaining 4.7 per cent. rump was placed with investors and settled on 17 December 2009. The Exchange Offers were substantially completed during December 2009 and generated approximately £7.5 billion in nominal value of contingent core tier 1 capital at that time. The remaining elements of the Exchange Offers were completed on 18 February 2010 when Lloyds Banking Group plc issued 3,140,686,402 ordinary shares at a price of £0.486985 per share. The issue of ordinary shares generated approximately £1.5 billion in core tier 1 capital.

HM Treasury voted in favour of the resolutions to implement the Proposals to the extent it was entitled to vote. HM Treasury also participated in full in respect of its rights in the Rights Issue. In addition, all of Lloyds Banking Group's Directors participated in respect of their rights in the Rights Issue. HM Treasury currently holds approximately 41.3 per cent. of Lloyds Banking Group plc's ordinary share capital.

Alongside the Proposals, Lloyds Banking Group has paid to HM Treasury, with shareholder approval (excluding HM Treasury), a fee of £2.5 billion for the benefit to Lloyds Banking Group's trading operations arising as a result of HM Treasury proposing to make GAPS available to Lloyds Banking Group (the "**GAPS Payment**") and a commission, being a commission of up to £143.7 million in consideration, inter alia, of HM Treasury's pre-launch commitment to participate in full in respect of its entitlements under the Rights Issue (the "**HMT Commitment Commission**"). Payment of a fee in relation to the benefit to Lloyds Banking Group's trading operations as described above was also required by the European Commission as part of the state aid remedies. Lloyds Banking Group has also agreed to reaffirm the lending commitments that it gave to HM Treasury in March 2009 and to maintain in the 12 months commencing 1 March 2010 similar overall levels of lending as in the 12 months commencing 1 March 2009.

During the second half of 2009, HM Treasury and Lloyds Banking Group were involved in detailed negotiations with the European Commission in relation to the terms of a restructuring plan which was required in the context of a review resulting from the state aid received by Lloyds Banking Group. On 18 November 2009 the European Commission approved Lloyds Banking Group's restructuring plan. Lloyds Banking Group is confident that the implementation of the restructuring plan will not have a materially negative impact on Lloyds Banking Group. However, Lloyds Banking Group has been prevented from paying dividends on ordinary shares for so long as it is prohibited from making coupon payments on certain of its other securities (which is between 31 January 2010 and 31 January 2012) as a result of the restrictions required by the European Commission as part of the restructuring plan. Further details on the state aid position are set out below under the section entitled "State Aid".

The Proposals comprised:

- (i) an equity raising of £13.5 billion (£13 billion net of the expenses of the Proposals) by way of a rights issue. The Rights Issue was fully underwritten. The issue price at which qualifying shareholders were invited to subscribe for new shares was set at 37 pence per new share at the general meeting held on 26 November 2009; and
- (ii) two separate exchange offers. Under the Exchange Offers, eligible holders of existing securities were invited to offer to exchange such existing securities for either: (a) new lower tier 2 capital qualifying notes which are guaranteed by either Lloyds Banking Group plc and/or Lloyds TSB Bank plc ("**Enhanced Capital Notes**" or "**ECNs**") and which will convert into ordinary shares if Lloyds Banking Group's published consolidated core tier 1 capital ratio falls to less than 5 per cent.; or (b) in one of the Exchange Offers only, an exchange consideration amount which was settled in new ordinary shares. The Exchange Offers were substantially completed during December 2009 and generated approximately £7.5 billion in nominal value of contingent core tier 1 capital at that time. The remaining elements of the Exchange Offers were completed on 18 February 2010 when Lloyds Banking Group plc issued 3,140,686,402 ordinary shares at a price of £0.486985 per share. The issue of ordinary shares generated approximately £1.5 billion in core tier 1 capital.

*Rationale and key benefits of the Proposals*

The Board believes that the economic environment in the UK has begun to stabilise and that the UK economy is now expected to return to growth in 2010. This represents a significantly more positive environment for Lloyds Banking Group than the conditions prevailing when a stress test was carried out under Lloyds Banking Group's financial modelling which is based on the economic assumptions published by the FSA in March 2009 (the "FSA Stress Test") at the time at which Lloyds Banking Group announced its intended participation in GAPS. As previously announced, the Board continues to expect that Lloyds Banking Group's overall impairments in 2010 will be significantly lower than those incurred in 2009, with progressive reductions expected thereafter.

Claims under GAPS could only be made after the First Loss (as defined below) had been exceeded. However, based on the Board's view of the economic outlook for the UK, Lloyds Banking Group does not expect that its overall impairments will be high enough to have justified entering into GAPS. On this basis Lloyds Banking Group would not have expected to make any claim were it to have participated in GAPS, but would nevertheless still incur significant costs. Even if the UK economy were to deteriorate to the level assumed in the FSA Stress Test, which the Board considers to be unlikely, the Board believes that the net amounts that Lloyds Banking Group would have received under GAPS would have been less than the £15.6 billion participation fee which it would have been required to pay to participate in GAPS on the terms announced in March.

Accordingly, the Board is of the view that an alternative approach to meeting its current and long-term capital commitments, in the form of the Proposals, is in the best interests of Lloyds Banking Group. The Proposals have been structured in consultation with the FSA. The Board is therefore confident that the Proposals, together with other management actions which the Board considers to be readily actionable, will generate sufficient capital to ensure that Lloyds Banking Group no longer requires the asset protection which it would have obtained through participation in GAPS, even if the severe scenario envisaged by the FSA Stress Test were to occur. The Board believes that the Proposals represent a significant step in meeting its long-term objective: that Lloyds Banking Group operates as a wholly privately-owned, self-supporting commercial enterprise.

The Board was pleased that it was able to offer a market-based solution to meet its capital requirements. Such a solution was not available to Lloyds Banking Group at the time of the announcement of Lloyds Banking Group's intended participation in GAPS in March 2009.

#### *Key benefits*

Were it to have participated in GAPS, Lloyds Banking Group would have benefited from certain loss and regulatory capital relief. However, the Board believes that the Proposals offer substantial benefits to shareholders, both on their own merits and as a significantly more attractive option in comparison to GAPS, for the reasons described in more detail below. The Board believes that the Proposals, after taking into account the GAPS Payment, will enhance both earnings per share and returns on equity for Lloyds Banking Group plc relative to GAPS, even if the UK economy deteriorates to the level implied by the FSA Stress Test, which the Board considers to be unlikely.

*Substantial increase in non-amortising core tier 1 equity capital:* The Rights Issue raised a total of £13.5 billion of immediately available and non-amortising core tier 1 capital, before expenses of the Proposals. Lloyds Banking Group had a core tier 1 capital ratio of approximately 8.1 per cent. at 31 December 2009. Lloyds Banking Group's core tier 1 ratio would have been 8.4 per cent. had the Exchange Offers settled in December 2009. The Board considers that this implied level of core tier 1 capital represents a strong capital foundation to support the future stability and success of Lloyds Banking Group.

Moreover, the core tier 1 capital raised by the Rights Issue will be available to absorb potential losses across all of Lloyds Banking Group's assets, as opposed to GAPS which would have



only protected against losses on those particular assets covered by the scheme. The core tier 1 capital which would be created on conversion of the ECNs (if and when they were to convert) would also be available to absorb potential losses across all Lloyds Banking Group's assets.

By contrast, based on the terms announced in March 2009, GAPS would have created an initial £15.6 billion of core tier 1 capital through the subscription by HM Treasury, using the GAPS participation fee, for B Shares. However, the core tier 1 capital benefit of £15.6 billion from the issue of the B Shares would have been largely offset over the subsequent seven-year period by the GAPS participation fee which would have been amortised through Lloyds Banking Group's income statement. After taking tax into consideration, this would have reduced core tier 1 capital by £11.2 billion. Furthermore, although GAPS would offer an additional core tier 1 capital benefit by providing capital relief on the risk-weighted assets that would initially have been included in the scheme, this benefit would have reduced significantly as the assets within GAPS matured or otherwise ceased to be covered by GAPS in the short-to-medium term.

*Improved capital efficiency and lower shareholder dilution:* The ECNs issued pursuant to the Exchange Offers have been designed to provide capital to Lloyds Banking Group without being dilutive to shareholders at the time of their issue. The ECNs qualified at the time of their issue as lower tier 2 capital and automatically convert into ordinary shares if Lloyds Banking Group's published consolidated core tier 1 capital ratio falls to less than 5 per cent., thereby increasing Lloyds Banking Group's core tier 1 capital at such time. In the event of a conversion pursuant to this feature, up to £7.5 billion of core tier 1 capital would be generated. This provides protection against unexpected deterioration in the UK economy and the effect that such deterioration would have on Lloyds Banking Group's capital ratios. Conversion of the ECNs, and the resulting dilution of ordinary shareholders, would only occur if Lloyds Banking Group's results (in particular impairments) were significantly worse than the Board currently expects.

By contrast, under GAPS, the B Shares to be issued to HM Treasury, at a cost to HM Treasury of £15.6 billion, would have been available for conversion at HM Treasury's option into 13.6 billion ordinary shares, and would have converted automatically if the volume weighted average trading price of the ordinary shares equalled or exceeded 150 pence per ordinary share for 20 complete trading days in any 30 trading-day period. Upon such conversion, HM Treasury's ownership of Lloyds Banking Group plc would have increased to approximately 62.3 per cent. from its current level of approximately 41.3 per cent. This substantial dilution to ordinary shareholders (other than HM Treasury) would, therefore, have occurred in the event that Lloyds Banking Group plc's share price increased to such levels or if HM Treasury exercised its option to convert to ordinary shares.

*Cost effective:* By implementing the Proposals, although Lloyds Banking Group was required to make the GAPS Payment, Lloyds Banking Group will not have to pay the £15.6 billion GAPS participation fee to HM Treasury. In addition, Lloyds Banking Group plc will not issue any B Shares and, accordingly, will not have to pay HM Treasury the proposed annual dividend on the B Shares of at least £1.1 billion, subject to Lloyds Banking Group plc having sufficient distributable reserves.

*Improved EU state aid position relative to GAPS:* Based on discussions with HM Treasury and the European Commission, the Board believes that the total amount of state aid received by Lloyds Banking Group is significantly lower than would have been expected to be the case had Lloyds Banking Group participated in GAPS. The Board believes that this has significantly reduced the severity of the final terms of the restructuring plan required by the European Commission to limit distortions of competition resulting from the state aid received by Lloyds Banking Group. An update on Lloyds Banking Group's current state aid position is set out below, see "*State Aid*".

*No additional administrative and operational burden:* Participation in GAPS would have required Lloyds Banking Group to create an additional administrative and reporting infrastructure that

would have been costly, both from a financial perspective and in terms of management time. This would have inhibited Lloyds Banking Group's operational and commercial efficiency and flexibility and absorbed substantial Lloyds Banking Group resources.

#### *GAPS Withdrawal Deed*

Alongside the Proposals, Lloyds Banking Group plc has entered into the GAPS Withdrawal Deed. This agreement sets out the various commitments and terms agreed with HM Treasury including with respect to the implementation of the expected state aid remedies.

The GAPS Withdrawal Deed provides for Lloyds Banking Group to make the GAPS Payment. This is a fee which Lloyds Banking Group has paid to HM Treasury for the benefit to Lloyds Banking Group's trading operations arising as a result of HM Treasury proposing to make GAPS available to Lloyds Banking Group from the time of the announcement of its intention to participate in GAPS in March 2009 until the announcement of the Proposals. Payment of a fee was also required by the European Commission as part of the state aid remedies.

Had Lloyds Banking Group not reached agreement with HM Treasury on the amount of the GAPS Payment, Lloyds Banking Group would not have been able to pursue and implement the Proposals since payment of an agreed fee was a prerequisite to finalising negotiations with the European Commission in respect of the remedies to address the state aid Lloyds Banking Group has received.

The terms announced in March in connection with Lloyds Banking Group's intended participation in GAPS did not address whether a fee should be paid by Lloyds Banking Group if it did not ultimately accede to GAPS. Therefore, there was no contractual measure by which Lloyds Banking Group could determine the level of such fee. Furthermore, whilst the European Commission required that a commercially appropriate fee be paid, they did not prescribe the amount. The GAPS Payment was negotiated between Lloyds Banking Group plc and HM Treasury and was approved by the European Commission.

In order to determine what level of fee it would be appropriate to pay, Lloyds Banking Group sought to quantify the benefit to Lloyds Banking Group's trading operations arising as a result of HM Treasury making GAPS available to Lloyds Banking Group.

The benefit to Lloyds Banking Group was calculated based on an estimate of the cost of capital for Lloyds Banking Group equal to the amount of regulatory capital benefit which the Board considers would have been received by or generated for Lloyds Banking Group through GAPS for the period from the announcement of its intention to participate in GAPS until the announcement of the Proposals. Had GAPS not been available to Lloyds Banking Group it would have needed to raise further capital. The calculation is difficult and, in some material respects, relies upon subjective judgements of some complexity and uncertainty. However, the amount of such regulatory capital benefit is based on: (i) the reduction of risk-weighted assets which would have arisen by virtue of GAPS; and (ii) the issuance of the B Shares. In order to determine the cost of capital for Lloyds Banking Group, a range of outcomes can be derived from long-term historical data as well as relevant market transactions during the period. However, in this case, the Board took into account the fact that, in March 2009, the capital markets were under severe stress and the cost of capital for Lloyds Banking Group would have been correspondingly materially higher than might have been available were only long-term historical data being used.

There are several other reasonable and supportable bases on which one can seek to quantify the benefit to Lloyds Banking Group, and therefore the appropriate amount of the GAPS Payment.

Before coming to an agreement with HM Treasury on the amount of the GAPS Payment based on the cost of capital for Lloyds Banking Group, Lloyds Banking Group carried out a number of analyses, in addition to the analysis referenced above, and determined a range of amounts which the Board believes reflect the amount of benefit received by Lloyds Banking Group. The amount of the GAPS Payment negotiated and agreed with HM Treasury falls within the range of such appropriate amounts, albeit at the high end of that range. However, the Board believes that the GAPS Payment is a proportionate fee and reflects the amount of benefit received by Lloyds Banking Group's trading operations.

The Board, having assessed carefully the amount of the GAPS Payment and the substantial benefits of the Proposals, believes that the Proposals, after taking into account the GAPS Payment, will enhance earnings per share and returns on equity for Lloyds Banking Group plc relative to GAPS and, therefore, represent superior economic value to shareholders.

#### Undertakings with respect to the state aid approval

Under the GAPS Withdrawal Deed Lloyds Banking Group also makes certain undertakings in relation to the state aid approval obtained from the European Commission. In particular, Lloyds Banking Group is required to do all acts and things necessary to ensure the UK Government's compliance with its obligations under the European Commission's decision approving state aid to Lloyds Banking Group. This undertaking includes an obligation: (i) to comply with the restructuring measures that Lloyds Banking Group agreed to undertake; (ii) to comply with the terms of the restructuring plan submitted to and accepted by the European Commission in connection with the approval of state aid to Lloyds Banking Group; and (iii) to provide certain information to HM Treasury and do such acts as are necessary to enable compliance with the state aid approval to be monitored. HM Treasury has undertaken that, now that the European Commission has approved the state aid to Lloyds Banking Group, it will not, without the consent of Lloyds Banking Group plc, agree modifications to Lloyds Banking Group's undertakings with respect to state aid which are significantly more onerous to Lloyds Banking Group plc than those granted in order to obtain the state aid approval.

Lloyds Banking Group has undertaken to repay any state aid required by any future decision of the European Commission (subject to Lloyds Banking Group's right to challenge any such decision in the European courts).

#### Other undertakings

The GAPS Withdrawal Deed also includes undertakings by Lloyds Banking Group plc in respect of certain other matters. In particular, with respect to remuneration, Lloyds Banking Group plc has acknowledged its commitment to the principle that, from 2010, it should be at the leading edge of implementing the G20 principles, the FSA code on remuneration and any remuneration provisions accepted by the Government from the Walker Review, provided that this principle shall always allow Lloyds Banking Group to operate on a level playing field with its competitors. In addition, Lloyds Banking Group plc has agreed with HM Treasury the specific deferral and clawback terms which will apply to any bonuses in respect of the 2009 performance year.

Furthermore, under the GAPS Withdrawal Deed, Lloyds Banking Group has agreed to reaffirm the lending commitments which were originally given in the Lending Commitments Deed entered into by Lloyds Banking Group on 6 March 2009 in connection with Lloyds Banking Group's then proposed participation in GAPS. Under those lending commitments, Lloyds Banking Group plc agreed to increase lending by approximately £14 billion in the 12 months commencing 1 March 2009 to support UK businesses (£11 billion) and homeowners (£3 billion). Lloyds Banking Group has agreed to maintain similar levels of lending in the 12 months commencing 1 March 2010, subject to

adjustment of the funding commitments by agreement with the UK Government to reflect circumstances at the start of the 12-month period commencing 1 March 2010.

This additional lending in 2009 and 2010 is expressed to be subject to Lloyds Banking Group's prevailing commercial terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, Lloyds Banking Group's standard credit and other acceptance criteria. This lending commitment is part of Lloyds Banking Group's ongoing support for UK businesses and homeowners.

Lloyds Banking Group has additionally pledged its support for various Government schemes designed to provide additional funding for small businesses, and has also published charters for its small business customers making a range of pledges to help firms through the downturn.

In addition, as part of its lending commitment to businesses, Lloyds Banking Group has agreed to contribute to the National Investment Corporation the lesser of £100 million and 10 per cent. of the total sums invested in the National Investment Corporation. It has also committed: (i) to ensure that its public financial statements comply with best industry practice; and (ii) to enter into discussions with HM Treasury with a view to ensuring that such public financial statements: (a) enable investors to assess the quality of the assets and liabilities of banking institutions, the financial position and performance of banking institutions and the nature and extent of risks arising from financial instruments to which banking institutions are exposed; and (b) are comparable as between similar banking institutions.

Further Lloyds Banking Group has agreed to develop with the FSA, and implement, a medium term funding plan aimed at reducing dependence on short term funding to be regularly reviewed by the FSA, UKLA and HM Treasury and has agreed to implement any measures relating to personal current accounts agreed between the OFT and the UK banking industry: (i) as detailed in the OFT's report "Personal current accounts in the UK – a follow up report, October 2009" and (ii) relating to fees and charges, and the terms and conditions of personal current accounts where any such measures are within the scope of current negotiations with respect thereto.

#### *HMT Undertaking to Subscribe*

Under the HMT Undertaking to Subscribe, subject to certain terms and conditions, HM Treasury irrevocably agreed to procure, and did procure, that the Solicitor for the Affairs of Her Majesty's Treasury (as nominee for HM Treasury) (i) voted in favour of all of the resolutions relating to the Proposals upon which it was eligible to vote and (ii) took up its rights to subscribe for all of the shares to which it was entitled under the Rights Issue. On that basis, Lloyds Banking Group plc paid to HM Treasury the HMT Commitment Commission. If HM Treasury had not committed to participate in full in respect of its entitlements under the Rights Issue, then Lloyds Banking Group would have sought to ensure that HM Treasury's entitlement under the Rights Issue would have been covered by the underwriting commitments given by the Underwriters in which case an amount similar to that to be paid to HM Treasury would have been expected to have been paid instead to the Underwriters.

#### *State Aid*

Lloyds Banking Group has previously announced that, as a result of HM Treasury's investment in Lloyds Banking Group in the context of the placing and open offer in November 2008 and Lloyds Banking Group's participation in the Credit Guarantee Scheme, Lloyds Banking Group was required to work with HM Treasury to submit a restructuring plan to the European Commission in the context of a state aid review. The plan was required to contain measures to limit any competition distortions resulting from the state aid received by Lloyds Banking Group.

The College of Commissioners announced its formal approval of Lloyds Banking Group's restructuring plan on 18 November 2009. See Risk Factor 2.3.2 for further discussion of the risks relating to the state aid proceedings. The restructuring plan consists of the following principal elements:

- (i) the disposal of a retail banking business with at least 600 branches, a 4.6 per cent. share of the personal current accounts market in the UK and approximately 19 per cent. of Lloyds Banking Group's mortgage assets. The business would consist of:
  - the TSB brand;
  - the branches, savings accounts and branch-based mortgages of Cheltenham & Gloucester;
  - the branches and branch-based customers of Lloyds TSB Scotland and a related banking licence;
  - additional Lloyds TSB branches in England and Wales, with branch-based customers; and
  - Intelligent Finance,and would need to be disposed of within four years;
- (ii) an asset reduction programme to achieve a £181 billion reduction in a specified pool of assets by 31 December 2014; and
- (iii) behavioural commitments, including commitments:
  - not to make certain acquisitions for approximately three to four years; and
  - not to make discretionary payments of coupons or to exercise voluntary call options on hybrid securities from 31 January 2010 until 31 January 2012, which will prevent Lloyds Banking Group from paying dividends on its ordinary shares for the same duration.

The assets and liabilities, and associated income and expenses, of the business to be divested (referred to in sub-paragraph (i) above) cannot be determined with any precision until nearer the date of sale. However, Lloyds Banking Group estimated that, as at 31 December 2008 and after aggregating the elements relating to Lloyds TSB Bank plc and its subsidiary undertakings (which at that date did not include the HBOS Group) and the HBOS Group, the business to be divested comprised approximately £70 billion of customer lending and £30 billion of customer deposits and, on this basis, approximately £18 billion of risk-weighted assets. For the year ended 31 December 2008, the Board estimated that the business to be divested generated income of approximately £1.4 billion and, after associated direct expenses of approximately £600 million and impairment charges of £300 million, contributed approximately £500 million of profit before tax to Lloyds Banking Group.

The Board is confident that this restructuring plan will not have a materially negative impact on Lloyds Banking Group.

#### *Background to GAPS*

Given the extremely uncertain outlook for the UK economy at the end of 2008 and into 2009, Lloyds Banking Group worked with the FSA to identify and analyse the potential impact of an

extended and severe UK recession on Lloyds Banking Group's regulatory capital ratios. Due to the significant uncertainty at that time over the length and depth of the recession, Lloyds Banking Group was tested against the FSA Stress Test.

The conclusion from this exercise was that Lloyds Banking Group would need additional capital to enable it to absorb the future impairments anticipated in such a severe scenario.

As a result, on 7 March 2009, Lloyds Banking Group announced its intention to participate in GAPS in respect of certain assets with an aggregate par value of approximately £260 billion. This announcement was made, in part, on the basis of the term sheet published by HM Treasury on 26 February 2009, which set out the expected key terms, conditions and operational principles of GAPS.

As consideration for entering into GAPS, it was expected that Lloyds Banking Group would pay a participation fee to HM Treasury of £15.6 billion, to be amortised over an estimated seven-year period. The proceeds of this fee would have been applied by HM Treasury in subscribing for an issue of B Shares by Lloyds Banking Group plc. In addition to the participation fee, Lloyds Banking Group would also have had to assume 100 per cent. of the losses relating to the first £35 billion of impairments (including historical impairments and write-downs) relating to the assets covered by GAPS (the "First Loss") and a further 10 per cent. of cumulative losses in the whole portfolio of assets thereafter, up until the date specified as the maturity date of each covered asset.

The £15.6 billion of B Shares would have carried an annual dividend to be paid to HM Treasury (subject to the availability of distributable reserves and any restriction on payment of dividends that might have been required by the European Commission) of the greater of 7 per cent. of the issue price of the B Shares and 125 per cent. of any dividend on ordinary shares for each period. It was expected that the dividend payable on the B Shares would have been at least £1.1 billion per annum, subject to the availability of distributable reserves.

The entry into GAPS was intended to provide two key benefits to Lloyds Banking Group. First, loss relief, particularly in a scenario of severe economic stress such as would be implied by the FSA Stress Test. Once the First Loss had been utilised Lloyds Banking Group would not have been exposed to the full amount of losses it might otherwise have incurred in respect of non-performing assets covered by the scheme. Second, the entry into GAPS was intended to provide regulatory capital relief (or an increase in Lloyds Banking Group's core tier 1 capital ratio), arising from a reduction in Lloyds Banking Group's risk-weighted assets as well as the generation of new core tier 1 capital through the issuance of the B Shares.

### *Background to the Proposals*

Lloyds Banking Group accepts and agrees with the merits of severe stress testing of regulatory capital, and the Proposals, together with other management actions which the Board considers to be readily actionable, are specifically designed to provide the capital enhancement that the Board believes is necessary to meet the capital requirements of the FSA Stress Test. The Board believes that, since commencing the negotiation of the terms of GAPS, the UK economy has begun to stabilise and is now expected to return to growth in 2010.

Accordingly, the Board believes that the likelihood of the UK economy deteriorating to the levels implied by the FSA Stress Test, the assumptions behind which remain unchanged, is now materially lower than was the case in March 2009.

Since March 2009, Lloyds Banking Group's core business has proved to be resilient despite the difficult economic circumstances under which it has had to operate.

In addition, Lloyds Banking Group has completed detailed credit reviews of its asset portfolio in accordance with Lloyds Banking Group's risk management approach, including, most importantly, the legacy HBOS portfolio and file-level credit reviews of Lloyds Banking Group's wholesale portfolio. This analysis, in conjunction with management's view of the economic outlook for the UK, underpins the Board's belief that Lloyds Banking Group's overall impairments peaked in the first half of 2009.

It also gives the Board a high level of confidence both in the adequacy of the substantial impairments which it has already taken against these assets (including with respect to Lloyds Banking Group's commercial and residential property exposures) and in the scale and timing of expected future impairments. Further detail on Lloyds Banking Group impairments by division is set out below, on page 1 of the Issuer's 2009 Results Announcement and on page 2 of the HBOS Group Guarantor's 2009 Results Announcement which are incorporated by reference herein.

### *Impairments*

A significant proportion of Lloyds Banking Group's impairments to date have originated in Lloyds Banking Group's Wholesale division, primarily reflecting the decline in commercial property valuations and reducing levels of corporate cash flow. In particular the real estate related lending exposures in the legacy HBOS portfolios were more sensitive to the downturn in the economic environment. The Board continues to believe that the overall Wholesale impairment charge peaked in the first half of 2009 and we have seen a significant reduction in the Wholesale impairment charge in the second half of 2009. The Board expects a significant overall reduction in the Wholesale impairment charge in 2010, and beyond.

In the Retail division impairment losses increased, particularly reflecting increases in UK unemployment during 2009 on the unsecured charge, which was partly offset by a lower secured impairment charge as house prices stabilised. Compared to 2009, the Board expects to see a reduction in the impairment charge in 2010, with further improvements thereafter as the UK economic environment improves and house prices continue to stabilise.

In the Wealth and International division, the impairment charge increased in 2009, reflecting significant provisions against Lloyds Banking Group's Irish and Australian commercial real estate portfolios. Lloyds Banking Group continues to have ongoing concerns with regard to the outlook for the Irish economy although we expect 2009 to have been the peak for the International impairment charge.

In conclusion, given its view of the economic outlook for the UK, the Board believes that, at Lloyds Banking Group level, the overall impairment charge has now peaked and that the overall impairment charge in 2010 will be significantly lower than the overall impairment charge in 2009. The impairment charge in the second half of 2009 was 21 per cent lower than that in the first half of the year. Given our current economic outlook we expect to see a similar pace of half yearly improvement throughout 2010, with further substantial reductions in 2011 and beyond.

### GAPS

Since 7 March 2009, Lloyds Banking Group plc worked closely with HM Treasury to finalise the terms and conditions and operational mechanics of Lloyds Banking Group's participation in GAPS. However, as these terms and conditions were being negotiated, it became clear that the benefits of GAPS to Lloyds Banking Group would have been materially less extensive and that the costs to Lloyds Banking Group of participating in the scheme, both financially and in terms of management time, would have been materially higher (and the impact on Lloyds Banking Group

materially more onerous) than was anticipated by the Board at the time its intended participation in GAPS was announced. The following issues in particular are relevant:

**Capital Relief:** The capital relief arising as a result of the large reduction in risk-weighted assets would have been much lower than had been anticipated by the Board in March 2009. This is due to various factors, including the fact that: (i) in March 2009 significant benefit was expected to arise in respect of Lloyds Banking Group's Treasury assets (however, Lloyds Banking Group has (with FSA approval) successfully resecured those assets and thereby reduced the risk-weighting of the assets); and (ii) updated, more accurate forecasting has changed Lloyds Banking Group's expectations of its quantum of risk-weighted assets. Further, it has become clear to the Board that the operation of GAPS, as it would apply to Lloyds Banking Group, would serve to remove certain assets from coverage within a short period after commencement of the scheme, which would mean the risk-weighted asset relief afforded by GAPS would reduce more quickly than had been anticipated by the Board in March.

**GAPS Rules:** The development of the detailed scheme rules for GAPS since the GAPS term sheet was published in February 2009 has meant that, in many areas, the scheme rules are more disadvantageous for Lloyds Banking Group than the position which had been anticipated by the Board when it announced its initial intention to participate. In practice, the Board believes it is highly likely that the operation of GAPS would have been economically unsatisfactory for Lloyds Banking Group. For example, although it is expected that, under GAPS, losses relating to restructuring events would be covered, Lloyds Banking Group may not have benefited from full coverage for certain restructuring and refinancing activities.

#### *Consideration of alternative solutions*

These circumstances and improved economic conditions caused the Board to consider alternative solutions that might provide superior economic value to shareholders than entry into GAPS. These potential alternative solutions included:

- renegotiating the commercial terms of GAPS, the type and quantum of assets covered by the scheme and the scheme rules;
- not entering into GAPS at all and instead raising sufficient additional capital on the public capital markets; or
- a combination of either of the above options.

During 2009, the Board held negotiations with HM Treasury and discussions with other relevant authorities in relation to these potential alternatives. The Board gave careful consideration to possible alternative formulations of GAPS, including a possible combination of a smaller version of GAPS with elements of the Proposals. The Board concluded it would not be in the best interests of its shareholders to pursue these alternative formulations for the reasons set out below:

- **State aid:** The alternative formulations of GAPS would, in the view of the Board, constitute additional state aid, which would likely require more severe compensatory measures than is expected to be the case if the Proposals are implemented;
- **Uncertainty of outcome and potential delay:** There was no agreement between Lloyds Banking Group and HM Treasury either on the general outline of any specific alternative formulation of GAPS or on the precise commercial terms on which any alternative formulation would have been made available to Lloyds Banking Group. While the Board believes that had negotiations continued, they would have been conducted in good faith, it had no certainty as to the outcome of such negotiations or



whether or when such negotiations would have been concluded to the parties' mutual satisfaction, whereas the Proposals can be implemented immediately;

- Shareholder dilution: The issue of any B Shares in connection with a renegotiated or reduced form of GAPS would still have resulted in dilution for ordinary shareholders (other than HM Treasury) and would have increased the percentage holding of HM Treasury in Lloyds Banking Group plc, thereby potentially delaying and making more difficult any eventual orderly exit by HM Treasury from its shareholding;
- Non-market-based solution: The Board's aim is that Lloyds Banking Group returns to being a self-standing, wholly privately-financed institution as soon as practicable. The Board believes that the Proposals advance this objective more quickly and effectively than would have been the case had Lloyds Banking Group participated in GAPS. At the same time, the Proposals improve the quality of Lloyds Banking Group's capital structure in a way that is to the long-term benefit of Lloyds Banking Group; and
- Cost and complexity: The alternative formulations of GAPS would have involved additional administrative and reporting structures which would, in the Board's view, have inhibited Lloyds Banking Group's operational and commercial flexibility.

#### *Group capital and liquidity policies*

In September 2008, Lloyds Banking Group set out a target that its core tier 1 capital ratio be in the range of 6 to 7 per cent. Reflecting the increase in expected levels of core tier 1 capital across the industry since that time, the Board's target has now been increased to be more than 7 per cent.

As discussed above, the Rights Issue raised a total of £13.5 billion of core tier 1 capital before expenses of the Proposals and before the making of the GAPS Payment. Had the Rights Issue been completed as at 30 June 2009, this would have resulted in a pro forma core tier 1 capital ratio for Lloyds Banking Group of approximately 8.6 per cent. after expenses of the Proposals and the GAPS Payment.

#### **Retail Holdings Offer**

On 19 January 2010, Lloyds Banking Group plc announced that it had repurchased £13,836,376 in liquidation preferences of its £186,190,532 6.475 per cent. Non-Cumulative Preference Shares and £7,591 in liquidation preference of its £99,999,942 9.75 per cent. Non-Cumulative Preference Shares for cash. The repurchases were made pursuant to an invitation to certain individuals who had been ineligible to participate in the Exchange Offers.

## HBOS

### Overview of the HBOS Group

The HBOS Group is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers. Its main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

HBOS plc was incorporated in Scotland under the Companies Act 1985 as a public limited company on 3 May 2001 (Registration number SC218813) following the merger of Halifax and Bank of Scotland and now comprises a number of key brands including Halifax, Bank of Scotland and Clerical Medical. The registered office and head office of HBOS plc in the United Kingdom is at The Mound, Edinburgh EH1 1YZ, Scotland and its telephone number is +44 (0)870 600 5000. Following the acquisition of HBOS plc by Lloyds Banking Group plc (formerly Lloyds TSB Group plc) on 16 January 2009, and the subsequent transfer of 100 per cent. of the ordinary share capital of HBOS plc to Lloyds TSB Bank plc by Lloyds Banking Group plc on 1 January 2010, HBOS plc is a directly owned and controlled subsidiary of Lloyds TSB Bank plc and is indirectly owned and controlled by Lloyds Banking Group plc. The main businesses of HBOS plc are split into four divisions, Retail, Insurance, Wholesale and the Wealth and International division. Services provided by Retail include the provision of banking and other financial services to personal customers and mortgages. Insurance offers life assurance, pensions and investment products and general insurance services. Wholesale provides banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers, manages HBOS's activities in financial markets through its treasury function and provides banking and financial services overseas. Services provided by Wealth and International include the provision of private banking, fund management services and International Banking.

### Strategy of HBOS plc

Following the acquisition of HBOS plc by Lloyds Banking Group plc (formerly Lloyds TSB Group plc), the strategy of the HBOS businesses has been aligned to the business model and strategy of Lloyds Banking Group, as outlined below.

Lloyds Banking Group's vision is now to be recognised as the best financial services organisation in the UK by customers, colleagues (employees) and shareholders.

The strategy for Lloyds Banking Group remains to grow the business through developing long-term relationships and building its customer franchise, and its primary focus remains within the UK. Lloyds Banking Group's businesses are focused on extending the reach and depth of their customer relationships, whilst enhancing product capabilities to build competitive advantage. The prudent 'through the cycle' approach to risk continues to be applied within Lloyds Banking Group and will remain important as Lloyds Banking Group plc strives to improve its processing efficiency and use of capital.

Lloyds Banking Group has a diversified UK financial services model. The board believes that the UK remains an attractive market and that Lloyds Banking Group has good potential within its existing franchises to grow by meeting more of Lloyds Banking Group's customers' needs as well as through adding new customers to the franchise, notwithstanding near term economic conditions (see *"Risk Factors – Risks relating to the BOS Group – The BOS Group's businesses are subject to inherent risks arising from general and sector-specific economic conditions in the UK and other markets in which the BOS Group operates. Adverse developments, such as the severe dislocation in*

*the global financial markets, recession, and further deterioration of general economic conditions, particularly in the UK, have already adversely affected the BOS Group's earnings and profits and could continue to cause its earnings and profitability to decline. In addition, any actual or potential credit rating downgrades of sovereigns, particularly the United Kingdom, Spain and Republic of Ireland and/or contagion from other countries could have a significant material adverse effect on the BOS Group's operating results, financial condition and prospects"* for a discussion of such economic conditions).

The integration presents an opportunity to achieve cost leadership through combining both customer bases into the proven Lloyds TSB platform. The board believes that Lloyds Banking Group has market leading distribution and sales capabilities, products and services as well as middle and back office processes that deliver a high quality customer experience. Lloyds Banking Group aspires to have one of the lowest cost to income ratios for financial institutions in the UK, and the anticipated synergies, which are expected to be substantial, arising from the Acquisition will be key to further improving efficiency levels. The effective integration of the two businesses will be a significant challenge over the next few years, but the combination of the two businesses provides a real opportunity to create the UK's leading financial services organisation.

Lloyds Banking Group's directors believe that the heritage Lloyds TSB Group relationship-focused 'through the cycle' approach to risk management has demonstrated its effectiveness. This prudent approach to risk is being rolled out across Lloyds Banking Group. A number of non-core areas in which HBOS previously participated have been exited and Lloyds Banking Group will continue to assess participation in business areas on a conservative basis.

During 2009, HBOS plc had four primary operating divisions: Retail; Insurance, Wholesale; and Wealth and International. The key product markets in which these divisions participate is presented in "Businesses and Activities".

Since August 2007, global financial markets have experienced a period of significant turmoil resulting in a negative impact on capital ratios and liquidity in the banking sector. Throughout this period, Lloyds Banking Group has maintained a robust liquidity position based on its significant retail and corporate deposit base and funding from the wholesale markets. Lloyds Banking Group has continued to reinforce its funding position by actively participating in the liquidity initiatives introduced by the Bank of England and HM Treasury.

Lloyds Banking Group believes that the successful execution of this strategy focusing on core markets, customer and cost leadership, capital efficiency and a prudent risk appetite will enable Lloyds Banking Group to achieve its vision to be recognised as the best financial services organisation in the UK.

### **Principal activities of HBOS plc**

HBOS operates with four main divisions: Retail, Insurance, Wholesale and the Wealth and International division.

#### ***Retail***

Retail provides banking, financial services and mortgages to personal customers through HBOS's multi-channel distribution capabilities, including branches, direct mail, telephone and the internet. Its range of multi-branded products includes mortgages, savings, bank accounts, personal loans and credit cards. Bank accounts range from full facilities current accounts to basic social banking facilities and a range of savings accounts are also offered.

HBOS currently provides mortgages and savings products under the Halifax, Bank of Scotland and Birmingham Midshires brands. Personal loans and credit cards are offered through the Halifax and Bank of Scotland brands.

The Retail division also distributes HBOS insurance and investment products on behalf of the Insurance division and participates in a number of joint ventures, such as Sainsbury's Bank.

### ***Insurance***

The HBOS Insurance division is one of the U.K.'s largest providers of general insurance and investment products, offering multi-brand life, pensions, mutual funds and general insurance products. The division uses a multi-channel, multi-brand operating model which it believes allows it to maximise both distribution reach and product and pricing flexibility. While low cost access to the large Retail division customer base is a core strength, the division also benefits from solid third-party distribution relationships with partners and intermediaries. Products offered by the Insurance division include savings, investments and pensions, life, household, repayment and motor insurance.

The Investment businesses focus on manufacturing and distributing investment funds, bond, pension and protection products. The Insurance division operates through both intermediary and bancassurance channels. HBOS also has a European business which primarily distributes products in the German market under the Heidelberger Leben and Clerical Medical brands.

The General Insurance business focuses on household, repayment and motor insurance. The Retail division's distribution network serves as the Insurance division's core distribution channel for household insurance. However, sales of household insurance are also made direct to customers via e-commerce and telephone channels and through partners and intermediaries. Repayment insurance products are also distributed through the Retail division's network as well as a number of large third party relationships.

### ***Wholesale***

The Wholesale division serves businesses, ranging from start-ups and small enterprises to global corporations, with a range of propositions fully segmented according to customer need. The division comprises Corporate Markets, Treasury and Trading and Asset Finance.

Corporate Markets comprises Corporate, Commercial, Corporate Real Estate, Specialist Finance and Wholesale Markets. Corporate, Commercial and Corporate Real Estate provide relationship based banking, risk management and advisory services to corporate and commercial customers, principally in the UK. Relationships with customers with an annual turnover of £15 million are managed within Corporate, and commercial property based relationships (including hotel, property based leisure and construction) are managed within the Corporate Real Estate Business. Commercial provides financial services to business customers ranging from new start-ups to those with a turnover up to £15 million and invoice discounting and factoring services to a broader range of customers. Wholesale Markets provides risk management solutions, specialised lending, capital markets' advisory, and multi-product financing solutions to the corporate customer franchise, whilst managing the bank's own portfolio of structured credit investments and treasury assets.

Treasury and Trading's role is to provide access to financial markets in order to meet Lloyds Banking Group's balance sheet management requirements, and provides trading infrastructure to support execution of customer driven risk management transactions, whilst operating within a well controlled and conservative risk appetite.

Asset Finance consists of a number of leasing and specialty lending businesses including Contract Hire, Specialist Assets and Consumer Finance which provide individuals and companies with specialist personal lending and financial solutions.

### ***Wealth and International***

Wealth and International provides private banking services and International Banking services.

#### *UK Wealth Management*

Wealth Management provides financial planning and advice for HBOS's affluent customers, providing financial solutions across investments, retirement planning and income, trusts, tax and estate planning as well as share dealing. Expert advice is provided through a large population of the HBOS financial advisors who can be accessed via the retail branch network and Private Banking offices throughout the United Kingdom.

#### *International Banking*

The International division comprises HBOS' international banking businesses outside the UK. These largely comprise corporate, commercial and asset finance businesses in Australia, Ireland and continental Europe, and retail businesses in Ireland, Germany and the Netherlands.

### **Competitive Environment**

The HBOS Group Guarantor, an indirect subsidiary of Lloyds Banking Group plc, is a diversified UK based financial services group providing a wide range of banking and financial services, predominately in the UK, to personal and corporate customers. Its main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

In the retail banking market, the HBOS Group Guarantor competes with banks and building societies, major retailers and internet-only providers. In the mortgage market, competitors include the traditional banks and building societies and specialist providers. The HBOS Group Guarantor competes with both UK and foreign financial institutions in the wholesale banking markets and with bancassurance, life assurance and general insurance companies in the UK insurance market.

The HBOS Group Guarantor's businesses are subject to inherent risks arising from general and sector-specific economic conditions in the markets in which it operates, particularly the United Kingdom in which the HBOS Group Guarantor's earnings are predominantly generated. The HBOS Group Guarantor also operates in a substantial number of other jurisdictions, including Ireland, Australia and the United States, and hence is exposed to economic conditions in these markets as well. Over approximately the past 30 months, the global economy and the global financial system have been experiencing a period of significant turbulence and uncertainty, particularly (i) the very severe dislocation of the financial markets around the world that began in August 2007 and substantially worsened in September 2008 and (ii) related problems at many large global and UK commercial banks, investment banks, insurance companies and other financial and related institutions.

UK Government or EU intervention in the banking sector may impact the competitive position of banks within a country and among international competitors which may be subject to different forms of government intervention, thus potentially putting the HBOS Group Guarantor at a competitive disadvantage to other banks.

## Legal Actions

The HBOS Group is periodically subject to threatened or filed legal actions in the ordinary course of business.

The HBOS Group is involved in ongoing issues relating to unarranged overdraft charges, the payment of interchange fees and payment protection insurance. See “*Regulation and Supervision — Unarranged Overdraft Charges*”, “*Regulation and Supervision — Interchange Fees*” and “*Regulation and Supervision — UK Competition Commission*” herein.

## Principal HBOS Group Subsidiaries

HBOS is the holding company of the HBOS Group. The following table shows the principal direct and indirect subsidiary undertakings of HBOS as at 30 November 2009 which HBOS believes are likely to have a significant effect on the assessment of the assets and liabilities, the financial position and/or the profits and losses of the HBOS Group and HBOS’s percentage interest in those companies. Under the HBOS Group Reorganisation Act 2006 (the “**Act**”) (and with effect from 17 September 2007), all assets and liabilities in respect of three former principal subsidiaries of HBOS (HBOS Treasury Services plc, Capital Bank plc and Halifax plc) were assumed by Bank of Scotland.

<u>Company</u>	<u>Activity</u>	<u>Total % of ordinary share capital held (directly or indirectly) by HBOS</u>	<u>Country of incorporation or registration</u>	<u>Registered office/head office</u>
Bank of Scotland plc .....	Banking, financial and related services	100	Scotland	The Mound Edinburgh EH1 1YZ
Bank of Scotland (Ireland) Limited .....	Banking	100	Ireland	Bank of Scotland House 124-127 St. Stephen’s Green Dublin 2 Ireland
HBOS Covered Bonds LLP..	Residential mortgage funding	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
Lloyds International Pty Limited (formerly HBOS Australia Pty Limited) and subsidiaries	Banking	100	Australia	Level 27, 45 Clarence Street, Sydney, NSW 2000 Australia

<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly or indirectly) by HBOS</b>	<b>Country of incorporation or registration</b>	<b>Registered office/head office</b>
Halifax Share Dealing Limited .....	Execution only stockbroking	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
HBOS Insurance & Investment Group Limited....	Investment holding	100	England and Wales	33 Old Broad Street London EC2N 1HZ
Halifax General Insurance Services Limited .....	General insurance brokerage	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
St Andrew's Insurance plc....	General insurance	100	England and Wales	33 Old Broad Street London EC2N 1HZ
Clerical Medical Investment Group Limited.....	Life assurance	100	England and Wales	33 Old Broad Street London EC2N 1HZ
Clerical Medical Managed Funds Limited .....	Life assurance	100	England and Wales	33 Old Broad Street London EC2N 1HZ
Halifax Life Limited.....	Life assurance	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
HBOS Investment Fund Managers Limited .....	OEIC management	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
Invista Real Estate Investment Management Holdings plc.....	Property investment management	55	England and Wales	Exchequer Court 33 St. Mary Axe London EC3A 8AA
St. James's Place plc .....	Financial services	60	England and Wales	St. James's Place House, 1 Tetbury Road Cirencester GL7 1EP
St Andrew's Life Assurance plc.....	Pensions	100	England and Wales	33 Old Broad Street, London EC2N 1HZ

## Management of HBOS

The directors of HBOS, the business address of each of whom is 25 Gresham Street, London EC2V 7HN, England, and their respective principal outside activities, where significant to HBOS are as follows:

<b>Name</b>	<b>Principal outside activities</b>
<b>Sir Winfried Bischoff</b> Chairman	A non-executive director of the McGraw-Hill Companies, Inc. and Eli Lilly and Company. Chairman of the UK Career Academy Foundation. A member of the Akbank International Advisory Board.
<b>Lord Leitch</b> Deputy Chairman	Chairman of Scottish Widows. Chairman of the Government's Review of Skills and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster.
<b>Executive directors</b>	
<b>J. Eric Daniels</b> Group Chief Executive	A non-executive director of BT Group.
<b>Archie G. Kane</b> Group Executive Director, Insurance	Chairman of the Association of British Insurers and a member of the Chancellor's Financial Services Global Competitiveness Group, The Takeover Panel and the Chancellor's Insurance Industry Working Group.
<b>G. Truett Tate</b> Group Executive Director, Wholesale	A non-executive director of BritishAmerican Business Inc. A director of Business in the Community and Arora Holdings and a director and trustee of In Kind Direct.
<b>Tim J.W. Tookey</b> Group Finance Director	None.
<b>Helen A. Weir CBE</b> Group Executive Director, Retail	A member of the Said Business School Advisory Board.
<b>Non-executive directors</b>	
<b>Wolfgang C.G. Berndt</b>	A non-executive director of Cadbury, GfK AG and MIBA AG.
<b>Sir Julian Horn-Smith</b>	A non-executive director of De La Rue, Digicel Group, and Emobile (Japan), a director of Sky



<b>Name</b>	<b>Principal outside activities</b>
<b>Glen Moreno (from 1 March 2010)</b>	<p data-bbox="810 264 1410 398">Malta, a member of the Altimo International advisory board and a senior adviser to UBS and CVC Capital Partners in relation to the global telecommunications sector.</p> <p data-bbox="810 434 1410 501">Chairman of Pearson and a non-executive director of Fidelity International.</p>
<b>David Roberts (from 1 March 2010)</b>	<p data-bbox="810 533 1410 672">A member of the strategy board for Henley Business School, non-executive chairman of The Mind Gym and a non-executive director of Campion Willcocks.</p>
<b>T. Timothy Ryan Jr</b>	<p data-bbox="810 703 1410 940">President and chief executive of the Securities Industry and Financial Markets Association. A director of the US-Japan Foundation, Great-West Life Annuity Insurance Co. and Putnam Investments and a member of the Global Markets Advisory Committee for the National Intelligence Council.</p>
<b>Martin A. Scicluna</b>	<p data-bbox="810 972 1410 1079">Chairman of Great Portland Estates. A member of the council of Leeds University and a governor of Berkhamsted School.</p>
<b>Anthony Watson CBE</b>	<p data-bbox="810 1111 1410 1281">A non-executive director of Hammerson, Vodafone and Witan Investment Trust and chairman of Marks and Spencer Pension Trust, Asian Infrastructure Fund and Lincoln's Inn investment committee.</p>

**Conflicts of Interest**

None of the directors of BOS has any actual or potential conflict between their duties to BOS and their private interests or other duties as listed above.

## THE ISSUER

### Overview of Bank of Scotland plc

Bank of Scotland plc (“**BOS**”) (incorporated in Scotland with limited liability, registration number SC327000) is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers. BOS is the parent company of the BOS Group (as defined on page 44). The registered office of Bank of Scotland is located at The Mound, Edinburgh EH1 1YZ, Scotland and its telephone number is +44 (0)870 600 5000.

Its main business activities are retail, commercial and corporate banking. The main businesses of BOS are split into three divisions, Retail, Wholesale and Wealth and International. Services provided by Retail include the provision of banking and other financial services to personal customers and mortgages. Wholesale provides banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers, manages BOS’s activities in financial markets through its treasury function and provides banking and financial services overseas. Services provided by Wealth and International include the provision of private banking and International Banking.

### History and development of BOS

BOS was originally established in 1695 as The Governor and Company of the Bank of Scotland by an Act of the Parliament of Scotland. On 17 September 2007, in accordance with the provisions of the Act (as defined on page 110), The Governor and Company of the Bank of Scotland registered as a public limited company under the Companies Act 1985 and changed its name to Bank of Scotland plc. On the same day, under the Act, the business activities, assets (including investments in subsidiaries) and liabilities of Capital Bank plc, Halifax plc and HBOS Treasury Services plc transferred to BOS.

BOS is a United Kingdom clearing bank with its headquarters in Edinburgh and an “authorised person” under the Financial Services and Markets Act 2000. It is a member of the British Bankers’ Association and the Committee of Scottish Clearing Bankers. The Bank Notes (Scotland) Act 1845 confirmed Bank of Scotland’s right to issue bank notes in Scotland.

Following the acquisition of HBOS plc by Lloyds Banking Group plc (formerly Lloyds TSB Group plc) on 16 January 2009, and the subsequent transfer of 100 per cent. of the ordinary share capital of HBOS plc to Lloyds TSB Bank plc by Lloyds Banking Group plc on 1 January 2010, BOS is a directly owned and controlled subsidiary of HBOS plc who in turn is now directly owned and controlled by Lloyds TSB Bank plc and is indirectly owned and controlled by Lloyds Banking Group plc.

### Strategy of BOS

Following the acquisition of HBOS plc by Lloyds Banking Group plc (formerly Lloyds TSB Group plc), the strategy of the BOS businesses has been aligned to the business model and strategy of Lloyds Banking Group, see “*HBOS - Strategy of HBOS plc*” above.

### Principal activities of BOS

BOS operates with three main divisions: Retail, Wholesale and the Wealth and International division.

## ***Retail***

Retail provides banking, financial services and mortgages to personal customers through BOS's multi-channel distribution capabilities, including branches, direct mail, telephone and the internet. Its range of multi-branded products includes mortgages, savings, bank accounts, personal loans and credit cards. Bank accounts range from full facilities current accounts to basic social banking facilities and a range of savings accounts are also offered.

BOS currently provides mortgages and savings products under the Halifax, Bank of Scotland and Birmingham Midshires brands. Personal loans and credit cards are offered through the Halifax and Bank of Scotland brands.

The Retail division also distributes HBOS insurance and investment products on behalf of the insurance division of HBOS and participates in a number of joint ventures, such as Sainsbury's Bank.

## ***Wholesale***

Wholesale provides banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers and manages BOS's activities in financial markets through its treasury function.

### *Corporate Markets*

Corporate Markets comprises Corporate, Commercial, Commercial Real Estate, Specialist Finance and Wholesale Markets. Corporate, Commercial and Commercial Real Estate provide relationship based financial and advisory services to corporate customers throughout the UK, US and Canada. Transactions with customers with an annual turnover greater than £15 million are managed within Corporate and commercial property based transactions (including hotel and property based leisure) are managed within the Commercial Real Estate business. Commercial specialises in financial services to customers ranging from new start-up business to those with a turnover up to £15 million, an element of which is property related. Wholesale Markets provides risk management solutions, specialised lending, capital markets' advisory, and multi-product financing solutions to the corporate customer franchise, whilst managing the bank's own portfolio of structured credit investments and treasury assets.

### *Treasury & Trading*

Treasury and Trading manages the global trading, funding and liquidity risks and provides risk management solutions to both internal and external clients.

### *Asset Finance*

The BOS asset finance businesses provide individuals and companies with specialist personal lending, and finance solutions.

## ***Wealth and International***

Wealth and International provides private banking services and International Banking services.

### *UK Wealth Management*

Wealth Management provides financial planning and advice for BOS's affluent customers, providing financial solutions across investments, retirement planning and income, trusts, tax and estate planning as well as share dealing. Expert advice is provided through a large population of BOS financial advisors who can be accessed via the retail branch network and Private Banking offices throughout the United Kingdom.

### *International Banking*

The International division comprises BOS' international banking businesses outside the UK. These largely comprise corporate, commercial and asset finance businesses in Australia, Ireland and continental Europe, and retail businesses in Ireland, Germany and the Netherlands.

### **Principal Bank of Scotland Subsidiaries**

The following table shows the principal direct and indirect subsidiary undertakings of Bank of Scotland as at 30 November 2009 which Bank of Scotland believes are likely to have a significant effect on the assessment of the assets and liabilities, the financial position and/or the profits and losses of the BOS Group and Bank of Scotland's percentage interest in those companies:

<u>Company</u>	<u>Activity</u>	<u>Total % of ordinary share capital held (directly or indirectly) by Bank of Scotland</u>	<u>Country of incorporation or registration</u>	<u>Registered office/head office</u>
Bank of Scotland (Ireland) Ltd	Banking	100	Ireland	Bank of Scotland House 124-127 St. Stephen's Green Dublin 2, Ireland
Lloyds International Pty Limited (formerly HBOS Australia Pty Ltd) and subsidiaries	Banking	100	Australia	Level 27, 45 Clarence Street, Sydney, NSW 2000, Australia
Banco Halifax Hispania SA	Banking	100	Spain	c/Anabel Segura 16 Edificio Vega Norte 2, 28108 Alcobendas, Madrid Spain
Halifax Estate Agencies Ltd	Estate agency and financial services	100	England and Wales	Trinity Road, Halifax West Yorkshire HX1 2RG

<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly or indirectly) by Bank of Scotland</b>	<b>Country of incorporation or registration</b>	<b>Registered office/head office</b>
HBOS Covered Bonds LLP	Residential Mortgage Loans	100	England and Wales	Trinity Road, Halifax West Yorkshire HX1 2RG
Uberior Investments plc	Investment holding	100	Scotland	Level 1 Citymark 150 Fountainbridge Edinburgh EH3 9PE

### Management of BOS

The directors of the Issuer, the business address of each of whom is 25 Gresham Street, London EC2V 7HN, England, and their respective principal outside activities, where significant to the Issuer are as follows:

#### Directors

<b>Name</b>	<b>Principal outside activities</b>
<b>Sir Winfried Bischoff</b> Chairman	A non-executive director of the McGraw-Hill Companies, Inc. and Eli Lilly and Company. Chairman of the UK Career Academy Foundation. A member of the Akbank International advisory board.
<b>Lord Leitch</b> <b>Deputy Chairman</b>	Chairman of Scottish Widows. Chairman of the Government's Review of Skills and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster.
<b>Executive directors</b>	
<b>J. Eric Daniels</b> Group Chief Executive	A non-executive director of BT Group.
<b>Archie G. Kane</b> Group Executive Director, Insurance	Chairman of the Association of British Insurers and a member of the Chancellor's Financial Services Global Competitiveness Group, The Takeover Panel and the Chancellor's Insurance Industry Working Group.
<b>G. Truett Tate</b> Group Executive Director, Wholesale	A non-executive director of BritishAmerican Business Inc. A director of Business in the

<b>Name</b>	<b>Principal outside activities</b>
	Community and a director and trustee of In Kind Direct.
<b>Tim J.W. Tookey</b> Group Finance Director	None.
<b>Helen A. Weir CBE</b> Group Executive Director, Retail	A member of the Said Business School Advisory Board.
<b>Non-executive directors</b>	
<b>Wolfgang C.G. Berndt</b>	A non-executive director of Cadbury, GfK AG and MIBA AG.
<b>Sir Julian Horn-Smith</b>	A non-executive director of De La Rue, Digicel Group, and Emobile (Japan), a director of Sky Malta, a member of the Altimo International advisory board and a senior adviser to UBS and CVC Capital Partners in relation to the global telecommunications sector.
<b>Glen Moreno (from 1 March 2010)</b>	Chairman of Pearson and a non-executive director of Fidelity International.
<b>David Roberts (from 1 March 2010)</b>	A member of the strategy board for Henley Business School, non-executive chairman of The Mind Gym and a non-executive director of Champion Willcocks.
<b>T. Timothy Ryan Jr</b>	President and chief executive of the Securities Industry and Financial Markets Association. A director of the US-Japan Foundation, Great-West Life Annuity Insurance Co. and Putnam Investments and a member of the Global Markets Advisory Committee for the National Intelligence Council.
<b>Martin A. Scicluna</b>	Chairman of Great Portland Estates. A member of the council of Leeds University and a governor of Berkhamsted School.
<b>Anthony Watson CBE</b>	A non-executive director of Hammerson, Vodafone and Witan Investment Trust and chairman of Marks and Spencer Pension Trust, Asian Infrastructure Fund and Lincoln's Inn investment committee.

#### **Conflicts of Interest**

None of the directors of BOS has any actual or potential conflict between their duties to BOS and their private interests or other duties as listed above.

## REGULATION AND SUPERVISION

### Overview of UK Regulation

The cornerstone of the regulatory regime in the UK is the FSMA which came into force on 1 December 2001 and replaced much of the previous legislation under which banks, insurance companies and investment businesses had been authorised and supervised. In accordance with the provisions of the FSMA on 30 November 2001, the FSA completed the process of assuming responsibility for the regulation and oversight of a wide range of financial services activities in the UK. More recently these responsibilities have been extended to include the regulation of mortgage lending, sales and administration (October 2004) and general insurance sales and administration (January 2005).

The FSA is responsible for the authorisation and supervision of institutions that provide regulated financial products and services as defined in the FSMA. As part of the authorisation process, the FSA reviews applicants to ensure that they satisfy the necessary criteria including honesty, competence and financial soundness, to engage in regulated activity. The majority of the HBOS Group's regulated financial institutions became authorised by the FSA by virtue of having been authorised under previous legislation to carry on financial services business ('grandfathering').

Following the new regulations that were introduced for mortgage and general insurance business, additional entities were authorised by the FSA.

### Regulatory Approach of the FSA

The FSA's regulatory approach aims to focus and reinforce the responsibility of senior management of a financial institution to ensure that it takes reasonable care to organise and control its affairs responsibly and effectively and that it develops and maintains adequate risk management systems.

The FSA Handbook of Rules and Guidance (the "**Handbook**") sets out eleven Principles for Businesses and the rules to which financial institutions are required to adhere.

A risk-based approach for the supervision of all financial institutions is adopted by the FSA and the starting point for the FSA's supervision is based on a systematic analysis of an institution's risk profile. Having determined the level of inherent risk, a minimum capital adequacy requirement is established, which the institution is required to meet at all times.

The FSA carries out its supervision of UK financial institutions through the collection of information from a series of prudential returns covering sterling and non-sterling operations, on-site reviews (through its ARROW reviews and through industry-wide thematic reviews), desk-based reviews, meetings with senior management and reports obtained from skilled persons. For major retail groups such as Lloyds Banking Group, a dedicated relationship team coordinates much of this activity via its 'Close and Continuous' supervision regime.

Regular prudential reports required by the FSA include operating statements and returns covering (amongst other things) capital adequacy, liquidity, large single exposures and large exposures to related borrowers. Capital adequacy returns are submitted on a periodic basis for all the authorised institutions within the HBOS Group. Regular non-prudential reports required by the FSA include complaints data, daily transaction reporting returns and product sales data. Some returns are submitted on a consolidated basis, whilst others are provided on a legal entity basis, depending on the requirements set out within the relevant FSA rules. The FSA reporting rules were recently revised through the introduction of the Integrated Regulatory Reporting Programme, which came into effect

in 2008. The HBOS Group was fully involved in the consultative process with the regulatory authorities and has implemented the required changes.

The Handbook sets out rules and guidance across a range of issues with which financial institutions are required to comply. These include, *inter alia*:

- Authorisation requirements – these are standards that need to be met in order to be authorised and continue to be met on an ongoing basis.
- Prudential rules – these relate to capital adequacy.
- Systems and controls requirements that are appropriate to the volume and complexity of activity undertaken.
- Conduct of Business rules that set out the requirements for aspects such as advising and selling, product disclosure, financial promotions (including compliance with the clear, fair and not misleading requirements), responsible lending and default.
- Reporting Requirements – these set out periodic reporting requirements and event driven notifications that must be submitted to the FSA.
- Training and Competence rules – these are standards that apply to firms providing advice to retail customers.
- Code of Market Conduct rules – this provides further rules and guidance on the market abuse offences set out in the FSMA.

A key theme running through most of the FSA's rules and regulations is the concept of Treating Customers Fairly ("TCF"), contained in Principle 6 of the FSA's Principles for Businesses. From 31 December 2008, the FSA now expects all firms to be able to demonstrate that full TCF compliance has been embedded within their business activities, operations and culture.

Although the FSA Conduct of Business standards apply to banks, the FSA historically allowed the Banking Code Standards Board to prescribe conduct rules governing the deposit-taking and account operating activities of banks and building societies (as is described further below). On 1 November 2009, responsibility for the regulation of deposit and payment products transferred to the FSA. In light of this change the Banking Code Standards Board has changed its name to the Lending Standards Board. The Lending Standards Board will monitor and enforce compliance with a new Lending Code that replaces those elements of the Banking Code and Business Banking Code relating to lending.

The FSA published the Turner Review ("A Regulatory Response to the Global Banking Crisis") on 18 March 2009. The Turner Review assesses the various factors which contributed to the severe financial problems suffered by banks at the end of 2008, and then considers a wide range of proposals to counter these factors and reform global financial regulation. These proposals include significantly increasing banks' minimum regulatory capital requirements, regulating banks' liquidity requirements, requiring banks to establish capital buffers, a maximum growth leverage ratio to prevent banks' excessive expansion, authorities' power to obtain information on significant unregulated financial institutions, central counterparty clearing of credit derivatives, and a major shift in the supervisory approach of the FSA, with an increased focus on high impact, complex and systemically important firms, business models and approved persons' technical skills. New arrangements for co-ordinated cross-border supervision of international and EU banking groups are also proposed. The FSA has also published a discussion paper intended to elicit market participants'



comments on many of the proposals contained in the Turner Review. The impact of the proposals on banks and their business models is likely, in the view of Lloyds Banking Group, to be very significant. The fundamental changes to capital and liquidity requirements could have a substantial impact on the shape of banks' business models. In Lloyds Banking Group's view, banks can also expect a shift from the previous "light touch" principles-based regime to an intensive, and interventionist, rules-based regime. The cost of compliance with these proposals may well lead to reduced profitability, as well as to a lower return on equity.

The FSA published a Feedback Statement on the Turner Review and associated discussion paper on 30 September 2009. This continues the debate regarding how systemically important firms are dealt with, suggesting they should be required to produce recovery and resolution plans ("living wills") setting out how operations would be resolved in the event that the bank fails. Given Lloyds Banking Group's systemic importance this is highly significant. If a bank's living will is deemed insufficient by the FSA and contains serious obstacles to resolution it could result in restructuring of the relevant bank's group.

A second Turner Review discussion paper was published by the FSA in October 2009 which developed issues highlighted for further discussion in the March review, specifically how to offset the moral hazard created by the existence of systemically important banks and the cumulative impact of changes to the capital and liquidity schemes. Key proposals include: using contingent capital which converts to equity when required; reducing the interconnectedness of large cross-border banks; restricting retail banks from engaging in proprietary trading activities; and emphasising the need to prioritise capital conservation and enhancement above employee bonus payments.

On 5 October 2009 the FSA published its new liquidity rules which significantly broaden the scope of the existing liquidity regime and are designed to enhance regulated firms' liquidity risk management practices and, in part, can be seen as a response to issues highlighted by the credit crisis. These new rules, which apply to a wider range of entities than the current liquidity regime, are based on the over-arching principle of regulated firms (their subsidiaries and branch offices) being self-sufficient and having adequate liquid resources to withstand particular liquidity stresses. The rules specify that this will be delivered through greatly enhanced systems and controls requirements and a regular and comprehensive liquidity risk assessment of the business which will be linked to the supervisory process and monitored through more granular and frequent reporting on the part of regulated firms. In particular, the rules have introduced enhanced quantitation requirements which will ultimately require regulated firms to hold a greater quantity of higher quality liquid assets as a buffer against liquidity stresses. It is noted that the specific rules vary depending on the type of regulated firm and some regulated firms may be able to benefit from particular relaxations.

The new systems and controls requirements will apply to most regulated firms from 1 December 2009 and the enhanced quantitative requirements will be introduced in stages over the course of 1 June to 1 November 2010, though are subject to further detailed nuances depending on the type of regulated firm affected. Lloyds Banking Group believes that these new rules will apply to it and will likely require changes to its business model, in particular, the requirement to hold increased and higher quality liquid assets and the onerous reporting requirements (which may require Lloyds Banking Group to change or upgrade its systems) may result in reduced profitability for Lloyds Banking Group.

#### *FSA Supervisory Review into Historical HBOS Disclosures*

The FSA is conducting a supervisory review into the accuracy and completeness of financial disclosures made by HBOS in connection with its capital raisings in 2008, including information as to corporate impairments disclosed in the circulars and/or prospectuses issued by HBOS in connection with such capital raisings. Lloyds Banking Group is cooperating fully with this review. See "*Risk*

*Factors — Risks relating to the BOS Group — The BOS Group’s businesses are subject to substantial regulation, and to regulatory and governmental oversight. Adverse regulatory developments or changes in government policy could have a significant material adverse effect on the BOS Group’s operating results, financial condition and prospects”* for a discussion of the risks relating to regulatory oversight to which Lloyds Banking Group is subject.

## **Financial Services Guarantee Schemes in the UK**

Under the FSMA a compulsory single, industry-wide, investors' compensation scheme, the Financial Services Compensation Scheme (FSCS) has been set up. All authorised institutions are required to be members of the FSCS and are subject to a levy in proportion to their deposit base or volume of business undertaken. The FSCS applies to business undertaken by an FSA authorised institution or by the UK branch of a European Economic Area firm carrying on ‘home state regulated activity’.

The FSMA allows for the establishment of different funds for different kinds of business and for different maximum amounts of claim. From 1 January 2010 (subject to the rules of the FSCS):

- eligible deposit claimants remain entitled to receive 100 per cent. compensation for financial loss up to £50,000;
- eligible investment business and mortgage advice and arranging claimants are entitled to receive 100 per cent. compensation for financial loss up to £50,000; and
- eligible insurance claimants are entitled to receive 90 per cent. of the claim (except compulsory insurance for which it is 100 per cent. of the claim).

On 16 March 2009, the Directive on Deposit Guarantee Schemes (1994/19/EC) was amended by Directive 2009/14/EC (the “**Amended Directive**”). The Amended Directive requires EU Member States, by 30 June 2009, to increase the minimum level of coverage they provide for deposits from €20,000 to €50,000 and to reduce the payout period in the event of bank failure from three months to 20 days. Furthermore, by 31 December 2010, Member States must set coverage for the aggregate deposits of each depositor at €100,000, unless a European Commission impact assessment, submitted to the European Parliament and the Council by 31 December 2009, concludes that such an increase and such harmonisation are inappropriate and are not financially viable for all Member States. See “*Risk Factors — Risks relating to the BOS Group — In the United Kingdom, firms within the BOS Group are responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers*” for a discussion of the current and potential impact of Lloyds Banking Group’s obligations under the FSCS.

The FSA announced further changes to the FSCS on 24 July 2009, which in part seek to implement the fast payout rules set out under the Amended Directive referred to above through a SCV policy, as further detailed in “*Risk Factors — Risks relating to the BOS Group — In the United Kingdom, the firms within the BOS Group are responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers*”. In addition, the other key changes announced by the FSA to the FSCS include the following:

- Changing the payout of compensation to avoid customers who hold loans and deposits with the same institution having any debt deducted from their compensation;
- Widening eligibility of the FSCS to include more individuals;

- Introducing a requirement that deposit takers must disclose the existence of the FSCS and the level of protection it offers to help familiarise consumers with the services it provides; and
- If an institution operates under a number of trading names, it must tell its customers which of the different trading names are covered by a particular authorisation.

### **Authorised firms within the HBOS Group**

As at 30 June 2009 there were approximately 30 UK authorised institutions across the HBOS Group. These are regulated by the FSA on both an individual and a consolidated basis. There was one UK authorised bank: Bank of Scotland plc. The UK investment firms authorised within the HBOS Group were: Bank of Scotland Independent Financial Advisers Ltd, Clerical Medical Financial Advisers Ltd, Clerical Medical Investment Fund Managers Ltd, Halifax Capital Trustees Ltd, Halifax Independent Financial Services Ltd, Halifax Investment Services Ltd, Halifax Share Dealing Ltd, HBOS Investment Fund Managers Ltd, IWEB (UK) Ltd, and Uberior Fund Manager plc.

The regulated entities conducting (i) insurance, (ii) life, or (iii) pensions business were: Clerical Medical Managed Funds Ltd, Clerical Medical Investment Group Ltd, General Insurance Services Limited, Halifax Life Ltd, Lex Vehicle Leasing Ltd, St Andrew's Insurance plc and St Andrew's Life Assurance plc. The regulated entity specifically providing mortgage business was: The Mortgage Business plc.

### **Basel II**

Basel II has been implemented throughout the EU through the Capital Requirements Directive (which is discussed below under 'European Union Impact on UK Financial Services Regulation'). This came into force for all European banks on 1 January 2007, following a consultative process which continued throughout 2006. Transitional provisions meant, however, that HBOS Group was not required to be in compliance with all of the rules until 1 January 2008.

With effect from 1 January 2008, the HBOS Group has adopted the Advanced Internal Ratings Based approach for both its non-retail and retail exposures. The HBOS Group also adopted the Advanced Measurement Approach for Operational Risk from 1 January 2008.

The adoption of these approaches benefits the HBOS Group in terms of its internal capital allocation.

### **Other Relevant Legislation and Regulation**

#### **The Bank of England**

The agreed framework for co-operation in the field of financial stability in the financial markets is set out in detail in the Memorandum of Understanding published jointly by HM Treasury, the FSA and the Bank of England at the end of October 1997 and updated in March 2006. The Bank of England has specific responsibilities in relation to financial stability, including: (i) ensuring the stability of the monetary system; (ii) oversight of the financial system infrastructure, in particular payments systems at home and abroad; and (iii) maintaining a broad overview of the financial system through its monetary stability role and the deputy governor's membership of the FSA's Board. HM Treasury, the FSA and the Bank of England work together to achieve stability in the financial markets.

## UK Government

The UK Government is responsible for the overall structure of financial regulation and the legislation which governs it. It has no operational responsibility for the activities of the FSA or the Bank of England. However, there are a variety of circumstances where the FSA and the Bank of England will need to alert HM Treasury (the representative of the UK Government) about possible problems, for example, where there may be a need for a support operation or a problem arises which could cause wider economic disruption.

In light of the current crisis in financial markets, the Banking Act 2009 secured Royal Assent in February 2009 and certain provisions, including those relating to the SRR, bank insolvency and bank administration, came into force at that time. The Banking Act provides the FSA, Bank of England and HM Treasury with tools for dealing with failing institutions as part of the SRR. These powers enable the Authorities to deal with and stabilise UK-incorporated institutions with permission to accept deposits pursuant to Part IV of the FSMA (each a “relevant entity”) that are failing or are likely to fail to satisfy the threshold conditions (within the meaning of section 41 of the FSMA).

The SRR consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity or the shares of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a ‘bridge bank’ wholly-owned by the Bank of England; and (iii) temporary public ownership of the relevant entity. HM Treasury may also take a parent company of a relevant entity into temporary public ownership where certain conditions are met. The Banking Act also provides for two new insolvency and administration procedures for relevant entities.

The stabilisation powers may only be exercised if the FSA is satisfied that a relevant entity (a) is failing, or is likely to fail, to satisfy the threshold conditions set out in Schedule 6 to the FSMA required to retain its FSA authorisation to accept deposits; and (b) having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilising options) action will be taken that will enable the relevant entity to satisfy those threshold conditions. In such circumstances, and where certain further conditions are satisfied, (i) the Bank of England or HM Treasury could exercise the stabilisation powers in relation to a relevant entity; or (ii) as a last resort, HM Treasury may take a parent undertaking of a relevant entity into temporary public ownership pursuant to section 82 of the Banking Act (“temporary public ownership”) irrespective of the financial condition of such parent undertaking.

If a parent undertaking is taken into temporary public ownership, HM Treasury may take various actions in relation to any securities issued by it without the consent of the holders thereof (“Investors”), including (among other things):

- transferring securities free from any restrictions on transfer and free from any trust, liability or encumbrance;
- delisting the securities;
- converting securities into another form or class; or
- prescribing that the transfer of shares takes place free from any trust.

Accordingly, the taking of any such actions could adversely affect the rights of Investors, the price or value of their investment, and the ability of such parent undertaking to satisfy its obligations under the issued securities or the related contracts.

If a parent undertaking is taken into temporary public ownership and a partial transfer of its, or a relevant entity in its group's, business to another entity is effected or if a relevant entity in Lloyds Banking Group is made subject to the SRR and a partial transfer of such relevant entity's business to another entity were effected:

- the transfer order or instrument may directly affect the parent undertaking and/or its group companies and commercial counterparties by creating, modifying or cancelling their contractual arrangements with a view to ensuring the provision of such services and facilities as are required to enable the bridge bank or private sector purchaser to operate the transferred business (or any part of it) effectively; and
- the quality of the assets and the quantum of the liabilities not transferred and remaining with the parent undertaking may result in a deterioration in its creditworthiness and increase the risk that it may eventually become subject to administration or insolvency proceedings pursuant to the Banking Act or the Insolvency Act 1986.

Where the stabilisation powers are exercised, HM Treasury must make statutory provision for a scheme or other arrangements for determining the compensation, if any, due to those affected by an exercise of the powers. However, there can be no assurance that Investors would thereby recover compensation promptly and equal to any loss actually incurred. See “Risk Factors — Risks relating to the BOS Group — The BOS Group’s businesses are subject to substantial regulation, and to regulatory and governmental oversight. Adverse regulatory developments or changes in government policy could have a significant material adverse effect on the BOS Group’s operating results, financial condition and prospects”

In July 2009, HM Treasury published a White Paper “Reforming financial markets” containing wide ranging proposals. The other main UK political parties have subsequently published their own alternative agendas for reform. It is not possible to predict which, if any, of these proposals will be implemented either before or subsequent to the next UK General Election. In November 2009 the draft Financial Services Bill was presented to Parliament. This bill consolidates some of the proposals presented in the White Paper, in addition to enhancing the FSA's disciplinary and enforcement powers. Specifically, the bill provides the FSA with the power to require authorised firms to prepare recovery and resolution plans (living wills) and proposes new mechanisms for consumer redress and class actions. The bill also proposes additional powers to the FSA in relation to remuneration following the introduction of the FSA’s new Remuneration Code in August 2009. The new Remuneration Code will take effect from 1 January 2010 and sets out how employers should mitigate risk when rewarding staff with pay and bonuses. The code is designed to make sure that boards focus more closely on ensuring that the total amount distributed by a firm is consistent with good risk management and sustainability, as well as ensure that individual compensation practices provide the right incentives.

### **UK Financial Ombudsman Service**

The Financial Ombudsman Service (FOS) was established on 1 December 2001 pursuant to the FSMA to provide customers with a free and independent service designed to resolve disputes where the customer is not satisfied with the response received from the regulated firm. The FOS resolves disputes that cover most financial products and services provided in (or from) the UK, from insurance and pension plans to bank accounts and investments, for eligible complainants, private individuals and small businesses, charities or trusts. The jurisdiction of FOS was extended in 2007 to include firms conducting activities under the Consumer Credit Act. Although the FOS takes account of relevant regulation and legislation, its guiding principle is to resolve cases on the basis of what is

fair and reasonable; in this regard, the FOS is not bound by law or even its own precedent. The decisions made by the FOS are binding on firms.

### **Banking Conduct Regime**

On 1 November 2009, the FSA assumed responsibility for the regulation of deposit and payment products under a new Banking Conduct regime. Such regulation includes banking conduct of business rules regarding retail deposit-taking business and FSA requirements relating to payment services pursuant to the Payment Services Regulations 2009.

### **Lending Code**

The Lending Standards Board (formerly the Banking Code Standards Board) is responsible for monitoring and enforcing compliance with a new Lending Code introduced on 1 November 2009 which relates to lending to private customers and small businesses.

### **Unarranged Overdraft Charges**

The Supreme Court published its judgment in respect of the fairness of unarranged overdraft charges on personal current accounts on 25 November 2009, finding in favour of the litigant banks. On 22 December 2009, the OFT announced that it will not continue its investigation into the fairness of these charges. The HBOS Group is working with the regulators to ensure that outstanding customer complaints are concluded as quickly as possible and anticipate that most cases in the county courts will be discontinued. The HBOS Group expects that some customers will argue that despite the test case ruling they are entitled to a refund of unarranged overdraft charges on the basis of other legal arguments or challenges. The HBOS Group would robustly defend any such complaints or claims and does not expect any such complaints or claims to have a material effect on the HBOS Group.

The OFT is however continuing to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. The OFT aims to report on progress in respect of further changes it believes are required to make the market work in the best interest of bank customers by the end of March 2010.

### **Interchange fees**

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the European General Court. BOS and Lloyds TSB Bank plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with European Commission competition laws. MasterCard has announced that it has reached an understanding with the European Commission on a new methodology for calculating intra European Economic Area multi-lateral interchange fees on an interim basis pending the outcome of the appeal.

Meanwhile, the European Commission and the UK's OFT are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions

also infringe European Commission and/or UK competition laws. As part of this initiative, the OFT will also intervene in the European General Court appeal supporting the European Commission position. The ultimate impact of the investigations on the HBOS Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

### **Continuing Obligations**

The Issuer and each of the other members of the HBOS Group which have securities listed on the Official List or on other regulated markets intend to comply with their obligations as companies with securities admitted to the Official List in connection with further disclosures in relation to the impact of the reviews and inquiries being conducted by the UK Office of Fair Trading, as disclosed above, on the HBOS Group. Under the GAPS Withdrawal Deed, Lloyds Banking Group has, among other things, agreed to implement any measures relating to personal current accounts agreed between the OFT and the UK banking industry. See “*Recent Developments — Capital Restructuring— GAPS Withdrawal Deed*” herein for a fuller description of such commitments.

### **UK Competition Commission**

In January 2009, the Competition Commission completed its formal investigation into the supply of Payment Protection Insurance (“PPI”) services (except store card PPI) to non-business customers in the UK. Various members of the HBOS Group underwrite PPI, while other members distribute PPI, by offering it for sale with a variety of the credit products which they supply.

On 5 June 2008, the Competition Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with the result being detrimental to consumers.

Following consultation, the Competition Commission published its final report on 29 January 2009 setting out its remedies. In summary, the Competition Commission has decided to adopt the following remedies: (i) a prohibition on the active sale of PPI by a distributor to a customer within 7 days of the distributor’s sale of credit to that customer. However, customers may pro-actively return to the distributor to initiate a purchase by telephone or online from 24 hours after the credit sale; (ii) a requirement on all PPI providers to provide certain information and messages in PPI marketing materials; (iii) a requirement to provide personal PPI quotes to customers; (iv) a requirement on all PPI providers to provide certain information on PPI policies to the FSA; (v) a recommendation to the FSA that it use the information provided under the requirement in (iii) to populate its PPI price comparison tables; (vi) a requirement on distributors to provide an annual statement for PPI customers containing information on their PPI policy and what it costs; and (vii) a prohibition on the levying by distributors of payments for PPI on a single premium basis. Instead, distributors are permitted to charge only regular premiums at a constant rate, paid monthly or annually. This remedy therefore precludes the selling of multi-year PPI policies for a single premium.

On 30 March 2009, Barclays Bank plc lodged an appeal in the Competition Appeal Tribunal against the Competition Commission’s findings. In particular, it requested that the Competition Appeal Tribunal quash the decision of the Competition Commission insofar as it relates to the prohibition of distributors selling PPI at the credit point of sale and the Competition Commission’s findings on market definition and the nature and extent of competition in the supply of PPI. Lloyds Banking Group filed a notice of its intention to intervene in the appeal on 23 April 2009. On 28 April 2009, Lloyds Banking Group was granted permission by the Competition Appeal Tribunal to intervene in the appeal. The hearing of the appeal took place from 7 September 2009 to 11 September 2009. The Competition Appeal Tribunal handed down its judgment on 16 October 2009. It found in favour of Barclays in respect of its challenge to the Competition Commission’s prohibition of

distributors selling PPI at the credit point of sale but it did not uphold Barclays' challenge to the Competition Commission's findings on market definition. The matter will now be referred back to the Competition Commission with direction to reconsider their remedies and make a new decision in accordance with the Competition Appeal Tribunal's ruling. This may or may not result in the Competition Commission ultimately reaching a different conclusion.

Depending on the outcome of the referral back to the Competition Commission, the Competition Commission's decision may have a significant adverse impact on the level of sales and thus the revenue generation and profitability of the payment protection insurance products which the HBOS Group offers its customers, but the ultimate impact would be determined by a number of factors including the extent to which the HBOS Group was able to mitigate the potentially adverse effects of such statutory changes through restructuring the payment protection products which it offers its customers and/or developing alternative products and revenue streams. To this end, the HBOS Group took a commercial decision to sell only regular monthly premium PPI to its personal loan customers in the UK from early 2009. The FSA subsequently wrote to certain other firms still selling single premium PPI with unsecured personal loans asking them to withdraw the product as soon as possible, and no later than 29 May 2009.

### **UK Financial Ombudsman Service**

On 1 July 2008 the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The HBOS Group and other industry members and trade associations have made submissions to the FSA regarding this referral. The matter was considered at the FSA Board meeting on 25 September 2008. The HBOS Group has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints. On 29 September 2009, the FSA issued a consultation paper on PPI complaints handling to which Lloyds Banking Group responded on 30 October 2009, endorsing the response submitted on behalf of the retail banking industry by the British Banking Association. The FSA has escalated its regulatory activity in relation to past PPI sales generally and has proposed new guidance on the fair assessment of a complaint and the calculation of redress and a new rule requiring firms to reassess historically rejected complaints.

The statement on 29 September 2009 also announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. Lloyds Banking Group has subsequently agreed in principle that it will undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. The precise details of the review are still being discussed with the FSA. The ultimate impact on the HBOS Group of any review and/or assessment can only be known at the conclusion of these discussions and on publication of the FSA's final rules.

### **UK Information Commissioner's Office**

This office is responsible for overseeing implementation of the Data Protection Act 1998. This Act regulates, among other things, the retention and use of data relating to individual customers.

The Freedom of Information Act 2000 (the "FOIA") sets out a scheme under which any person can obtain information held by, or on behalf of, a "public authority" without needing to justify the request. A public authority will not be required to disclose information if certain exemptions set out in the FOIA apply. Under section 2(1) of the FOIA, a public authority is not required to disclose information where an absolute exemption applies or if the public interest in maintaining the exemption outweighs the public interest in disclosing the information. If a requester is dissatisfied with his response from a public authority, he may refer the matter to the Information Commissioner who may order the disclosure of the information, for example if he considers that the public interest in



disclosing the information outweighs the public interest in maintaining the exemption. The HBOS Group is not a public body but HM Treasury and certain other public authorities and associated companies are. Any confidential information required to be disclosed by the HBOS Group to a public authority could be subject to enforced disclosure to members of the public pursuant to the FOIA.

## **European Union Impact on UK Financial Services Regulation**

### ***Retail banking investigation***

On 10 January 2007, the European Commission published the Final Report of its sector inquiry into European retail banking markets covering payment cards and (non-card) payment systems and current accounts and related services. The European Commission found that markets were fragmented along national lines, limiting consumer choice and leading to higher costs for current accounts, loans or payments. High degrees of variation of prices, profit margins and selling patterns between EU Member States and high degrees of homogeneity within EU Member States were found to be indicative of persisting regulatory or behavioural barriers to competition.

The Final Report identified competition concerns in several areas of retail banking, including:

- the combination of sustained high profitability, high market concentration and evidence of entry barriers in some Member States raise concerns about banks' ability to influence the level of prices for consumers and small firms;
- large variations in merchant and interchange fees between banks across the EU may indicate competition barriers;
- the existence of high joining fees for payment cards, co-branding, surcharging and the practice of "blending" card fees where a retailer is charged the same merchant fee irrespective of the different costs of card types;
- some credit registers, holding confidential data that lenders use to set loan rates, may be used to exclude new entrants to retail banking markets;
- some aspects of co-operation among banks, including savings and co-operative banks, can reduce competition and deter market entry;
- product tying by banks is widespread in Member States and can reduce consumer choice and increase banks' power in the market place to influence prices; and
- obstacles to customer mobility in banking, notably the inconvenience of changing a current account, are high.

Some of these concerns have already been addressed, at least in part. For example, following the interim report being published, the European Commission met with Austrian banks who agreed to review arrangements for setting interchange fees and announced that a reduction can be expected. In Portugal, issuers and acquirers have met some of the concerns raised in the report by reducing domestic interchange fees and removing preferential bilateral domestic interchange fees. The establishment of a Single Euro Payments Area ("SEPA") is also seen as a method of remedying some of the competition concerns raised in the report. Since 1 January 2008, banks have been able to make the first SEPA products available and are aiming to make SEPA a reality for all customers by the end of 2010.

The Final Report also listed the following specific areas where enforcement action by the European Commission and the national competition authorities is appropriate:

- high interchange fees and merchant fees in some payment card networks;
- access barriers and discriminatory rules in relation to credit registers;
- tying of products by some banks; and
- bank co-operation (in respect to which the European Commission indicated that it intended to gather more information before acting).

Since the Final Report was published, the European Commission has adopted three decisions affecting payment card services. On 3 October 2007, the European Commission fined Visa International and Visa Europe €10.2 million for refusing to admit Morgan Stanley as a member from March 2000 to September 2006. In a decision dated 17 October 2008, the European Commission concluded that the Groupement des Cartes Bancaires infringed Article 101 of the Treaty on the Functioning of the European Union by adopting price measures hindering the issuing of cards in France at competitive rates by certain member banks, thereby keeping the price of payment cards artificially high and thus favouring the major French banks. As referred to above, on 19 December 2007, the European Commission adopted a decision prohibiting MasterCard's multilateral interchange fees for cross-border card payments with MasterCard and Maestro consumer credit and debit cards between Member States of the European Economic Area (intra-EEA MIFs).

### ***EU directives***

Work continues on the Financial Services Action Plan which is intended to create a single market for financial services across the EU. The HBOS Group will continue to monitor the progress of these initiatives, provide specialist input on their drafting and assess the likely impact on its business.

EU directives, which are required to be implemented in EU Member States through national legislation, have a strong influence over the framework for supervision and regulation of financial services in the UK. The directives aim to harmonise financial services regulation and supervision throughout the EU by setting standards in key areas such as capital adequacy, access to financial markets, consumer protection and compensation schemes.

Financial institutions, such as those in the HBOS Group, are primarily regulated in their home state by a local regulator but the EU directives prescribe criteria for the authorisation of such institutions and the prudential conduct of business supervision applicable to them. Different directives require Member States to give 'mutual recognition' to each other's standards of regulation through the operation of a 'passport' concept.

This passport gives a financial institution which has been authorised in its 'home' state the freedom to establish branches in, and to provide cross-border services into, other Member States without the need for additional local authorisation.

### ***Directives recently implemented***

The Acquisitions Directive was implemented in the UK on 21 March 2009. The purpose of the Directive is to prevent EU Member States from blocking acquisitions of financial services firms for improper (e.g. protectionist) reasons and to facilitate the acquisition process.

Key measures include:

- introduction of assessment criteria, which are more tightly defined than the current assessment criteria and are limited to a prudential assessment; and

- provisions to increase the transparency of the process and ensure that potential acquirers that are declined permission are given the information they need to challenge the decision.

The Payment Services Directive was fully implemented in the UK on 1 November 2009 and enhances the movement towards a Single European Payments Area.

Key measures include:

- the right to provide payment services to the public;
- transparency and information requirements; and
- rights and obligations of users and providers of payment services.

### ***Directives currently being implemented***

A number of other EU directives, including amendments to the Deposit Guarantee Schemes Directive (please see “Financial Services Guarantee Schemes in the UK” above), Payment Services Directive and the Consumer Credit Directive are currently being implemented in the UK.

Draft provisions for implementing the Consumer Credit Directive were published in 2009, with the deadline for implementation being June 2010. The Directive aims to establish the conditions for a genuine EU market, ensure a high level of consumer protection, and improve clarity by recasting the existing EU directive on consumer credit.

### ***Directives under review***

Amendments to a number of EU directives are being considered, including the Distance Marketing Directive, Capital Requirements Directive, E-Money Directive, Undertakings for Collective Investment in Transferable Securities (UCITS) Directive and the Financial Groups Directive. Legislative amendments may be forthcoming.

The EU is also considering regulatory proposals for, *inter alia*:

- mortgage credit;
- a recast UCITS Directive; and
- capital adequacy requirements for insurance companies (Solvency II).

### **International regulation**

The HBOS Group operates in many other countries around the world. The HBOS Group’s overseas operations are subject to reporting and reserve requirements and controls imposed by the relevant central banks and regulatory authorities.

In view of the global financial crisis and the increased scrutiny financial regulators have come under, it is also expected that regulatory regimes in many jurisdictions will be significantly tightened, e.g. emergency restrictions on short selling practices were implemented in a number of jurisdictions including the UK, Ireland, France, Germany and the Netherlands following the market volatility in September 2008. At a G20 meeting to tackle the financial crisis in November 2008, a set of common principles for the reform of financial markets was set out. These principles have the aim of strengthening transparency and accountability; enhancing sound regulation; promoting integrity in

financial markets; re-enforcing international co-operation and reforming international institutions. As a result of this and other domestic pressures, it is expected that HBOS Group entities in all jurisdictions will be subject to increased scrutiny.

## THE LLP

### Introduction

The LLP was incorporated in England and Wales on 15 May 2003 as a limited liability partnership (registered number OC304674) with limited liability under the LLPA 2000 by the Original Seller and the Issuer as its Members. The Liquidation Member was admitted as a Member of the LLP pursuant to a deed of admission entered into on or before the Programme Date between the Original Seller, the Issuer, the LLP and the Liquidation Member (the “**Deed of Admission**”). The principal place of business of the LLP is at LP/3/3/SEC Trinity Road, Halifax, West Yorkshire HX1 2RG and its telephone number is 01132 352 176. The LLP has no subsidiaries.

The LLP is a subsidiary of the Original Seller, which itself is a subsidiary of HBOS plc. For a description of the HBOS group please see pages 72-85 under *HBOS*, above. The Original Seller, the Issuer and the Liquidation Member are the members of the LLP.

### Principal Activities

The principal objects of the LLP are set out in the LLP Deed and include, *inter alia*, the ability to carry on the business of acquiring the Loans and their Related Security pursuant to the terms of the Mortgage Sale Agreement with a view to profit and to do all such things as are incidental or conducive to the carrying on of that business and to borrow money.

The LLP has not engaged since its incorporation, and will not engage whilst the Covered Bonds or any Term Advance remain outstanding, in any material activities other than activities incidental to its incorporation under the LLPA 2000, activities contemplated under the Transaction Documents to which it is or will be a party, applying for a standard licence under the CCA, filing a notification under the Data Protection Act 1998 and other matters which are incidental or ancillary to the foregoing.

### Members

The members of the LLP as at the date hereof are and their registered offices are:

<b>Name</b>	<b>Registered Office</b>
Bank of Scotland plc	The Mound Edinburgh EH1 1YZ
Connery Limited	47 Esplanade St. Helier Jersey JE1 0BD

The LLP has no employees.

### Members of the Management Board of the LLP

<u>Name</u>	<u>Responsibility within LLP</u>	<u>Principal activities outside the LLP</u>
Ian Stewart.....	Management Board Chairman	Head of Securitisation and Mortgage Funding, Lloyds Banking Group, Retail
Darren Pope .....	Management Board Member	Mortgage Finance Director, Lloyds Banking Group, Retail
Tracey Hill.....	Management Board Member	Senior Securitisation Manager, Lloyds Banking Group, Retail
Monica de Vries.....	Management Board Member	Co-Head Retail Secured, Structured Securitisation Group, Lloyds Banking Group Wholesale Markets

The business address of Ian Stewart, Darren Pope and Tracey Hill is LP/3/3/SEC, Trinity Road, Halifax HX1 2RG.

### Conflicts of Interest

There are no potential conflicts of interest between any duties of the above Members of the Management Board and their private interests or other duties.

### Directors of the Members

The following table sets out the directors of Connery Limited and their respective business addresses and occupations.

<u>Name</u>	<u>Business Address</u>	<u>Business Occupation</u>
Elizabeth Ann Mills .....	47 Esplanade St. Helier Jersey JE1 0BD	Director of special purpose companies
Peter John Richardson.....	47 Esplanade St. Helier Jersey JE1 0BD	Director of special purpose companies

The directors of Bank of Scotland plc are set out under: The Issuer.

## FORM OF THE COVERED BONDS

The Covered Bonds of each Series will be in either bearer form, with or without interest coupons attached, or registered form, without interest coupons attached. Bearer Covered Bonds will be issued outside the United States in reliance on Regulation S under the Securities Act (“**Regulation S**”) and Registered Covered Bonds will be issued both outside the United States in reliance on the exemption from registration provided by Regulation S and within the United States or to, or for the benefit of U.S. persons as described herein, in reliance on Rule 144A.

### Bearer Covered Bonds

Each Tranche of Bearer Covered Bonds will be initially issued in the form of a temporary bearer global covered bond without interest coupons attached (a “**Temporary Bearer Global Covered Bond**”) or, if so specified in the applicable Final Terms (the “**applicable Final Terms**”), a permanent bearer global covered bond without interest coupons attached (a “**Permanent Bearer Global Covered Bond**”) and, together with the Temporary Bearer Global Covered Bonds, the “**Bearer Global Covered Bonds**” and each a “**Bearer Global Covered Bond**”) which, in either case, will:

- (i) if the Bearer Global Covered Bonds are intended to be issued in new global covered bond (“**NGCB**”) form, as stated in the applicable Final Terms, be delivered on or prior to the original issue date of the Tranche to a common safekeeper (the “**Common Safekeeper**”) for Euroclear Bank S.A./N.V. (“**Euroclear**”) and Clearstream Banking, *société anonyme* (“**Clearstream, Luxembourg**”); and
- (ii) if the Bearer Global Covered Bonds are not intended to be issued in NGCB form, be delivered on or prior to the original issue date of the Tranche to a common depositary (the “**Common Depositary**”) for Euroclear and Clearstream, Luxembourg.

Whilst any Bearer Covered Bond is represented by a Temporary Bearer Global Covered Bond, payments of principal, interest (if any) and any other amount payable in respect of the Covered Bonds due prior to the Exchange Date (as defined below) will be made (against presentation of the Temporary Bearer Global Covered Bond if the Temporary Bearer Global Covered Bond is not intended to be issued in NGCB form) only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Bearer Covered Bond are not United States persons for US federal income tax purposes (“**United States person**”) or persons who have purchased for resale to any United States person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Agent.

On and after the date (the “**Exchange Date**”) which is 40 days after a Temporary Bearer Global Covered Bond is issued, interests in such Temporary Bearer Global Covered Bond will be exchangeable (free of charge) upon a request as described therein either for (i) interests in a Permanent Bearer Global Covered Bond of the same Series or (ii) for definitive Bearer Covered Bonds of the same Series with, where applicable, receipts, interest coupons and talons attached (as indicated in the applicable Final Terms and subject, in the case of definitive Covered Bonds, to such notice period as is specified in the applicable Final Terms), in each case against certification of non-U.S. beneficial ownership as described above unless such certification has already been given. The holder of a Temporary Bearer Global Covered Bond will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Bearer Global Covered Bond for an interest in a Permanent Bearer Global Covered Bond or for definitive Bearer Covered Bonds is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Bearer Global Covered Bond will be made through Euroclear and/or Clearstream, Luxembourg (against presentation or surrender (as the case may be) of the Permanent Bearer Global Covered Bond if the Permanent Bearer Global Covered Bond is not intended to be issued in NGCB form) without any requirement for certification.

The applicable Final Terms will specify that a Permanent Bearer Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Bearer Covered Bonds with, where applicable, receipts, interest coupons and talons attached upon either (i) when the Covered Bonds have a Minimum Specified Denomination or integral multiples thereof, not less than 60 days' written notice from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Covered Bond) to the Agent as described therein or (ii) only upon the occurrence of an "**Exchange Event**". For these purposes, Exchange Event means that (i) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (ii) the Issuer has or will become subject to adverse tax consequences as a result of legislative changes in the domicile of the Issuer which would not be suffered were the Covered Bonds represented by the Permanent Bearer Global Covered Bond in definitive form. The Issuer will promptly give notice to Covered Bondholders of each Series in accordance with Condition 13 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Bearer Global Covered Bond) or the Bond Trustee may give notice to the Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (ii) above, the Issuer may also give notice to the Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Agent.

Global Covered Bonds and Bearer Covered Bonds in definitive form will be issued pursuant to the Agency Agreement.

The following legend will appear on all Bearer Covered Bonds which have an original maturity of more than 365 days and on all receipts and interest coupons relating to such Covered Bonds:

"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 provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on Bearer Covered Bonds, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of such Covered Bonds, receipts or interest coupons.

Covered Bonds which are represented by a Global Bearer Covered Bond will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be.



## Registered Covered Bonds

The Registered Covered Bonds of each Tranche offered and sold in reliance on Regulation S, which will be sold to non-U.S. persons outside the United States, will initially be represented by a global covered bond in registered form (a “**Regulation S Global Covered Bond**”). Prior to expiry of the distribution compliance period (as defined in Regulation S) applicable to each Tranche of Covered Bonds, beneficial interests in a Regulation S Global Covered Bond may not be offered or sold to, or for the account or benefit of, a U.S. person save as otherwise provided in Condition 2 and may not be held otherwise than through Euroclear or Clearstream, Luxembourg and such Regulation S Global Covered Bond will bear a legend regarding such restrictions on transfer.

The Registered Covered Bonds of each Tranche may only be offered and sold in the United States or to U.S. persons in private transactions exempt from registration under the Securities Act (i) to QIBs or (ii) to IAIs who agree to purchase the Covered Bonds for their own account and not with a view to the distribution thereof in accordance with the Securities Act. The Registered Covered Bonds of each Tranche sold to QIBs will be represented by a global covered bond in registered form (a “**Rule 144A Global Covered Bond**” and, together with a Regulation S Global Covered Bond, the “**Registered Global Covered Bonds**”). Registered Global Covered Bonds will either (i) be deposited with a custodian for, and registered in the name of a nominee of, DTC or (ii) be deposited with a common depository for, and registered in the name of a common nominee of, Euroclear and Clearstream, Luxembourg, as specified in the applicable Final Terms. Persons holding beneficial interests in Registered Global Covered Bonds will be entitled or required, as the case may be, under the circumstances described below, to receive physical delivery of definitive Covered Bonds in fully registered form.

The Registered Covered Bonds of each Tranche sold to Institutional Accredited Investors will be in definitive form, registered in the name of the holder thereof (“**Definitive IAI Registered Covered Bonds**”). Unless otherwise set forth in the applicable Final Terms, Definitive IAI Registered Covered Bonds will be issued only in minimum denominations of U.S.\$500,000 and integral multiples of U.S.\$1,000 in excess thereof (or the approximate equivalents in the applicable Specified Currency). Definitive IAI Registered Covered Bonds will be subject to the restrictions on transfer set forth therein and will bear the restrictive legend described under *Subscription and Sale and Transfer and Selling Restrictions*. Institutional Accredited Investors that hold Definitive IAI Registered Covered Bonds may elect to hold such Covered Bonds through DTC, but transferees acquiring the Covered Bonds in transactions exempt from Securities Act registration pursuant to Regulation S or Rule 144A under the Securities Act (if available) may do so upon satisfaction of the requirements applicable to such transfer as described under *Subscription and Sale and Transfer and Selling Restrictions*. The Rule 144A Global Covered Bond and the Definitive IAI Registered Covered Bonds will be subject to certain restrictions on transfer set forth therein and will bear a legend regarding such restrictions.

Payments of principal, interest and any other amount in respect of the Registered Global Covered Bonds will, in the absence of provision to the contrary, be made to the person shown on the Register (as defined in Condition 6(d)) as the registered holder of the Registered Global Covered Bonds. None of the Issuer, the Guarantors, any Paying Agent or the Bond Registrar will have any responsibility or liability for any aspect of the records relating to or payments or deliveries made on account of beneficial ownership interests in the Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Payments of principal, interest or any other amount in respect of the Registered Covered Bonds in definitive form will, in the absence of provision to the contrary, be made to the persons shown on the Register on the relevant Record Date (as defined in Condition 6(d)) immediately preceding the due date for payment in the manner provided in that Condition.

Interests in a Registered Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Registered Covered Bonds without receipts, interest coupons or talons attached only upon the occurrence of an Exchange Event. For these purposes, “**Exchange Event**” means (i) in the case of Covered Bonds registered in the name of a nominee for DTC, either DTC has notified the Issuer that it is unwilling or unable to continue to act as depository for the Covered Bonds and no alternative clearing system is available or DTC has ceased to constitute a clearing agency registered under the Exchange Act, (ii) in the case of Covered Bonds registered in the name of a nominee for a common depository for Euroclear and Clearstream, Luxembourg, the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and, in any such case, no successor clearing system is available or (iii) the Issuer has or will become subject to adverse tax consequences as a result of legislative changes in the domicile of the Issuer which would not be suffered were the Covered Bonds represented by the Registered Global Covered Bond in definitive form. The Issuer will promptly give notice to Covered Bondholders in accordance with Condition 14 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, DTC, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Registered Global Covered Bond) may give notice to the Bond Registrar requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iii) above, the Issuer may also give notice to the Bond Registrar requesting exchange. Any such exchange shall occur not later than 10 days after the date of receipt of the first relevant notice by the Bond Registrar.

### **Transfer of Interests**

Interests in a Registered Global Covered Bond may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such interest in another Registered Global Covered Bond or in the form of a Definitive IAI Registered Covered Bond and Definitive IAI Registered Covered Bonds may, subject to compliance with all applicable restrictions, be transferred to a person who wishes to hold such Covered Bonds in the form of an interest in a Registered Global Covered Bonds. No beneficial owner of an interest in a Registered Global Covered Bond will be able to transfer such interest, except in accordance with the applicable procedures of DTC, Euroclear and Clearstream, Luxembourg, in each case to the extent applicable. **Registered Covered Bonds are also subject to the restrictions on transfer set forth therein and will bear a legend regarding such restrictions, see *Subscription and Sale and Transfer and Selling Restrictions*.**

Pursuant to the Agency Agreement (as defined under *Terms and Conditions of the Covered Bonds*), the Agent shall arrange that, where a further Tranche of Covered Bonds is issued which is intended to form a single Series with an existing Tranche of Covered Bonds, the Covered Bonds of such further Tranche shall be assigned a common code and ISIN and, where applicable, a CUSIP and CINS number which are different from the common code, ISIN, CUSIP and CINS assigned to Covered Bonds of any other Tranche of the same Series until at least the expiry of the distribution compliance period (as defined in Regulation S under the United States Securities Act of 1933, as amended (the “**Securities Act**”)) applicable to the Covered Bonds of such Tranche.

Any reference herein to Euroclear and/or Clearstream, Luxembourg and/or DTC shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms or as may otherwise be approved by the Issuer, the Agent and the Bond Trustee.

No Covered Bondholder, Receipholder or Couponholder shall be entitled to proceed directly against the Issuer or any Guarantor unless the Bond Trustee or, as the case may be, the Security Trustee, having become bound so to proceed, fails so to do within a reasonable period and the failure shall be continuing.

## FORM OF FINAL TERMS

Set out below is the form of Final Terms which, subject to any necessary amendment, will be completed for each Tranche of Covered Bonds issued under the Programme.

[Date]

**Bank of Scotland plc**

**Issue of [Regulated] [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds]  
Unconditionally guaranteed by HBOS plc**

**and**

**Irrevocably and unconditionally guaranteed as to payment of principal and interest by  
HBOS Covered Bonds LLP  
under the €60 billion  
Covered Bond Programme**

### PART A – CONTRACTUAL TERMS

The Programme has been registered and notice of these Covered Bonds has been made, under the Regulated Covered Bonds Regulations 2008 (SI 2008/346) as amended by the Regulated Covered Bonds (Amendment) Regulations 2008 (SI 2008/1714).

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Offering Circular dated 10 March 2010 which constitutes a base prospectus for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the “**Prospectus Directive**”). This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Offering Circular. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Offering Circular. The Offering Circular is available for viewing at the registered office of the Issuer and the specified office of the Agent.

*[The following alternative language applies if the first Tranche of an issue which is being increased was issued under an Offering Circular with an earlier date.]*

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the “**Conditions**”) set forth in the Offering Circular dated [original date]. This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the “**Prospectus Directive**”) and must be read in conjunction with the Offering Circular dated 10 March 2010, save in respect of the Conditions which are extracted from the Offering Circular dated [original date] and are attached hereto. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of a combination of these Final Terms and the Offering Circulars dated 10 March 2010. Copies of such Offering Circulars are available for viewing at the registered office of the Issuer and the specified office of the Agent.]

*[Include whichever of the following apply or specify as “Not Applicable” (N/A). Note that the numbering should remain as set out below, even if “Not Applicable” is indicated for individual paragraphs or sub-paragraphs. Italics denote directions for completing the Final Terms.]*

*[When adding any other final terms or information consideration should be given as to whether such terms or information constitute “significant new factors” and consequently trigger the need for a supplement to the Offering Circular under Article 16 of the Prospectus Directive.]*

1. (i) Issuer: Bank of Scotland plc
- (ii) Guarantors: HBOS plc and HBOS Covered Bonds LLP
2. (i) Series Number: [ ]
- (ii) Tranche Number: [ ]  
*(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)*
3. Specified Currency or Currencies: [ ]
4. Aggregate Nominal Amount:
  - (i) Series: [ ]
  - (ii) Tranche: [ ]
5. Issue Price: [ ] per cent. Of the Aggregate Nominal Amount [plus accrued interest from *[insert date]* (*in the case of fungible issues only, if applicable*)]
6. (i) Specified Denominations: [ ]  
*(in the case of Registered Covered Bonds, this means the minimum integral amount in which transfers can be made)* *(N.B. Where multiple denominations above €50,000 or equivalent are being used the following sample wording should be followed: €50,000 and integral multiples of [€1,000] in excess thereof up to and including [€99,000]. No Covered Bonds in definitive form will be issued with a denomination above [€99,000].)*  
  
*(N.B. if an issue of Covered Bonds is (i) NOT admitted to trading on a European Economic Area exchange; and (ii) only offered in the European Economic Area in circumstances where a prospectus is not required to be published under the Prospectus Directive the €50,000 minimum denomination is not required)*
- (ii) Calculation Amount: [ ]  
  
*(If only one Specified Denomination, insert the Specified Denomination.*  
  
*If more than one Specified Denomination, insert the highest common factor. Covered Bond: There must be a common factor in the case of two or more Specified Denominations.)*

7. (i) Issue Date: [       ]
- (ii) Interest Commencement Date: [*specify*/Issue Date/Not Applicable]
- (N.B. An Interest Commencement Date will not be relevant for certain Covered Bonds, for example Zero Coupon Covered Bonds.)*
8. Final Maturity Date: [Fixed rate – specify date/Floating rate – Interest Payment Date falling in or nearest to [*specify month*]]
9. Interest Basis: [[       ] per cent. Fixed Rate]  
 [[LIBOR/EURIBOR] +/- [       ] per cent. Floating Rate]  
 [Zero Coupon]  
 [Index Linked Interest]  
 [Dual Currency Interest]  
 [*specify other*]  
 (further particulars specified below)
10. Redemption/Payment Basis: [Redemption at par]  
 [Index Linked Redemption]  
 [Dual Currency Redemption]  
 [Instalment]  
 [Hard Bullet Covered Bond]  
 [*specify other*]  
*(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply)*
11. Change of Interest Basis or Redemption/ Payment Basis: [*Specify details of any provision for change of Covered Bonds into another Interest Basis or Redemption/Payment Basis*]
12. Call Option: [Issuer Call]  
 [(further particulars specified below)]
13. (i) Status of the Covered Bonds: Senior
- (ii) Status of the Guarantees: Senior
- (iii) [Date [Board] approval for issuance of Covered Bonds [and Guarantee] obtained: [       ] [and [       ], respectively] *(N.B. Only relevant where Board (or similar) authorisation is required for the particular tranche of Covered Bonds or related Guarantee)*]
14. Method of distribution: [Syndicated/Non-syndicated]

## PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

15. **Fixed Rate Covered Bond Provisions** [Applicable/Not Applicable]
- (If not applicable, delete the remaining subparagraphs of this paragraph)*
- (i) Rate(s) of Interest: [ ] per cent. per annum [payable [annually/semi annually/quarterly] in arrear]
- (If payable other than annually, consider amending Condition 5)*
- (ii) Interest Payment Date(s): [ ] in each year up to and including the Final Maturity Date][specify other]
- (NB: This will need to be amended in the case of long or short Coupons)*
- (iii) Fixed Coupon Amount(s): [ ] per Calculation Amount
- (Applicable to Covered Bonds in definitive form)*
- (iv) Broken Amount(s): [ ] per Calculation Amount, payable on the Interest Payment Date falling [in/on] [ ]
- (Applicable to Covered Bonds in definitive form)*
- (v) Day Count Fraction: [30/360 or Actual/Actual (ICMA) or [specify other]]
- (vi) [Determination Date(s): [ ] in each year
- [Insert regular Interest Payment Dates, ignoring Issue Date or Final Maturity Date in the case of a long or short first or last Coupon]*
- NB: This will need to be amended in the case of regular Interest Payment Dates which are not of equal duration*
- NB: Only relevant where Day Count Fraction is Actual/Actual (ICMA)]]*
- (vii) Other terms relating to the method of calculating interest for Fixed Rate Covered Bonds: [None/Give details]

16. **Floating Rate Covered Bond Provisions**

[Applicable/Not Applicable]

*(If not applicable, delete the remaining sub paragraphs of this paragraph)*

- (i) Specified Period(s) /Specified Interest Payment Dates: [     ]
- (ii) Business Day Convention: [Floating Rate Convention / Following Business Day Convention / Modified Following Business Day Convention / Preceding Business Day Convention/ [specify other]]
- (iii) Additional Business Centre(s): [     ]
- (iv) Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/ *specify other*]
- (v) Party responsible for calculating the Rate of Interest and Interest Amount (if not the Agent): [     ]
- (vi) Screen Rate Determination:
  - Reference Rate: [     ]  
*(Either LIBOR, EURIBOR or other, although additional information is required if other – including fallback provisions in the Agency Agreement)*
  - Interest Determination Date(s): [     ]  
*(Second London Business Day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET2 System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR)*
  - Relevant Screen Page: [     ]  
*(In the case of EURIBOR, if not Reuters EURIBOR01 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)*

- (vii) ISDA Determination:
- Floating Rate Option: [ ]
  - Designated Maturity: [ ]
  - Reset Date: [ ]
- (viii) Margin(s): [ +/- ] [ ] per cent. per annum
- (ix) Minimum Rate of Interest: [ ] per cent. per annum
- (x) Maximum Rate of Interest: [ ] per cent. per annum
- (xi) Day Count Fraction: [Actual/365  
Actual/365 (Fixed)  
Actual/360  
30/360  
30E/360  
Other]  
(See Condition 5 for alternatives)
- (xii) Fall back provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Covered Bonds, if different from those set out in the Conditions: [ ]
17. **Zero Coupon Covered Bond Provisions** [Applicable/Not Applicable]
- (If not applicable, delete the remaining sub paragraphs of this paragraph)*
- (i) Accrual Yield: [ ] per cent. per annum
  - (ii) Reference Price: [ ]
  - (iii) Any other formula/basis of determining amount payable: [ ]
  - (iv) Day Count Fraction in relation to Early Redemption Amounts and late payment: [Conditions 7(d)(iii) and (h) apply/specify other]  
(Consider applicable day count fraction if not U.S. dollar denominated)
18. **Index Linked Interest Covered Bond Provisions** [Applicable/Not Applicable]
- (If not applicable, delete the remaining subparagraphs of this paragraph)*



*(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)*

- (i) Index/Formula: [give or annex details]
- (ii) Calculation Agent: [give name (and, if the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies, address)]
- (iii) Party responsible for calculating the Rate of Interest (if not the Calculation Agent) and Interest Amount (if not the Agent) [ ]
- (iv) Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable: [need to include a description of market disruption or settlement disruption events and adjustment provisions]
- (v) Specified Period(s) / Specified Interest Payment Dates: [ ]
- (vi) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/specify other]
- (vii) Additional Business Centre(s): [ ]
- (viii) Minimum Rate of Interest: [ ] per cent. per annum
- (ix) Maximum Rate of Interest: [ ] per cent. per annum
- (x) Day Count Fraction: [ ]

19. **Dual Currency Interest Covered Bond Provisions** [Applicable/Not Applicable]

*(If not applicable, delete the remaining sub paragraphs of this paragraph)*

*(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)*

- (i) Rate of Exchange/method of calculating Rate of Exchange: [give or annex details]
- (ii) Party, if any, responsible for calculating the principal and/or interest due (if not the Agent): [ ]
- (iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [need to include a description of market disruption or settlement disruption events and adjustment provisions]
- (iv) Person at whose option Specified Currency(ies) is/are payable: [ ]

### PROVISIONS RELATING TO REDEMPTION

20. Issuer Call: [Applicable/Not Applicable]  
*(If not applicable, delete the remaining sub paragraphs of this paragraph)*
- (i) Optional Redemption Date(s): [ ]
  - (ii) Optional Redemption Amount and method, if any, of calculation of such amount(s): [[ ] per Calculation Amount/specify other/see Appendix]
  - (iii) If redeemable in part:
    - (a) Minimum Redemption Amount:
    - (b) Maximum Redemption Amount:
  - (iv) Notice period (if other than as set out in the Conditions): *(N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent or Trustee)*
21. Final Redemption Amount: [Nominal Amount/specify other/see Appendix]  
*(N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply)*

22. Early Redemption Amount payable on redemption for taxation reasons, on acceleration following an HBOS Event of Default as against the Issuer and the HBOS Group Guarantor or an LLP Event of Default: [[ ] per Calculation Amount/ *specify other/* See Appendix]

#### GENERAL PROVISIONS APPLICABLE TO THE COVERED BONDS

23. Form of Covered Bonds:

- (a) [Form:] Bearer Covered Bonds [Temporary Bearer Global Covered Bond exchangeable for a Permanent Bearer Global Covered Bond which is exchangeable for Covered Bonds in definitive form [on 60 days' notice given at any time/only upon an Exchange Event]] [Temporary Bearer Global Covered Bond exchangeable for Bearer Covered Bonds in definitive form on and after the Exchange Date] [Permanent Bearer Global Covered Bond exchangeable for Covered Bonds in definitive form [on 60 days' notice given at any time/only upon an Exchange Event]] Registered Covered Bonds Regulation S Global Covered Bond (U.S.\$[ ] nominal amount) registered in the name of a nominee for [DTC/a common depository for Euroclear and Clearstream, Luxembourg] /Rule 144 A Global Covered Bond (U.S.\$[ ] nominal amount) registered in the name of a nominee for [DTC/a common depository for Euroclear and Clearstream, Luxembourg/Definitive IAI Registered Covered Bond (*specify nominal amount*)

*(Ensure that this is consistent with the wording in the "Form of the Covered Bonds" section in the Offering Circular and the Covered Bonds themselves. [N.B. Need to amend exchange provisions to disapply Covered Bondholder optional exchange where Covered Bonds are expressed to have a minimum denomination of €50,000 and are tradeable in integral multiples of €1,000 thereafter in order for Covered Bonds to be accepted by the clearing systems. Furthermore, such Specified Denomination Construction is not permitted in relation to any issue of Covered Bonds which is to be represented on issue by a Temporary Bearer Global Covered Bond exchangeable for Bearer Covered Bonds in definitive form.]*

- (b) [New Global Covered Bond] [Yes] [No]
24. Additional Financial Centre(s) or other special provisions relating to Payment Dates: [Not Applicable/give details]  
(Note that this item relates to the place of payment and not Interest Period end dates to which items 16(iii) and 18(vii) relate)
25. Talons for future Coupons or Receipts to be attached to Definitive Bearer Covered Bonds (and dates on which such Talons mature): [Yes/No. If yes, give details]
26. Details relating to Partly Paid Covered Bonds: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Covered Bonds and interest due on late payment: [Not Applicable/give details. N.B. a new form of Temporary Global Note and/or Permanent Global Note may be required for Partly Paid issues]
27. Details relating to Instalment Covered Bonds:
- (i) [Instalment Amount(s):] [Not Applicable/give details]
- (ii) [Instalment Date(s):] [Not Applicable/give details]
28. Redenomination applicable: Redenomination [not] applicable  
(If Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating rate interest calculation (including alternative reference rates))
29. Additional U.S. Federal Income Tax Considerations [Not Applicable/give details]
30. Other Final Terms: [Not Applicable/give details]  
(When adding any other final terms consideration should be given as to whether such terms constitute “significant new factors” and consequently trigger the need for a supplement to the Offering Circular under Article 16 of the Prospectus Directive).

## DISTRIBUTION

31. (i) If syndicated, names of Managers [and address where issue of Covered Bonds to which Annex XII applies]: [Not Applicable/give names]  
*(If the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies, include names of entities agreeing to underwrite the issue on a firm commitment basis and names of the entities agreeing to place the issue without a firm commitment or on a "best efforts" basis if such entities are not the same as the Managers.)*
- (ii) Date of Subscription Agreement: [ ]  
*(The above is only relevant if the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies)*
- (iii) Stabilising Manager (if any): [Not Applicable/give name]
32. If non-syndicated, name of relevant Dealer(s): [and address where issue of Covered Bonds to which Annex XII applies]: [Not Applicable/give name]
33. U.S. Selling Restrictions: [Reg S Compliance Category, TEFRA D/TEFRA C/TEFRA not applicable]
34. Additional selling restrictions: [Not Applicable/give details]
35. Additional US tax considerations: [Not Applicable/give details]

## [LISTING AND ADMISSION TO TRADING

These Final Terms comprise the final terms required to list on the official list of the Luxembourg Stock Exchange and for issue and admission to trading on the regulated market of the Luxembourg Stock Exchange of the Covered Bonds described herein pursuant to the €60,000,000,000 Covered Bond Programme of Bank of Scotland plc]

## RESPONSIBILITY

Each of the Issuer, the HBOS Group Guarantor and the LLP accepts responsibility for the information contained in these Final Terms. [[ ] has been extracted from [ ]. The Issuer confirms that such information has been accurately reproduced and that, so far as it is aware and able to ascertain from information published by [ ], no facts have been omitted which would render the reproduced information inaccurate or misleading.]

Signed on behalf of the Issuer:

Signed on behalf of HBOS plc:

By:.....  
*Duly authorised*

By:.....  
*Duly authorised*

Signed on behalf of HBOS Covered Bonds LLP:

By: .....  
Duly authorised

## PART B – OTHER INFORMATION

### 1. LISTING AND ADMISSION TO TRADING

- (i) Listing and Admission to trading: [Application has been made by the Issuer (or on its behalf) for the Covered Bonds to be listed on the Official List of the Luxembourg Stock Exchange and admitted to trading on the Luxembourg Stock Exchange's regulated market with effect from [ ]]. Application is expected to be made by the Issuer (or on its behalf) for the Covered Bonds to be listed on the Official List of the Luxembourg Stock Exchange and admitted to trading on the Luxembourg Stock Exchange's regulated market with effect from [ ].] [Not Applicable.]

*(Where documenting a fungible issue, indicate that original Covered Bonds are already admitted to trading)*

- (ii) Estimate of total expenses related to admission to trading: [ ]

### 2. RATINGS

Ratings: The Covered Bonds to be issued have been rated:

[S & P: [ ]]  
[Moody s: [ ]]  
[[Other]: [ ]]

*(The above disclosure should reflect the rating allocated to Covered Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)*

### 3. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUE

[Save for any fees payable to the Dealers, so far as the Issuer is aware, no person involved in the issue of the Covered Bonds has an interest material to the offer. – Amend as appropriate if there are other interests]

### 4. REASONS FOR THE OFFER ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

- (i) [Reasons for the offer:] [ ]
- (ii) [Estimated net proceeds:] [ ]
- (iii) [Estimated total expenses:] [ ]

*(N.B.: Delete unless the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies in which case (i) above is required where the reasons for the offer are different from making profit and/or hedging certain risks and where such reasons are inserted in (i) disclosure of net proceeds and total expenses at (ii) and (iii) above are also required.)*

**5. YIELD (Fixed Rate Covered Bonds only)**

Indication of yield: [     ]

The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

**6. PERFORMANCE OF INDEX/FORMULA EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING (Index-Linked Covered Bonds only)**

*[Need to include details of where information about the past and future performance and volatility of the index/formula can be obtained.]*

*[Need to include a description of any market disruption or settlement disruption events that affect the underlying.]*

*[Need to include adjustment rules in relation to events covering the underlying.]*

*[Where the underlying is a security the name of the issuer of the security and its ISIN or other such security identification code.]*

*[Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained. Where the underlying is not an index need to include equivalent information.]*

*[Where the underlying is an interest rate a description of the interest rate.]*

*[Where the underlying is a basket of underlyings disclosure of the relevant weightings of each underlying in the basket.]*

**7. PERFORMANCE OF RATE[S] OF EXCHANGE (Dual Currency Covered Bonds only)**

*[Need to include details of where information about the past and future performance and volatility of the relevant rates can be obtained.]*

*[(When completing this paragraph, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Offering Circular under Article 16 of the Prospectus Directive.)]*

*(N.B. This paragraph 7 only applies if the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies.)*



## 8. OPERATIONAL INFORMATION

- (i) ISIN Code: [ ]
- (ii) Common Code: [ ]  
(insert here any other relevant codes such CUSIP and CINS codes)
- (iii) Any clearing system(s) other than Euroclear Bank S.A./N.V. and Clearstream Banking société anonyme and DTC and the relevant identification number(s): [Not Applicable/give name(s) and number(s)]
- (iv) Delivery: Delivery [against/free of] payment
- (v) Names and addresses of additional Paying Agent(s) (if any): [ ]
- (vi) [Intended to be held in a manner which would allow Eurosystem eligibility: [Yes] [No]

[Note that the designation “yes” simply means that the Covered Bonds are intended upon issue to be deposited with one of the ICSDs as common safekeeper and does not necessarily mean that the Covered Bonds will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.] *[include this text if “yes” selected in which case the Covered Bonds must be issued in NGCB form]*

## TERMS AND CONDITIONS OF THE COVERED BONDS

*The following are the Terms and Conditions of the Covered Bonds which will be incorporated by reference into each Global Covered Bond (as defined below) and each definitive Covered Bond, in the latter case only if permitted by the relevant stock exchange or other relevant authority (if any) and agreed by the Issuer and the relevant Dealer(s) at the time of issue but, if not so permitted and agreed, such definitive Covered Bond will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Final Terms in relation to any Tranche of Covered Bonds may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Covered Bonds. The applicable Final Terms (or the relevant provisions thereof) will be endorsed upon, or attached to, each Global Covered Bond and definitive Covered Bond. Reference should be made to “Form of the Notes” for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Covered Bonds.*

This Covered Bond is one of a Series (as defined below) of Covered Bonds issued by Bank of Scotland plc (the “**Issuer**”) constituted by a trust deed (such trust deed as modified and/or supplemented and/or restated from time to time, the “**Trust Deed**”) dated 18 July 2003 (the “**Programme Date**”) made between the Issuer, HBOS plc as guarantor (“**HBOS**” or “**HBOS Group Guarantor**”), HBOS Covered Bonds LLP as guarantor (the “**LLP**” and, together with the HBOS Group Guarantor, the “**Guarantors**” and each a “**Guarantor**”, which expression shall include any additional or successor guarantor) and Citicorp Trustee Company Limited as bond trustee (in such capacity, the “**Bond Trustee**”, which expression shall include any successor as Bond Trustee) and as security trustee (in such capacity, the “**Security Trustee**”, which expression shall include any successor as Security Trustee).

Save as provided for in Conditions 10 and 15 references herein to the Covered Bonds shall be references to the Covered Bonds of this Series and shall mean:

- (i) in relation to any Covered Bonds represented by a global bond (a “**Global Covered Bond**”), units of the lowest Specified Denomination in the Specified Currency;
- (ii) any Global Covered Bond;
- (iii) any definitive Covered Bonds in bearer form (Bearer Covered Bonds) issued in exchange for a Global Covered Bond; and
- (iv) any definitive Covered Bonds in registered form (Registered Covered Bonds) (whether or not issued in exchange for a Global Covered Bond in registered form).

The Covered Bonds, the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an agency agreement (such agency agreement as amended and/or supplemented and/or restated from time to time, the “**Agency Agreement**”) dated the Programme Date and made between the Issuer, the HBOS Group Guarantor, the LLP, the Bond Trustee, Citibank, N.A., London Branch, as issuing and principal paying agent and agent bank (the “**Agent**”, which expression shall include any successor agent) and the other paying agents named therein (together with the Agent, the “**Paying Agents**”, which expression shall include any additional or successor paying agents), Citibank, N.A., London Branch as exchange agent (the “**Exchange Agent**”, which expression shall include any successor exchange agent) and as bond registrar (the “**Bond Registrar**”, which expression shall include any successor registrar) and a transfer agent and the other transfer agents named therein (together with the Bond Registrar, the “**Transfer Agents**”, which expression shall include any additional or successor transfer agents).

Interest bearing definitive Bearer Covered Bonds have (unless otherwise indicated in the applicable Final Terms) interest coupons (“**Coupons**”) and, if indicated in the applicable Final Terms, talons for further Coupons (“**Talons**”) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Bearer Covered Bonds repayable in instalments have receipts (“**Receipts**”) for the payment of the instalments of principal (other than the final instalment) attached on issue. Registered Covered Bonds and Global Covered Bonds do not have Receipts, Coupons or Talons attached on issue.

The “**Final Terms**” for this Covered Bond (or the relevant provisions thereof) are set out in Part A of the Final Terms attached to or endorsed on this Covered Bond and supplement these Terms and Conditions (the “**Conditions**”) and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the Conditions, replace or modify the Conditions for the purposes of this Covered Bond. References to the applicable Final Terms are to Part A of the Final Terms (or the relevant provisions thereof) attached to or endorsed on this Covered Bond.

The Bond Trustee acts for the benefit of the holders for the time being of the Covered Bonds (the “**Covered Bondholders**”, which expression shall, in relation to any Covered Bonds represented by a Global Covered Bond, be construed as provided below), the holders of the Receipts (the “**Receiptholders**”) and the holders of the Coupons (the “**Couponholders**”, which expression shall, unless the context otherwise requires, include the holders of the Talons), and for holders of each other Series of Covered Bonds in accordance with the provisions of the Trust Deed.

As used herein, “**Tranche**” means Covered Bonds which are identical in all respects (including as to listing and admission to trading) and “**Series**” means a Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

The HBOS Group Guarantor has, in the Trust Deed, unconditionally guaranteed the due and punctual payment of principal and interest and other amounts due by the Issuer under or in respect of the Covered Bonds and the Trust Deed as and when the same shall become due and payable (including accelerated amounts).

The LLP has, in the Trust Deed, irrevocably and unconditionally guaranteed (on a several basis as between the HBOS Group Guarantor and itself) the due and punctual payment of Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment, but only after service of a Notice to Pay on the LLP following an HBOS Event of Default and service by the Bond Trustee of an HBOS Acceleration Notice on the Issuer and HBOS Group Guarantor.

The security for the obligations of the LLP under the Covered Bond Guarantee and the other Transaction Documents to which it is a party, has been created in and pursuant to, and on the terms set out in, a deed of charge (such deed of charge as amended and/or supplemented and/or restated from time to time, the “**Deed of Charge**”) dated the Programme Date and made between the LLP, Citicorp Trustee Company Limited as Bond Trustee and Security Trustee and certain other Secured Creditors.

These Conditions include summaries of, and are subject to, the provisions of the Trust Deed, the Deed of Charge and the Agency Agreement.

Copies of the Trust Deed, the Deed of Charge, the Master Definitions and Construction Agreement (as defined below), the Agency Agreement, the Deed Poll and each of the other Transaction Documents are available for inspection during normal business hours at the registered office for the time being of the Bond Trustee being at Citigroup Centre, Canada Square, Canary

Wharf, London E14 5LB and at the specified office of each of the Paying Agents. Copies of the applicable Final Terms for all Covered Bonds of each Series (including in relation to Covered Bonds of any Series which are unlisted or not admitted to trading) are obtainable during normal business hours at the specified office of each of the Paying Agents and any Covered Bondholder must produce evidence satisfactory to the Issuer and the Bond Trustee or, as the case may be, the relevant Paying Agent as to its holding of Covered Bonds and identity. The Covered Bondholders, the Receiptholders and the Couponholders are deemed to have notice of, are bound by, and are entitled to the benefit of, all the provisions of, and definitions contained in, the Trust Deed, the Deed of Charge, the Master Definitions and Construction Agreement, the Agency Agreement, the Deed Poll, each of the other Transaction Documents and the applicable Final Terms which are applicable to them and to have notice of each Final Terms relating to each other Series.

Except where the context otherwise requires, capitalised terms used and not otherwise defined in these Conditions shall bear the meanings given to them in the applicable Final Terms and/or the master definitions and construction agreement made between the parties to the Transaction Documents on or about the Programme Date (such master definitions and construction agreement as amended and/or supplemented and/or restated from time to time, the “**Master Definitions and Construction Agreement**”), a copy of each of which may be obtained as described above.

## **1. FORM, DENOMINATION AND TITLE**

The Covered Bonds are in bearer form or in registered form as specified in the applicable Final Terms and, in the case of definitive Covered Bonds, serially numbered, in the Specified Currency and the Specified Denomination(s). Covered Bonds of one Specified Denomination may not be exchanged for Covered Bonds of another Specified Denomination and Bearer Covered Bonds may not be exchanged for Registered Covered Bonds and vice versa.

This Covered Bond may be a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond, an Index Linked Interest Covered Bond, a Dual Currency Interest Covered Bond or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms.

This Covered Bond may be an Index Linked Redemption Covered Bond, an Instalment Covered Bond, a Dual Currency Redemption Covered Bond or a combination of any of the foregoing, depending upon the Redemption/Payment Basis shown in the applicable Final Terms.

Definitive Bearer Covered Bonds are issued with Coupons attached, unless they are Zero Coupon Covered Bonds in which case references to Coupons and Couponholders in these Conditions are not applicable.

Subject as set out below, title to the Bearer Covered Bonds, Receipts and Coupons will pass by delivery and title to the Registered Covered Bonds will pass upon registration of transfers in accordance with the provisions of the Agency Agreement. The Issuer, the HBOS Group Guarantor, the LLP, the Paying Agents, the Security Trustee and the Bond Trustee may (except as otherwise required by law) deem and treat the bearer of any Bearer Covered Bond, Receipt or Coupon and the registered holder of any Registered Covered Bond as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for all purposes but, in the case of any Global Covered Bond, without prejudice to the provisions set out in the next succeeding paragraph.

For so long as any of the Covered Bonds are represented by a Global Covered Bond held on behalf of Euroclear Bank S.A./N.V. (“**Euroclear**”) and/or Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”), each person (other than Euroclear or Clearstream, Luxembourg)

who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Covered Bonds (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Covered Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer, the HBOS Group Guarantor, the LLP, the Paying Agents, the Security Trustee and the Bond Trustee as the holder of such nominal amount of such Covered Bonds for all purposes other than with respect to the payment of principal or interest or other amounts on such nominal amount of such Covered Bonds, for which purpose the bearer of the relevant Bearer Global Covered Bond or the registered holder of the relevant Registered Global Covered Bond shall be treated by the Issuer, the HBOS Group Guarantor, the LLP, any Paying Agent, the Security Trustee and the Bond Trustee as the holder of such nominal amount of such Covered Bonds in accordance with and subject to the terms of the relevant Global Covered Bond and the expressions “**Covered Bondholder**” and “**holder of Covered Bonds**” and related expressions shall be construed accordingly. In determining whether a particular person is entitled to a particular nominal amount of Covered Bonds as aforesaid, the Bond Trustee may rely on such evidence and/or information and/or certification as it shall, in its absolute discretion, think fit and, if it does so rely, such evidence and/or information and/or certification shall, in the absence of manifest error or an error established as such to the satisfaction of the Bond Trustee, be conclusive and binding on all concerned.

For so long as the Depository Trust Company (“**DTC**”) or its nominee is the registered owner or holder of a Registered Global Covered Bond, DTC or such nominee, as the case may be, will be considered the sole owner or holder of the Covered Bonds represented by such Registered Global Covered Bond for all purposes under the Agency Agreement and the Covered Bonds except to the extent that in accordance with DTC’s published rules and procedures any ownership rights may be exercised by its participants or beneficial owners through participants.

Covered Bonds which are represented by a Global Covered Bond will be transferable only in accordance with the rules and procedures for the time being of DTC, Euroclear and Clearstream, Luxembourg, as the case may be.

References to DTC, Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms or as may otherwise be approved by the Issuer, the Agent and the Bond Trustee.

## **2. TRANSFERS OF REGISTERED COVERED BONDS**

### **(a) *Transfers of interests in Registered Global Covered Bonds***

Transfers of beneficial interests in Registered Global Covered Bonds will be effected by DTC, Euroclear or Clearstream, Luxembourg, as the case may be, and, in turn, by other participants and, if appropriate, indirect participants in such clearing systems acting on behalf of beneficial transferors and transferees of such interests. A beneficial interest in a Registered Global Covered Bond will, subject to compliance with all applicable legal and regulatory restrictions, be transferable for Registered Covered Bonds in definitive form or for a beneficial interest in another Registered Global Covered Bond only in the authorised denominations set out in the applicable Final Terms and only in accordance with the rules and operating procedures for the time being of DTC, Euroclear or Clearstream, Luxembourg, as the case may be, and in accordance with the terms and conditions specified in the Agency Agreement. Transfers of a Registered Global Covered Bond registered in the name of a nominee for DTC shall be limited to transfers of such Registered Global Covered Bond, in

whole but not in part, to another nominee of DTC or to a successor of DTC or such successor's nominee.

(b) *Transfers of Registered Covered Bonds in definitive form*

Subject as provided in paragraphs (e), (f) and (g) below, upon the terms and subject to the conditions set forth in the Agency Agreement, a Registered Covered Bond in definitive form may be transferred in whole or in part (in the authorised denominations set out in the applicable Final Terms). In order to effect any such transfer (i) the holder or holders must (A) surrender the Registered Covered Bond for registration of the transfer of the Registered Covered Bond (or the relevant part of the Registered Covered Bond) at the specified office of the Bond Registrar or any Transfer Agent, with the form of transfer thereon duly executed by the holder or holders thereof or his or their attorney or attorneys duly authorised in writing and (B) complete and deposit such other certifications as may be required by the Bond Registrar or, as the case may be, the relevant Transfer Agent and (ii) the Bond Registrar or, as the case may be, the relevant Transfer Agent must, after due and careful enquiry, be satisfied with the documents of title and the identity of the person making the request. Any such transfer will be subject to such reasonable regulations as the Issuer and the Bond Registrar may from time to time prescribe (the initial such regulations being set out in Schedule 6 to the Agency Agreement). Subject as provided above, the Bond Registrar or, as the case may be, the relevant Transfer Agent will, within three business days (being for this purpose a day on which banks are open for business in the city where the specified office of the Bond Registrar or, as the case may be, the relevant Transfer Agent is located) of the request (or such longer period as may be required to comply with any applicable fiscal or other laws or regulations), authenticate and deliver, or procure the authentication and delivery of, at its specified office to the transferee or (at the risk of the transferee) send by uninsured mail, to such address as the transferee may request, a new Registered Covered Bond in definitive form of a like aggregate nominal amount to the Registered Covered Bond (or the relevant part of the Registered Covered Bond) transferred. In the case of the transfer of part only of a Registered Covered Bond in definitive form, a new Registered Covered Bond in definitive form in respect of the balance of the Registered Covered Bond not transferred will be so authenticated and delivered or (at the risk of the transferor) sent to the transferor.

(c) *Registration of transfer upon partial redemption*

In the event of a partial redemption of Covered Bonds under Condition 7, the Issuer shall not be required to register the transfer of any Registered Covered Bond, or part of a Registered Covered Bond, called for partial redemption.

(d) *Costs of registration*

Covered Bondholders will not be required to bear the costs and expenses of effecting any registration of transfer as provided above, except for any costs or expenses of delivery other than by regular uninsured mail and except that the Issuer may require the payment of a sum sufficient to cover any stamp duty, tax or other governmental charge that may be imposed in relation to the registration.

(e) *Transfers of interests in Regulation S Global Covered Bonds*

Prior to expiry of the applicable Distribution Compliance Period, transfers by the holder of, or of a beneficial interest in, a Regulation S Global Covered Bond to a transferee in the United States or who is a U.S. person will only be made:

- (i) upon receipt by the Bond Registrar of a written certification substantially in the form set out in the Agency Agreement, amended as appropriate (a “**Transfer Certificate**”), copies of which are available from the specified office of the Bond Registrar or any Transfer Agent, from the transferor of the Covered Bond or beneficial interest therein to the effect that such transfer is being made:
  - (A) to a person whom the transferor reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A; or
  - (B) to a person who is an Institutional Accredited Investor, together with, in the case of (B), a duly executed investment letter from the relevant transferee substantially in the form set out in the Agency Agreement (an “**IAI Investment Letter**”); or
- (ii) otherwise pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States,

and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

In the case of (A) above, such transferee may take delivery through a Legended Covered Bond in global or definitive form and, in the case of (B) above, such transferee may take delivery only through a Legended Covered Bond in definitive form. After expiry of the applicable Distribution Compliance Period (i) beneficial interests in Regulation S Global Covered Bonds registered in the name of a nominee for DTC may be held through DTC directly, by a participant in DTC, or indirectly through a participant in DTC and (ii) such certification requirements will no longer apply to such transfers.

*(f) Transfers of interests in Legended Covered Bonds*

Transfers of Legended Covered Bonds or beneficial interests therein may be made:

- (i) to a transferee who takes delivery of such interest through a Regulation S Global Covered Bond, upon receipt by the Bond Registrar of a duly completed Transfer Certificate from the transferor to the effect that such transfer is being made in accordance with Regulation S and that in the case of a Regulation S Global Covered Bond registered in the name of a nominee for DTC, if such transfer is being made prior to expiry of the applicable Distribution Compliance Period, the interests in the Covered Bonds being transferred will be held immediately thereafter through Euroclear and/or Clearstream, Luxembourg; or
- (ii) to a transferee who takes delivery of such interest through a Legended Covered Bond:
  - (A) where the transferee is a person whom the transferor reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, without certification; or
  - (B) where the transferee is an Institutional Accredited Investor, subject to delivery to the Bond Registrar of a Transfer Certificate from the transferor to the effect that such transfer is being made to an Institutional Accredited Investor, together with a duly executed IAI Investment Letter from the relevant transferee; or

- (iii) otherwise pursuant to the Securities Act or an exemption therefrom, subject to receipt by the Issuer of such satisfactory evidence as the Issuer may reasonably require, which may include an opinion of U.S. counsel, that such transfer is in compliance with any applicable securities laws of any State of the United States,

and, in each case, in accordance with any applicable securities laws of any State of the United States or any other jurisdiction.

Covered Bonds transferred by Institutional Accredited Investors to QIBs pursuant to Rule 144A or outside the United States pursuant to Regulation S will be eligible to be held by such QIBs or non-U.S. investors through DTC, Euroclear or Clearstream, Luxembourg, as appropriate, and the Bond Registrar will arrange for any Covered Bonds which are the subject of such a transfer to be represented by the appropriate Registered Global Covered Bond, where applicable.

Upon the transfer, exchange or replacement of Legended Covered Bonds, or upon specific request for removal of the Legend, the Bond Registrar shall deliver only Legended Covered Bonds or refuse to remove the Legend, as the case may be, unless there is delivered to the Issuer such satisfactory evidence as may reasonably be required by the Issuer, which may include an opinion of U.S. counsel, that neither the Legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

(g) *Definitions*

In this Condition, the following expressions shall have the following meanings:

“**Distribution Compliance Period**” has the meaning given to it in Regulation S;

“**Institutional Accredited Investor**” means an “**accredited investor**” (as defined in Rule 501(a)(1), (2), (3) or (7) of Regulation D under the Securities Act) that is an institution;

“**Legended Covered Bonds**” means Registered Covered Bonds in definitive form that are issued to Institutional Accredited Investors and Registered Covered Bonds (whether in definitive form or represented by a Registered Global Covered Bond) sold in private transactions to QIBs in accordance with the requirements of Rule 144A;

“**QIB**” means a qualified institutional buyer within the meaning of Rule 144A;

“**Regulation S**” means Regulation S under the Securities Act;

“**Regulation S Global Covered Bond**” means a Registered Global Covered Bond representing Covered Bonds sold outside the United States in reliance on Regulation S;

“**Rule 144A**” means Rule 144A under the Securities Act;

“**Rule 144A Global Covered Bond**” means a Registered Global Covered Bond representing Covered Bonds sold in the United States to QIBs in reliance on Rule 144A; and

“**Securities Act**” means the United States Securities Act of 1933, as amended.



### 3. STATUS OF THE COVERED BONDS AND THE GUARANTEES

#### (a) Status of the Covered Bonds

The Covered Bonds and any relative Receipts and Coupons constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and rank *pari passu* without any preference among themselves and at least *pari passu* with all other unsecured and unsubordinated obligations of the Issuer, present and future, other than any obligations preferred by mandatory provisions of applicable law.

#### (b) Status of the HBOS Group Guarantee

The payment of principal and interest in respect of the Covered Bonds and all other moneys (including default interest) payable by the Issuer under or pursuant to the Trust Deed has been unconditionally guaranteed by the HBOS Group Guarantor (the “**HBOS Group Guarantee**”) in the Trust Deed. The obligations of the HBOS Group Guarantor under the HBOS Group Guarantee are direct, unconditional (subject to a written demand by the Bond Trustee on the HBOS Group Guarantor for payment under the HBOS Group Guarantee), unsubordinated and unsecured obligations of the HBOS Group Guarantor and claims under the HBOS Group Guarantee rank at least *pari passu* with all other unsecured and unsubordinated obligations of the HBOS Group Guarantor, present and future, other than any obligations preferred by mandatory provisions of applicable law.

#### (c) Status of the Covered Bond Guarantee

The payment of Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment has been unconditionally and irrevocably guaranteed (on a several basis as between the HBOS Group Guarantor on the one hand and the LLP on the other) by the LLP (the “**Covered Bond Guarantee**”) in the Trust Deed. However, the LLP shall have no obligation under the Covered Bond Guarantee to pay any Guaranteed Amount when the same shall become Due for Payment under the Covered Bonds or the Trust Deed until the occurrence of an HBOS Event of Default, service by the Bond Trustee on the Issuer and HBOS Group Guarantor of an HBOS Acceleration Notice and service by the Bond Trustee on the LLP of a Notice to Pay. The obligations of the LLP under the Covered Bond Guarantee are direct, (following an HBOS Event of Default, service of an HBOS Acceleration Notice and service of a Notice to Pay) unconditional and unsubordinated obligations of the LLP, which are secured as provided in the Deed of Charge.

As security for the LLP’s obligations under the Covered Bond Guarantee and the other Transaction Documents (as defined in the Master Definitions and Construction Agreement) to which it is a party, the LLP has granted fixed and floating security over all of its assets under the Deed of Charge in favour of the Security Trustee (for itself and on behalf of the other Secured Creditors).

### 4. REDENOMINATION

#### (a) Redenomination

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Covered Bondholders, the Receiptholders and the Couponholders, on giving prior written notice to the Bond Trustee, the Security Trustee, the Agent, (in the case of Registered Covered Bonds) the Bond Registrar Euroclear and Clearstream, Luxembourg and at least 30 days’ prior notice to the Covered Bondholders in accordance with Condition 14, elect that, with effect from the Redenomination Date specified

in the notice, the Covered Bonds shall be redenominated in euro. In relation to any Covered Bonds where the applicable Final Terms provide for a minimum Specified Denomination in the Specified Currency which is equivalent to at least euro 50,000 and which are admitted to trading on a regulated market in the European Economic Area, it shall be a term of any such article that the holder of any Covered Bonds held through Euroclear and/or Clearstream, Luxembourg and/or DTC must have credited to its securities account with the relevant clearing system a minimum balance of Covered Bonds of at least euro 50,000.

The election will have effect as follows:

- (i) the Covered Bonds and the Receipts shall be deemed to be redenominated in euro in the denomination of euro 0.01 with a nominal amount for each Covered Bond and Receipt equal to the nominal amount of that Covered Bond or Receipt in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, in consultation with the Agent and the Bond Trustee, that the then market practice in respect of the redenomination in euro of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Covered Bondholders, the competent listing authority, stock exchange, and/or market (if any) on or by which the Covered Bonds may be listed and/or admitted to trading and the Paying Agents of such deemed amendments;
- (ii) save to the extent that an Exchange Notice has been given in accordance with paragraph (v) below, the amount of interest due in respect of the Covered Bonds will be calculated by reference to the aggregate nominal amount of Covered Bonds presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01;
- (iii) if definitive Covered Bonds are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations of euro 50,000 and/or such higher amounts as the Agent may determine and notify to the Covered Bondholders and any remaining amounts less than euro 50,000 shall be redeemed by the Issuer and paid to the Covered Bondholders in euro in accordance with Condition 6;
- (iv) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Covered Bonds) will become void with effect from the date on which the Issuer gives notice (the “**Exchange Notice**”) that replacement euro-denominated Covered Bonds, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Covered Bonds, Receipts and Coupons so issued will also become void on that date although those Covered Bonds, Receipts and Coupons will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Covered Bonds, Receipts and Coupons will be issued in exchange for Covered Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Agent may specify and as shall be notified to the Covered Bondholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Covered Bonds;
- (v) after the Redenomination Date, all payments in respect of the Covered Bonds, the Receipts and the Coupons, other than payments of interest in respect of periods

commencing before the Redenomination Date, will be made solely in euro as though references in the Covered Bonds to the Specified Currency were to euro. Payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque;

- (vi) if the Covered Bonds are Fixed Rate Covered Bonds and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest subunit of the relevant Specified Currency, half of any such subunit being rounded upwards or otherwise in accordance with applicable market convention;
- (vii) if the Covered Bonds are Floating Rate Covered Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest; and
- (viii) such other changes shall be made to this Condition (and the Transaction Documents) as the Issuer may decide, after consultation with the Agent and the Bond Trustee, and as may be specified in the notice, to conform it to conventions then applicable to instruments denominated in euro.

(b) *Definitions*

In these Conditions, the following expressions have the following meanings:

“**Established Rate**” means the rate for the conversion of the relevant Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Union regulations) into euro established by the Council of the European Union pursuant to Article 123 of the Treaty.

“**euro**” means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty.

“**Redenomination Date**” means (in the case of interest bearing Covered Bonds) any date for payment of interest under the Covered Bonds or (in the case of Zero Coupon Covered Bonds) any date, in each case specified by the Issuer in the notice given to the Covered Bondholders pursuant to paragraph (a) above and which falls on or after the date on which the country of the relevant Specified Currency first participates in the third stage of European economic and monetary union.

“**Treaty**” means the Treaty on the Functioning of the European Union, as amended.

## 5. INTEREST

(a) *Interest on Fixed Rate Covered Bonds*

Each Fixed Rate Covered Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Final Maturity Date.

Except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such

date will amount to the Fixed Coupon Amount. Payments of interest on any Interest Payment Date will, if so specified in the applicable Final Terms, amount to the Broken Amount so specified.

As used in the Conditions, “**Fixed Interest Period**” means the period from (and including) an Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If interest is required to be calculated for a period other than a Fixed Interest Period or if no Fixed Coupon Amount is specified in the Final Terms, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 5(a):

- (i) if “Actual/Actual (ICMA)” is specified in the applicable Final Terms:
  - (A) in the case of Covered Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the “**Accrual Period**”) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or
  - (B) in the case of Covered Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:
    - (1) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
    - (2) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
- (ii) if “30/360” is specified in the applicable Final Terms, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360.

In these Conditions:

“**Determination Period**” means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest

Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date); and

“**Principal Amount Outstanding**” means in respect of a Covered Bond the principal amount of that Covered Bond on the relevant Issue Date thereof less principal amounts received by the relevant Covered Bondholder in respect thereof.

“**sub-unit**” means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, one cent.

(b) *Interest on Floating Rate Covered Bonds and Index Linked Interest Covered Bonds*

(i) *Interest Payment Dates*

Each Floating Rate Covered Bond and Index Linked Interest Covered Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

- (A) the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or
- (B) if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an Interest Payment Date) which falls the number of months or other period specified as the Specified Period in the applicable Final Terms after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period. In these Conditions, the expression “**Interest Period**” shall mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

- (1) in any case where Specified Periods are specified in accordance with Condition 5(b)(i)(B) above, the “**Floating Rate Convention**”, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (B) above shall apply mutatis mutandis or (ii) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (A) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (B) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or

- (2) the “**Following Business Day Convention**”, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (3) the “**Modified Following Business Day Convention**”, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (4) the “**Preceding Business Day Convention**”, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In the Conditions, “**Business Day**” means a day which is both:

- (C) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and each Additional Business Centre specified in the applicable Final Terms; and
- (D) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than London and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET2) System (the “**TARGET2 System**”) is open.

(ii) *Rate of Interest*

The Rate of Interest payable from time to time in respect of Floating Rate Covered Bonds and Index Linked Interest Covered Bonds will be determined in the manner specified in the applicable Final Terms.

(A) *ISDA Determination for Floating Rate Covered Bonds*

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this sub-paragraph (A), “**ISDA Rate**” for an Interest Period means a rate equal to the Floating Rate that would be determined by the Agent under an interest rate swap transaction if the Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Covered Bonds (the “**ISDA Definitions**”) and under which:

- (1) the Floating Rate Option is as specified in the applicable Final Terms;

- (2) the Designated Maturity is a period as specified in the applicable Final Terms; and
- (3) the relevant Reset Date is either (i) if the applicable Floating Rate Option is based on the London inter-bank offered rate (“**LIBOR**”) or on the Euro-zone inter-bank offered rate (“**EURIBOR**”), the first day of that Interest Period or (ii) in any other case, as specified in the applicable Final Terms.

For the purposes of this sub-paragraph (A), “**Floating Rate**”, “**Calculation Agent**”, “**Floating Rate Option**”, “**Designated Maturity**” and “**Reset Date**” have the meanings given to those terms in the ISDA Definitions.

(B) *Screen Rate Determination for Floating Rate Covered Bonds*

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (1) the offered quotation; or
- (2) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

The Agency Agreement contains provisions for determining the Rate of Interest in the event that the Relevant Screen Page is not available or if, in the case of (1) above, no such offered quotation appears or, in the case of (2) above, fewer than three such offered quotations appear, in each case as at the time specified in the preceding paragraph.

If the Reference Rate from time to time in respect of Floating Rate Covered Bonds is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Covered Bonds will be determined as provided in the applicable Final Terms.

(iii) *Minimum Rate of Interest and/or Maximum Rate of Interest*

If the applicable Final Terms specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

(iv) *Determination of Rate of Interest and calculation of Interest Amounts*

The Agent, in the case of Floating Rate Covered Bonds, and the Calculation Agent, in the case of Index Linked Interest Covered Bonds, will at or as soon as practicable after each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period. In the case of Index Linked Interest Covered Bonds, the Calculation Agent will notify the Agent of the Rate of Interest for the relevant Interest Period as soon as practicable after calculating the same.

The Agent will calculate the amount of interest (the “**Interest Amount**”) payable on the Floating Rate Covered Bonds or Index Linked Interest Covered Bonds in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest subunit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 5(b):

- (i) if “Actual/Actual (ISDA)” or “Actual/Actual” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (ii) if “Actual/365 (Fixed)” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;
- (iii) if “Actual/365 (Sterling)” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;
- (iv) if “Actual/360” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;
- (v) if “30/360”, “360/360” or “Bond Basis” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360), calculated on a formula basis as follows:



$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y<sub>1</sub>” is the year, expressed as a number, in which the first day of the Interest Period falls;

“Y<sub>2</sub>” is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

“M<sub>1</sub>” is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

“M<sub>2</sub>” is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

“D<sub>1</sub>” is the first calendar day, expressed as a number, of the Interest Period, unless such number is 31, in which case D<sub>1</sub> will be 30; and

“D<sub>2</sub>” is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31 and D<sub>1</sub> is greater than 29, in which case D<sub>2</sub> will be 30;

- (vi) if “30E/360” or “Eurobond Basis” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y<sub>1</sub>” is the year, expressed as a number, in which the first day of the Interest Period falls;

“Y<sub>2</sub>” is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

“M<sub>1</sub>” is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

“M<sub>2</sub>” is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

“D<sub>1</sub>” is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case D<sub>1</sub> will be 30;

“D<sub>2</sub>” is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31, in which case D<sub>2</sub> will be 30; and

- (vii) if “30E/360 (ISDA)” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows:

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y<sub>1</sub>” is the year, expressed as a number, in which the first day of the Interest Period falls;

“Y<sub>2</sub>” is the year, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

“M<sub>1</sub>” is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

“M<sub>2</sub>” is the calendar month, expressed as a number, in which the day immediately following the last day of the Interest Period falls;

“D<sub>1</sub>” is the first calendar day, expressed as a number, of the Interest Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D<sub>1</sub> will be 30; and

“D<sub>2</sub>” is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless (i) that day is the last day of February but not the Maturity Date or (ii) such number would be 31, in which case D<sub>2</sub> will be 30.

(v) *Notification of Rate of Interest and Interest Amounts*

The Agent will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Issuer, the Bond Trustee and any competent listing authority, stock exchange and/or market on or by which the relevant Floating Rate Covered Bonds or Index Linked Interest Covered Bonds are for the time being listed (by no later than the first day of each Interest Period) and notice thereof to be published in accordance with Condition 14 as soon as possible after their determination but in no event later than the fourth London Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to each competent listing authority, stock exchange and/or market on or by which the relevant Floating Rate Covered Bonds or Index Linked Interest Covered Bonds are for the time being listed, and/or admitted to trading and to the Covered Bondholders in accordance with Condition 14. For the purposes of this paragraph, the expression “**London Business Day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(vi) *Determination or Calculation by Bond Trustee*

If for any reason at any relevant time the Agent or, as the case may be, the Calculation Agent defaults in its obligation to determine the Rate of Interest or the Agent defaults in its obligation to calculate any Interest Amount in accordance with sub-paragraph (ii)(A) or (B) above or as otherwise specified in the applicable Final Terms, as the case may be, and in each case in accordance with paragraph (iv) above, the Bond Trustee shall determine the Rate of Interest at such rate as, in its absolute discretion (having such regard as it shall think fit to the foregoing provisions of this Condition, but subject always to any Minimum Rate of Interest or Maximum Rate of Interest specified in the applicable Final Terms), it shall deem fair and reasonable in all the circumstances or, as the case may be, the Bond Trustee shall calculate the Interest Amount(s) in such manner as it shall deem fair and reasonable in all the circumstances and each such determination or calculation shall be deemed to have been made by the Agent or the Calculation Agent, as applicable.

(vii) *Certificates to be final*

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 5(b), whether by the Agent or, if applicable, the Calculation Agent, or the Bond Trustee shall (in the absence of wilful default, bad faith or manifest error or an error established as such to the satisfaction of the Bond Trustee) be binding on the Issuer, the HBOS Group Guarantor, the LLP, the Agent, the Calculation Agent (if applicable), the other Paying Agents, the Bond Trustee and all Covered Bondholders, Receiptholders and Couponholders and (in the absence of wilful default or bad faith) no liability to the Issuer, the HBOS Group Guarantor, the LLP, the Covered Bondholders, the Receiptholders or the Couponholders shall attach to the Agent or (if applicable) the Calculation Agent or the Bond Trustee in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(c) *Interest on Dual Currency Interest Covered Bonds*

The rate or amount of interest payable in respect of Dual Currency Interest Covered Bonds shall be determined in the manner specified in the applicable Final Terms.

(d) *Accrual of interest*

Each Covered Bond (or in the case of the redemption of part only of a Covered Bond, that part only of such Covered Bond) will cease to bear interest (if any) from the date for its redemption unless, upon due presentation thereof, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue as provided in the Trust Deed.

## **6. PAYMENTS**

(a) *Method of payment*

Subject as provided below:

- (i) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency maintained by the payee with, or, at the option of the payee, by a cheque in such Specified Currency drawn on, a bank in the principal financial centre of the country of such Specified Currency (which, if the

Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively); and

- (ii) payments in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque.

In the case of Bearer Covered Bonds, payments in U.S. Dollars will be made by transfer to a U.S. Dollar account maintained by the payee with a bank outside of the United States (which expression, as used in this Condition 5, means the United States of America including the State and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction), or by cheque drawn on a United States bank. In no event will payment in respect of Bearer Covered Bonds be made by a cheque mailed to an address in the United States. All payments of interest in respect of Bearer Covered Bonds will be made to accounts located outside the United States except as may be permitted by United States tax law in effect at the time of such payment without detriment to the Issuer.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment in these Conditions, the Trust Deed, the Agency Agreement and the Final Terms, but without prejudice to the provisions of Condition 8. References to Specified Currency will include any successor currency under applicable law.

(b) *Presentation of definitive Bearer Covered Bonds, Receipts and Coupons*

Payments of principal in respect of definitive Bearer Covered Bonds will (subject as provided below) be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Bearer Covered Bonds, and payments of interest in respect of definitive Bearer Covered Bonds will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States and its possessions.

Payments of instalments of principal (if any) in respect of definitive Bearer Covered Bonds, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph (a) above against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Bearer Covered Bond in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Bearer Covered Bond to which it appertains. Receipts presented without the definitive Bearer Covered Bond to which they appertain do not constitute valid obligations of the Issuer or any Guarantor. Upon the date on which any definitive Bearer Covered Bond becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate Covered Bonds in definitive bearer form (other than Dual Currency Interest Covered Bonds, Index Linked Covered Bonds or Long Maturity Covered Bonds (as defined below)) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from

the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of ten years after the Relevant Date (as defined in Condition 8) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 9) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

Upon any Fixed Rate Covered Bond in definitive bearer form becoming due and repayable prior to its Final Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Covered Bond, Dual Currency Interest Covered Bond, Index Linked Covered Bond or Long Maturity Covered Bond in definitive bearer form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof. A “**Long Maturity Covered Bond**” is a Fixed Rate Covered Bond (other than a Fixed Rate Covered Bond which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Covered Bond shall cease to be a Long Maturity Covered Bond on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the Principal Amount Outstanding of such Covered Bond.

If the due date for redemption of any definitive Bearer Covered Bond is not an Interest Payment Date, interest (if any) accrued in respect of such Covered Bond from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant definitive Bearer Covered Bond.

(c) *Payments in respect of Bearer Global Covered Bonds*

Payments of principal and interest (if any) in respect of Covered Bonds represented by any Global Covered Bond in bearer form will (subject as provided below) be made in the manner specified above in relation to definitive Bearer Covered Bonds and otherwise in the manner specified in the relevant Global Covered Bond against presentation or surrender, as the case may be, of such Global Covered Bond if the Global Covered Bond is not intended to be issued in new global covered bond (“**NGCB**”) form at the specified office of any Paying Agent outside the United States and its possessions. On the occasion of each payment, (i) in the case of any Global Covered Bond which is not issued in NGCB form, a record of such payment made on such Global Covered Bond, distinguishing between any payment of principal and any payment of interest, will be made on such Global Covered Bond by the Paying Agent, and such record shall be prima facie evidence that the payment in question has been made and (ii) in the case of any Global Covered Bond which is an NGCB, the Paying Agent shall instruct Euroclear and Clearstream, Luxembourg to make appropriate entries in their records to reflect such payment.

(d) *Payments in respect of Registered Covered Bonds*

Payments of principal (other than instalments of principal prior to the final instalment) in respect of each Registered Covered Bond (whether or not in global form) will be made against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the Registered Covered Bond at the specified office of the Bond Registrar or any of the Paying Agents. Such payments will be made by transfer to the Designated Account (as defined below) of the holder (or the first named of joint holders) of the Registered Covered Bond appearing in the register of holders of the Registered Covered Bonds

maintained by the Bond Registrar (the “**Register**”) at the close of business on the third business day (being for this purpose a day on which banks are open for business in the city where the specified office of the Bond Registrar is located) before the relevant due date. Notwithstanding the previous sentence, if (i) a holder does not have a Designated Account or (ii) the principal amount of the Covered Bonds held by a holder is less than U.S.\$250,000 (or its approximate equivalent in any other Specified Currency), payment will instead be made by a cheque in the Specified Currency drawn on a Designated Bank (as defined below). For these purposes, “**Designated Account**” means the account (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by a holder with a Designated Bank and identified as such in the Register and “**Designated Bank**” means (in the case of payment in a Specified Currency other than euro) a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney or Auckland, respectively) and (in the case of a payment in euro) any bank which processes payments in euro.

Payments of interest and payments of instalments of principal (other than the final instalment) in respect of each Registered Covered Bond (whether or not in global form) will be made by a cheque in the Specified Currency drawn on a Designated Bank and mailed by uninsured mail on the relevant due date in the city where the specified office of the Bond Registrar is located to the holder (or the first named of joint holders) of the Registered Covered Bond appearing in the Register at the close of business on the fifteenth day (whether or not such fifteenth day is a business day) before the relevant due date (the “**Record Date**”) at his address shown in the Register on the Record Date and at his risk. Upon application of the holder to the specified office of the Bond Registrar not less than three business days in the city where the specified office of the Bond Registrar is located before the due date for any payment of interest in respect of a Registered Covered Bond, the payment may be made by transfer on the due date in the manner provided in the preceding paragraph. Any such application for transfer shall be deemed to relate to all future payments of interest (other than interest due on redemption) and instalments of principal (other than the final instalment) in respect of the Registered Covered Bonds which become payable to the holder who has made the initial application until such time as the Bond Registrar is notified in writing to the contrary by such holder. Payment of the interest due in respect of each Registered Covered Bond on redemption and the final instalment of principal will be made in the same manner as payment of the principal amount of such Registered Covered Bond.

Holders of Registered Covered Bonds will not be entitled to any interest or other payment for any delay in receiving any amount due in respect of any Registered Covered Bond as a result of a cheque posted in accordance with this Condition arriving after the due date for payment or being lost in the post. No commissions or expenses shall be charged to such holders by the Bond Registrar in respect of any payments of principal or interest in respect of the Registered Covered Bonds.

All amounts payable to DTC or its nominee as registered holder of a Registered Global Covered Bond in respect of Covered Bonds denominated in a Specified Currency other than U.S. dollars shall be paid by transfer by the Bond Registrar to an account in the relevant Specified Currency of the Exchange Agent on behalf of DTC or its nominee for conversion into and payment in U.S. dollars in accordance with the provisions of the Agency Agreement.

None of the Issuer, the Guarantors or the Agents will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

(e) *General provisions applicable to payments*

The holder of a Global Covered Bond shall be the only person entitled to receive payments in respect of Covered Bonds represented by such Global Covered Bond and the Issuer or, as the case may be, the HBOS Group Guarantor or the LLP and the Bond Trustee will be discharged by payment to, or to the order of, the holder of such Global Covered Bond in respect of each amount so paid. Each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or DTC as the beneficial holder of a particular nominal amount of Covered Bonds represented by such Global Covered Bond must look solely to Euroclear or Clearstream, Luxembourg or DTC, as the case may be, for his share of each payment so made by the Issuer or, as the case may be, the HBOS Group Guarantor or the LLP or the Bond Trustee to, or to the order of, the holder of such Global Covered Bond.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Bearer Covered Bonds is payable in U.S. Dollars, such U.S. Dollar payments of principal and/or interest in respect of such Covered Bonds will be made at the specified office of a Paying Agent in the United States if:

- (i) the Issuer has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. Dollars at such specified offices outside the United States of the full amount of principal and interest on the Bearer Covered Bonds in the manner provided above when due;
- (ii) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. Dollars; and
- (iii) such payment is then permitted under United States law without involving, in the opinion of the Issuer, the HBOS Group Guarantor and the LLP, adverse tax consequences to the Issuer, the HBOS Group Guarantor or the LLP.

(f) *Payment Day*

If the date for payment of any amount in respect of any Covered Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, “**Payment Day**” means any day which (subject to Condition 9) is:

- (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
  - (A) the relevant place of presentation;
  - (B) London;
  - (C) each Additional Financial Centre specified in the applicable Final Terms; and
- (ii) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign

currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, London and any Additional Financial Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney and Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the TARGET2 System is open; and

- (iii) in the case of any payment in respect of a Registered Global Covered Bond denominated in a Specified Currency other than U.S. dollars and registered in the name of DTC or its nominee and in respect of which an accountholder of DTC (with an interest in such Registered Global Covered Bond) has elected to receive any part of such payment in U.S. dollars, a day on which commercial banks are not authorised or required by law or regulation to be closed in New York City.

(g) *Interpretation of principal and interest*

Any reference in these Conditions to principal in respect of the Covered Bonds shall be deemed to include, as applicable:

- (i) any additional amounts which may be payable with respect to principal under Condition 8 or under any undertaking or covenant given in addition thereto, or in substitution therefor, pursuant to the Trust Deed;
- (ii) the Final Redemption Amount of the Covered Bonds;
- (iii) the Early Redemption Amount of the Covered Bonds;
- (iv) the Optional Redemption Amount(s) (if any) of the Covered Bonds;
- (v) in relation to Covered Bonds redeemable in instalments, the Instalment Amounts;
- (vi) in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 7(d));
- (vii) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Covered Bonds; and
- (viii) any Excess Proceeds which may be payable by the Bond Trustee under or in respect of the Covered Bonds.

Any reference in these Conditions to interest in respect of the Covered Bonds shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 8 or under any undertaking or covenant given in addition thereto, or in substitution therefor, pursuant to the Trust Deed.

## **7. REDEMPTION AND PURCHASE**

(a) *Redemption at maturity*

Unless previously redeemed or purchased and cancelled as specified below, each Covered Bond will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Final Maturity Date.



(b) *Redemption for tax reasons*

The Covered Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Covered Bond is neither a Floating Rate Covered Bond, an Index Linked Interest Covered Bond nor a Dual Currency Interest Covered Bond) or on any Interest Payment Date (if this Covered Bond is either a Floating Rate Covered Bond, an Index Linked Interest Covered Bond or a Dual Currency Interest Covered Bond), on giving not less than 30 nor more than 60 days' notice to the Bond Trustee and the Agent and, in accordance with Condition 14, the Covered Bondholders (which notice shall be irrevocable), if the Issuer satisfies the Bond Trustee immediately before the giving of such notice that:

- (i) on the occasion of the next payment due under the Covered Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 or the HBOS Group Guarantor would be unable for reasons outside its control to procure payment by the Issuer and in making payment itself would be required to pay such additional amounts, in each case as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction (as defined in Condition 8) or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Covered Bonds; and
- (ii) such obligation cannot be avoided by the Issuer or, as the case may be, the HBOS Group Guarantor taking reasonable measures available to it,

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer or, as the case may be, the HBOS Group Guarantor would be obliged to pay such additional amounts were a payment in respect of the Covered Bonds then due.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Bond Trustee a certificate signed by two directors of the Issuer or, as the case may be, two directors of the HBOS Group Guarantor stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the Bond Trustee shall be entitled to accept the 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 Covered Bondholders, the Receipholders and the Couponholders.

Covered Bonds redeemed pursuant to this Condition 7(b) will be redeemed at their Early Redemption Amount referred to in paragraph (d) below together (if appropriate) with interest accrued to (but excluding) the date of redemption.

(c) *Redemption at the option of the Issuer (Issuer Call)*

If Issuer Call is specified in the applicable Final Terms, the Issuer may, having given:

- (i) not less than 15 nor more than 30 days' notice to the Covered Bondholders in accordance with Condition 14; and
- (ii) not less than 15 days before the giving of the notice referred to in (i), notice to the Bond Trustee, (in the case of Registered Covered Bonds) the Bond Registrar and to the Agent;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Covered Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such partial redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Covered Bonds, the Covered Bonds to be redeemed (the “**Redeemed Covered Bonds**”) will be selected individually by lot, in the case of Redeemed Covered Bonds represented by definitive Covered Bonds, and in accordance with the rules of Euroclear and/or Clearstream, Luxembourg (to be reflected in the records of Euroclear and Clearstream, Luxembourg as either a pool factor or a reduction in nominal amount, at their discretion) and/or DTC, in the case of Redeemed Covered Bonds represented by a Global Covered Bond, in each case, not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the “**Selection Date**”). In the case of Redeemed Covered Bonds represented by definitive Covered Bonds, a list of the serial numbers of such Redeemed Covered Bonds will be published in accordance with Condition 14 not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Covered Bonds represented by definitive Covered Bonds shall bear the same proportion to the aggregate nominal amount of all Redeemed Covered Bonds as the aggregate nominal amount of definitive Covered Bonds outstanding bears to the aggregate nominal amount of the Covered Bonds outstanding, in each case on the Selection Date, provided that such first mentioned nominal amount shall, if necessary, be rounded downwards to the nearest integral multiple of the Specified Denomination, and the aggregate nominal amount of Redeemed Covered Bonds represented by a Global Covered Bond shall be equal to the balance of the Redeemed Covered Bonds.

No exchange of the relevant Global Covered Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this paragraph (c) and notice to that effect shall be given by the Issuer to the Covered Bondholders in accordance with Condition 14 at least five days prior to the Selection Date.

(d) *Early Redemption Amounts*

For the purpose of paragraph (b) above and Condition 10, each Covered Bond will be redeemed at its Early Redemption Amount calculated as follows:

- (i) in the case of a Covered Bond with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;
- (ii) in the case of a Covered Bond (other than a Zero Coupon Covered Bond but including an Instalment Covered Bond) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Covered Bond is denominated, at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its nominal amount; or
- (iii) in the case of a Zero Coupon Covered Bond, at an amount (the “**Amortised Face Amount**”) calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})_y$$

where:

“**RP**” means the Reference Price;

“**AY**” means the Accrual Yield expressed as a decimal; and

“**y**” is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Covered Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Covered Bond becomes due and repayable and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Final Terms.

(e) *Instalments*

Instalment Covered Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to paragraph (d) above.

(f) *Purchases*

The Issuer, the HBOS Group Guarantor, the LLP or any of the HBOS Group Guarantor’s Subsidiaries may at any time purchase Covered Bonds (provided that, in the case of definitive Covered Bonds, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Covered Bondholders alike. Such Covered Bonds may be held, reissued, resold or, at the option of the Issuer, the HBOS Group Guarantor or the LLP, surrendered to any Paying Agent and/or the Bond Registrar for cancellation.

(g) *Cancellation*

All Covered Bonds which are redeemed will forthwith be cancelled (together with, in the case of Bearer Definitive Covered Bonds, all unmatured Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Covered Bonds so cancelled and any Covered Bonds purchased and cancelled pursuant to paragraph (f) above (together with, in the case of Bearer Definitive Covered Bonds, all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Agent and cannot be reissued or resold.

(h) *Late payment on Zero Coupon Covered Bonds*

If the amount payable in respect of any Zero Coupon Covered Bond upon redemption of such Zero Coupon Covered Bond pursuant to paragraph (a), (b) or (c) above or upon its becoming due and repayable as provided in Condition 10 is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Covered Bond shall be the amount calculated as provided in paragraph (d)(iii) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Covered Bond becomes due and payable were replaced by references to the date which is the earlier of:

- (i) the date on which all amounts due in respect of such Zero Coupon Covered Bond have been paid; and

- (ii) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Covered Bonds has been received by the Agent or the Bond Trustee or the Bond Registrar and notice to that effect has been given to the Covered Bondholders in accordance with Condition 14.

(i) *Redemption due to illegality*

The Covered Bonds of all Series may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Bond Trustee, the Agent, the Bond Registrar and, in accordance with Condition 14, all Covered Bondholders (which notice shall be irrevocable), if the Issuer satisfies the Bond Trustee immediately before the giving of such notice that it has, or will, before the next Interest Payment Date of any Covered Bond of any Series, become unlawful for the Issuer to make, fund or allow to remain outstanding any Term Advance made by it to the LLP under the Intercompany Loan Agreement, as a result of any change in, or amendment to, the applicable laws or regulations or any change in the application or official interpretation of such laws or regulations, which change or amendment has become or will become effective before the next such Interest Payment Date.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Bond Trustee a certificate signed by two directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the Bond Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on all Covered Bondholders, Receiptholders and Couponholders.

Covered Bonds redeemed pursuant to this Condition 7(i) will be redeemed at their Early Redemption Amount referred to in paragraph 7(d) above together (if appropriate) with interest accrued to (but excluding) the date of redemption.

## **8. TAXATION**

All payments of principal and interest in respect of the Covered Bonds, Receipts and Coupons by the Issuer, the LLP or the HBOS Group Guarantor, as the case may be, will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In the event of a withholding or deduction being made by either the Issuer or the HBOS Group Guarantor in respect of a payment made by any of them, the Issuer or the HBOS Group Guarantor, as the case may be, will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Covered Bonds, Receipts or Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Covered Bonds, Receipts or Coupons, as the case may be, in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Covered Bond, Receipt or Coupon:

- (a) presented for payment in the United Kingdom; or
- (b) presented for payment by or on behalf of a holder who is liable for such taxes or duties in respect of such Covered Bond, Receipt or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Covered Bond, Receipt or Coupon; or

- (c) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined in Condition 6(e)); or
- (d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Union Council Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (e) presented for payment by or on behalf of a holder who would be able to avoid such withholding or deduction by presenting the relevant Covered Bond, Receipt or Coupon to another Paying Agent in a Member State of the European Union.

As used herein:

- (i) “**Tax Jurisdiction**” means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax; and
- (ii) the “**Relevant Date**” means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Bond Trustee or the Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Covered Bondholders in accordance with Condition 14.

Should any payments made by the LLP under the Covered Bond Guarantee be made subject to any withholding or deduction on account of taxes or duties of whatever nature imposed or levied by or on account of any Tax Jurisdiction the LLP will not be obliged to pay any additional amounts as a consequence.

## 9. PRESCRIPTION

The Covered Bonds (whether in bearer or registered form), Receipts and Coupons will become void unless presented for payment within a period of ten years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 8) therefor, subject in each case to the provisions of Conditions 4 and 6(b).

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 6(b) or any Talon which would be void pursuant to Condition 6(b).

## 10. EVENTS OF DEFAULT AND ENFORCEMENT

### (a) *HBOS Events of Default*

The Bond Trustee at its discretion may (except in relation to the default set out in sub-paragraphs (i) and (viii) below in which case the Bond Trustee shall) and if so requested in writing by the holders of not less than twenty-five per cent. of the Principal Amount Outstanding of the Covered Bonds (which for this purpose and the purpose of any Extraordinary Resolution referred to in this Condition 10(a) means the Covered Bonds of all Series together as if they were a Single Series (with the nominal amount of Covered Bonds not denominated in sterling converted into sterling at the relevant Covered Bond Swap Rate) then outstanding or if so directed by an Extraordinary Resolution shall (subject in each case to being indemnified and/or secured to its satisfaction), but in the case of the happening of any

of the events described in paragraph (ii) below or, in relation to the HBOS Group Guarantor only, paragraphs (iii) to (vi) (inclusive) only if the Bond Trustee shall have certified in writing to the Issuer and the HBOS Group Guarantor that such event is, in its opinion, materially prejudicial to the interests of the Covered Bondholders of any Series give notice (an “**HBOS Acceleration Notice**”) in writing to the Issuer and the HBOS Group Guarantor that as against the Issuer and the HBOS Group Guarantor (but not against the LLP) each Covered Bond of each Series is, and each such Covered Bond shall thereupon immediately become, due and repayable at its Early Redemption Amount together with accrued interest as provided in the Trust Deed if any of the following events (each an “**HBOS Event of Default**”) shall occur and be continuing:

- (i) default is made by the Issuer and (following the delivery of a written demand on the HBOS Group Guarantor by the Bond Trustee for payment under the terms of the HBOS Group Guarantee) the HBOS Group Guarantor in the payment of any principal, or redemption amount or interest on the Covered Bonds of any Series when due (unless the Bond Trustee is satisfied that the default has arisen by reason of technical default or error and the Issuer and the HBOS Group Guarantor have the moneys available to make payment and payment is made within three London Business Days of the due date thereof); or
- (ii) a default is made in the performance by the Issuer or the HBOS Group Guarantor of any obligation (other than any obligation for the payment of principal, redemption amount or interest in respect of the Covered Bonds of any Series) under the provisions of the Covered Bonds of any Series or the Trust Deed or any other Transaction Document to which the Issuer or the HBOS Group Guarantor is a party (but excluding any obligation to provide notices to the FSA under the RCB Regulations and/or the RCB Sourcebook and breach of which would not otherwise constitute a breach of the other terms of the Transaction Documents) which (unless certified by the Bond Trustee, in its opinion, to be incapable of remedy) shall continue for more than 30 days after written notification requiring such default to be remedied and indicating that this provision may be invoked if it is not so remedied shall have been given to the Issuer and the HBOS Group Guarantor by the Bond Trustee in accordance with the Trust Deed; or
- (iii) an order is made or an effective resolution passed for the bankruptcy or liquidation or winding-up of the Issuer or the HBOS Group Guarantor (except a bankruptcy, liquidation, or winding-up for the purpose of a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the HBOS Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution (as defined in the Trust Deed) of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 15); or
- (iv) the Issuer or the HBOS Group Guarantor ceases to carry on its business or substantially all its business (except a cessation for the purpose of a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the HBOS Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 15); or
- (v) proceedings shall be initiated against the Issuer or the HBOS Group Guarantor under any applicable liquidation, winding-up, insolvency, bankruptcy, composition, reorganisation or other similar laws (except in connection with a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets

of the Issuer or the HBOS Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 15); or a receiver, administrator, trustee or other similar official shall be appointed in relation to the Issuer or the HBOS Group Guarantor or in relation to the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets or a distress, diligence or execution or other process shall be levied or enforced upon or sued out against the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets and, in any of the foregoing cases, it shall not be discharged within thirty days; or if the Issuer or the HBOS Group Guarantor shall initiate or consent to judicial proceedings relating to itself under any applicable liquidation, winding up, insolvency, bankruptcy, composition, reorganisation or other similar laws (except in connection with a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the HBOS Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 15) or shall make a conveyance, assignment or assignation for the benefit of, or shall enter into any composition with, its creditors generally; or

- (vi) the Issuer or the HBOS Group Guarantor shall be unable to pay its debts as they fall due (within the meaning of section 123(1)(b) to (e) and section 123(2) of the Insolvency Act 1986 (as those sections may be amended)) or shall admit inability to pay its debts as they fall due or shall stop payment in respect of any debts that are due (save, in the case of stopping payments, in each case in respect of any obligation for the payment of principal, redemption amount or interest in respect of the Covered Bonds of any Series) or shall be adjudged or found bankrupt or insolvent; or
- (vii) except as provided by the terms of the HBOS Group Guarantee, the HBOS Group Guarantee is not, or is claimed by the HBOS Group Guarantor not to be, in full force and effect; or
- (viii) a failure to satisfy the Asset Coverage Test (as set out in the LLP Deed) on any Calculation Date which has not been cured by the LLP by the next following Calculation Date; or
- (ix) if the Pre-Maturity Test in respect of any Series of Hard Bullet Covered Bonds is breached less than six months prior to the Final Maturity Date of that Series of Hard Bullet Covered Bonds, and the LLP has not cured the breach as described in the LLP Deed before the earlier to occur of (i) ten London Business Days from the date that the Sellers are notified of the breach of the Pre-Maturity Test and (ii) the Final Maturity Date of that Series of Hard Bullet Covered Bonds.

Upon the Covered Bonds becoming immediately due and repayable against the Issuer and HBOS Group Guarantor pursuant to this Condition 10(a), the Bond Trustee shall forthwith serve a notice to pay (the “**Notice to Pay**”) on the LLP pursuant to the Covered Bond Guarantee and the LLP shall be required to make payments of Guaranteed Amounts when the same shall become Due for Payment in accordance with the terms of the Covered Bond Guarantee.

Following the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice, the Bond Trustee may or shall take such proceedings against the Issuer and/or HBOS Group Guarantor in accordance with the first paragraph of Condition 10(c).

The Trust Deed provides that all moneys received by the Bond Trustee from the Issuer, the HBOS Group Guarantor or any administrator, administrative receiver, receiver, liquidator, or other similar official appointed in relation to the Issuer or the HBOS Group Guarantor following the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice and a Notice to Pay (the “**Excess Proceeds**”), shall be paid by the Bond Trustee on behalf of the Covered Bondholders of the relevant Series to the LLP for its own account, as soon as practicable, and shall be held by the LLP in the GIC Account and the Excess Proceeds shall thereafter form part of the Security and shall be used by the LLP in the same manner as all other moneys from time to time standing to the credit of the GIC Account. Any Excess Proceeds received by the Bond Trustee shall discharge the obligations of the Issuer in respect of the Covered Bonds, Receipts and Coupons and the obligations of the HBOS Group Guarantor under the HBOS Group Guarantee. However, the obligations of the LLP under the Covered Bond Guarantee are unconditional and irrevocable and the receipt by the Bond Trustee of any Excess Proceeds shall not reduce or discharge any of such obligations.

By subscribing for Covered Bond(s), each Covered Bondholder shall be deemed to have irrevocably directed the Bond Trustee to pay the Excess Proceeds to the LLP in the manner as described above.

(b) *LLP Events of Default*

The Bond Trustee at its discretion may, and if so requested in writing by the holders of not less than twenty-five per cent. of the Principal Amount Outstanding of the Covered Bonds (which for this purpose and the purpose of any Extraordinary Resolution referred to in this Condition 10(b) means the Covered Bonds of this Series together with the Covered Bonds of any other Series constituted by the Trust Deed) then outstanding as if they were a Single Series (with the nominal amount of Covered Bonds not denominated in sterling converted into sterling at the relevant Covered Bond Swap Rate) or if so directed by an Extraordinary Resolution shall (subject in each case to being indemnified and/or secured to its satisfaction), but in the case of the happening of any of the events described in paragraph (ii) below, only if the Bond Trustee shall have certified in writing to the Issuer and the LLP that such event is, in its opinion, materially prejudicial to the interests of the Covered Bondholders of any Series, give notice (the “**LLP Acceleration Notice**”) in writing to the Issuer, copied to the LLP, that each Covered Bond of each Series is, and each Covered Bond of each Series shall as against the Issuer and the HBOS Group Guarantor (if not already due and repayable against them following an HBOS Event of Default) and as against the LLP, thereupon immediately become, due and repayable at its Early Redemption Amount together with accrued interest as provided in the Trust Deed and thereafter the Security shall become enforceable if any of the following events (each an “**LLP Event of Default**”) shall occur and be continuing:

- (i) default is made by the LLP in the payment of any Guaranteed Amount when Due for Payment in respect of the Covered Bonds of any Series unless the Bond Trustee is satisfied that the default has arisen by reason of technical default or error and the LLP has the moneys available to make payment and payment is made within three London Business Days of the due date; or
- (ii) a default is made in the performance or observance by the LLP of any obligation binding upon it (other than any obligation for the payment of Guaranteed Amounts in respect of the Covered Bonds of any Series) under the Trust Deed, the Deed of Charge or any other Transaction Document to which the LLP is a party which (unless certified by the Bond Trustee, in its opinion, to be incapable of remedy) shall continue for more than thirty days after written notification requiring such default to be remedied and indicating that this provision may be invoked if it is not so remedied



shall have been given to the LLP by the Bond Trustee in accordance with the Trust Deed; or

- (iii) an order is made or an effective resolution passed for the liquidation or winding-up of the LLP; or
- (iv) the LLP ceases to carry on its business or substantially all its business; or
- (v) proceedings shall be initiated against the LLP under any applicable liquidation, winding-up, insolvency, bankruptcy, composition, reorganisation or other similar laws (including, but not limited to, presentation of a petition for an administration order); or a receiver, administrator, trustee or other similar official shall be appointed in relation to the LLP or in relation to the whole or any part of its assets, or a distress, diligence or execution or other process shall be levied or enforced upon or sued out against the whole or any part of its assets, or if the LLP shall initiate or consent to judicial proceedings relating to itself under any applicable liquidation, winding-up, insolvency, bankruptcy, composition, reorganisation or other similar laws or shall make a conveyance, assignment or assignation for the benefit of, or shall enter into any composition with, its creditors generally; or
- (vi) the LLP shall stop payment or shall be unable, or shall admit inability, to pay its debts generally as they fall due or shall be adjudicated or found bankrupt or insolvent; or
- (vii) the Covered Bond Guarantee is not, or is claimed by the LLP not to be, in full force and effect; or
- (viii) a failure to satisfy the Amortisation Test (as set out in the LLP Deed) on any Calculation Date following an HBOS Event of Default.

For the purposes hereof:

“**Amortisation Test**” means the Amortisation Test Aggregate Loan Amount (as defined in the Master Definitions and Construction Agreement) which shall be an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on each Calculation Date following an HBOS Event of Default.

Following the occurrence of an LLP Event of Default and service of an LLP Acceleration Notice, each of the Bond Trustee and the Security Trustee may or shall take such proceedings or steps in accordance with the first and second paragraphs, respectively, of Condition 10(c) and the Covered Bondholders shall have a claim against the LLP, under the Covered Bond Guarantee, for the Early Redemption Amount together with accrued interest as provided in the Trust Deed in respect of each Covered Bond.

(c) *Enforcement*

The Bond Trustee may at any time after service of an HBOS Acceleration Notice (in the case of the Issuer and HBOS Group Guarantor) or an LLP Acceleration Notice (in the case of the LLP), at its discretion and without further notice, take such proceedings against the Issuer and/or the HBOS Group Guarantor or the LLP, as the case maybe, and/or any other person as it may think fit to enforce the provisions of the Trust Deed, the Covered Bonds, the Receipts, and the Coupons, but it shall not be bound to take any such enforcement proceedings in relation to the Trust Deed, the Covered Bonds, the Receipts or the Coupons or any other Transaction Document unless (i) it shall have been so directed by an Extraordinary Resolution (with the Covered Bonds of all Series taken together as a single Series as aforesaid) or so

requested in writing by the holders of not less than twenty-five per cent. of the Principal Amount Outstanding of the Covered Bonds of all Series then outstanding (taken together and converted into sterling at the relevant Covered Bond Swap Rate as aforesaid) and (ii) it shall have been indemnified and/or secured to its satisfaction.

The Security Trustee may at any time, at its discretion and without further notice, take such proceedings against the LLP and/or any other person as it may think fit to enforce the provisions of the Deed of Charge and may, at any time after the Security has become enforceable, take such steps as it may think fit to enforce the Security, but it shall not be bound to take any such steps unless (i) it shall have been so directed by an Extraordinary Resolution (with the Covered Bonds of all Series taken together as a single Series as aforesaid) or a request in writing by the holders of not less than twenty-five per cent. of the Principal Amount Outstanding of the Covered Bonds of all Series then outstanding (taken together converted into sterling at the relevant Covered Bond Swap Rate as aforesaid); and (ii) it shall have been directed in writing to do so by each of the other Secured Creditors (other than the Issuer, the HBOS Group Guarantor or the Sellers); and (iii) it shall have been indemnified and/or secured to its satisfaction.

No Covered Bondholder, Receiptholder or Couponholder shall be entitled to proceed directly against the Issuer, the HBOS Group Guarantor or the LLP or to take any action with respect to the Trust Deed, the Receipts, the Coupons, or the Security unless the Bond Trustee or the Security Trustee, as applicable, having become bound so to proceed, fails so to do for a period of 30 days and the failure shall be continuing.

## **11. REPLACEMENT OF COVERED BONDS, RECEIPTS, COUPONS AND TALONS**

Should any Covered Bond, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Agent (in the case of Bearer Covered Bonds, Receipts or Coupons) or the Bond Registrar (in the case of Registered Covered Bonds) upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Covered Bonds, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

## **12. PAYING AGENTS**

The names of the initial Paying Agents, the initial Bond Registrar, the Initial Transfer Agent, the initial Exchange Agent and their initial specified offices are set out below.

The Issuer is entitled, with the prior written approval of the Bond Trustee (such approval not to be unreasonably withheld or delayed), to vary or terminate the appointment of any Paying Agent and/or appoint additional or other Paying Agents and/or approve any change in the specified office through which any Paying Agent acts, provided that:

- (a) there will at all times be a Principal Paying Agent and a Bond Registrar (in the case of Bearer Covered Bonds), which may be the Principal Paying Agent, and a Transfer Agent (in the case of Registered Covered Bonds) which may be the Bond Registrar;
- (b) so long as the Covered Bonds are listed and/or admitted to trading on or by any competent listing authority, on any stock exchange or market, there will at all times be a Paying Agent with a specified office in such place as may be required by the rules and regulations of the relevant competent listing authority, stock exchange or market; and

- (c) so long as any of the Registered Global Covered Bonds payable in a Specified Currency other than U.S.\$ are held through DTC or its nominee, there will at all times be an Exchange Agent; and
- (d) it will ensure that it maintains a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to the European Union Council Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 6(d). Any variation, termination, appointment or change shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Covered Bondholders in accordance with Condition 14.

In acting under the Agency Agreement, the Paying Agents act solely as agents of the Issuer, the HBOS Group Guarantor and the LLP and, in certain circumstances specified therein, of the Bond Trustee and do not assume any obligation to, or relationship of agency or trust with, any Covered Bondholders, Receipholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.

### **13. EXCHANGE OF TALONS**

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Bearer Covered Bond to which it appertains) a further Talon, subject to the provisions of Condition 9.

### **14. NOTICES**

All notices regarding the Bearer Covered Bonds will be deemed to be validly given if published in a leading English language daily newspaper of general circulation in London and (for so long as any Bearer Covered Bonds are listed on the Official List of the Luxembourg Stock Exchange and traded on the regulated market of the Luxembourg Stock Exchange) if published in a daily newspaper of general circulation in Luxembourg and/or on the website of the Luxembourg Stock Exchange, [www.bourse.lu](http://www.bourse.lu). It is expected that such publication in a newspaper will be made in the *Financial Times* in London and (in relation to Covered Bonds listed on the Luxembourg Stock Exchange) in the *Luxemburger Wort* and/or the *Tageblatt* in Luxembourg. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules of any competent listing authority, stock exchange or market on or by which the Bearer Covered Bonds are for the time being listed, and/or admitted to trading or by which they have been admitted to listing and/or trading. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. If publication as provided above is not practicable, a notice will be given in such other manner, and will be deemed to have been given on such date, as the Bond Trustee shall approve.

All notices regarding the Registered Covered Bonds will be deemed to be validly given if sent by first class mail or (if posted to an address overseas) by airmail to the holders (or the first named of

joint holders) at their respective addresses recorded in the Register and will be deemed to have been given on the fourth day after mailing and, in addition, for so long as any Registered Covered Bonds are listed on a stock exchange and the rules of that stock exchange (or any other relevant authority) so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules.

So long as the Covered Bonds are represented in their entirety by any Global Covered Bonds held on behalf of Euroclear and/or Clearstream, Luxembourg and/or DTC, there may be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg and/or DTC for communication by them to the holders of the Covered Bonds and, in addition, for so long as any Covered Bonds are listed and/or admitted to trading on or by any competent listing authority, stock exchange or market and the rules of that competent listing authority, stock exchange or market so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules. Any such notice shall be deemed to have been given to the holders of the Covered Bonds on the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg and/or DTC.

Notices to be given by any Covered Bondholder shall be in writing and given by lodging the same, together (in the case of any Covered Bond in definitive form) with the relative Covered Bond or Covered Bonds, with the Agent (in the case of Bearer Covered Bonds) or the Bond Registrar (in the case of Registered Covered Bonds). Whilst any of the Covered Bonds are represented by a Global Covered Bond, such notice may be given by any holder of a Covered Bond to the Agent or the Bond Registrar through Euroclear and/or Clearstream, Luxembourg and/or DTC, as the case may be, in such manner as the Agent, the Bond Registrar and Euroclear and/or Clearstream, Luxembourg and/or DTC, as the case may be, may approve for this purpose.

## **15. MEETINGS OF COVERED BONDHOLDERS, MODIFICATION, WAIVER AND SUBSTITUTION**

The Trust Deed contains provisions for convening meetings of the Covered Bondholders of any Series to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Covered Bonds of such Series or the related Receipts and/or Coupons or of any of the Transaction Documents (subject as provided below and in the Trust Deed). Such a meeting may be convened by the Issuer, the HBOS Group Guarantor, the LLP or the Bond Trustee and shall be convened by the Issuer if required in writing by Covered Bondholders of a Series of Covered Bonds holding not less than five per cent. of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being remaining outstanding. The quorum at any such meeting in respect of any Series of Covered Bonds for passing an Extraordinary Resolution is one or more persons holding or representing not less than 50 per cent. of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being outstanding, or at any adjourned meeting one or more persons being or representing Covered Bondholders of such Series whatever the nominal amount of the Covered Bonds of such Series so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Covered Bonds of a Series, the related Receipts or the Coupons or the Trust Deed (including a reduction or cancellation of the amount payable in respect of such Covered Bonds, the alteration of the currency in which payments under such Covered Bonds are to be made, the alteration of the majority required to pass an Extraordinary Resolution, any amendment to any of the Guarantees or the Deed of Charge (except in a manner determined by the Bond Trustee not to be materially prejudicial to the interests of the Covered Bondholders of any Series) or the sanction of any scheme or proposal for the exchange of such Covered Bonds in respect of such Series of Covered Bonds (each, a “**Series Reserved Matter**” all as more particularly set out in the Trust Deed)), the quorum shall be one or more persons holding or representing not less than two-thirds of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being outstanding, or at any adjourned such meeting one or more persons

holding or representing not less than one-third of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Covered Bondholders of a Series shall, subject as provided below, be binding on all the Covered Bondholders of such Series, whether or not they are present at the meeting, and on all Receiptholders and Couponholders in respect of such Series of Covered Bonds. Pursuant to the Trust Deed, the Bond Trustee may convene a single meeting of the holders of Covered Bonds of more than one Series if in the opinion of the Bond Trustee there is no conflict between the holders of the such Covered Bonds, in which event the provisions of this paragraph shall apply thereto *mutatis mutandis*.

Notwithstanding the provisions of the immediately preceding paragraph, any Extraordinary Resolution to direct the Bond Trustee to accelerate the Covered Bonds pursuant to Condition 10 or to direct the Bond Trustee or the Security Trustee to take any enforcement action (each a “**Programme Resolution**”) shall only be capable of being passed at a single meeting of the holders of the Covered Bonds of all Series then outstanding. Any such meeting to consider a Programme Resolution may be convened by the Issuer, the HBOS Group Guarantor, the LLP or the Bond Trustee or by Covered Bondholders of any Series. The quorum at any such meeting for passing a Programme Resolution is one or more persons holding or representing not less than fifty per cent. in aggregate of the Principal Amount Outstanding of the Covered Bonds of all Series for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing Covered Bonds whatever the nominal amount of the Covered Bonds of any Series so held or represented. A Programme Resolution passed at any meeting of the Covered Bondholders of all Series shall be binding on all Covered Bondholders of all Series, whether or not they are present at the meeting, and on all related Receiptholders and Couponholders in respect of such Series of Covered Bonds.

In connection with any meeting of the holders of Covered Bonds of more than one Series where such Covered Bonds are not denominated in sterling, the nominal amount of the Covered Bonds of any Series not denominated in sterling shall be converted into sterling at the relevant Covered Bond Swap Rate.

The Bond Trustee, the Security Trustee and the Issuer may also agree, without the consent of the Covered Bondholders, Receiptholders or Couponholders of any Series and without the consent of the other Secured Creditors (and for this purpose the Bond Trustee and the Security Trustee may disregard whether any such modification relates to a Series Reserved Matter), to:

- (a) any modification of the Covered Bonds of one or more Series, the related Receipts and/or Coupons or any Transaction Document provided that (i) in the opinion of the Bond Trustee and the Security Trustee such modification is not materially prejudicial to the interests of any of the Covered Bondholders of any Series or any of the other Secured Creditors (other than the LLP and the Sellers) (in which respect the Bond Trustee and the Security Trustee may rely upon the consent in writing of any other Secured Creditor as to the absence of material prejudice to the interests of such Secured Creditor) and (ii) it has not been informed in writing by any Secured Creditor (other than any Covered Bondholder(s)) that such Secured Creditor will be materially prejudiced thereby (other than a Secured Creditor who has given his/her written consent as aforesaid); or
- (b) any modification of the Covered Bonds of any one or more Series, the related Receipts and/or Coupons or any Transaction Document which is of a formal, minor or technical nature or is made to correct a manifest error or an error established as such to the satisfaction of the Bond Trustee or to comply with mandatory provisions of law.

The Bond Trustee may also agree, without the consent of the Covered Bondholders of any Series, the related Receiptholders and/or Couponholders or any other Secured Creditor, to the waiver or authorisation of any breach or proposed breach of any of the provisions of the Covered Bonds of any Series, or determine, without any such consent as aforesaid, that any HBOS Event of Default or LLP Event of Default or Potential HBOS Event of Default or Potential LLP Event of Default shall not be treated as such, where, in any such case, it is not, in the opinion of the Bond Trustee, materially prejudicial to the interests of any of the Secured Creditors (in which respect the Bond Trustee may (without further enquiry) rely upon the consent in writing of any other Secured Creditor as to the absence of material prejudice to the interests of such Secured Creditor) provided that the Bond Trustee has not been informed by any Secured Creditor (other than any Covered Bondholder(s)) that such Secured Creditor will be materially prejudiced thereby (other than a Secured Creditor who has given its written consent as aforesaid).

Prior to the Bond Trustee agreeing to any modification, waiver, authorisation or determination pursuant to this Condition 15, the Issuer must send written confirmation to the Bond Trustee that such modification, waiver, authorisation or determination, as applicable, would not result in a breach of the RCB Regulations or result in the Issuer and/or the Programme ceasing to be registered under the RCB Regulations and that either:

- (a) such modification, waiver, authorisation or determination would not require the FSA to be notified in accordance with Regulation 20 of the RCB Regulations; or
- (b) if such modification, waiver, authorisation or determination would require the FSA to be notified in accordance with Regulation 20 of the RCB Regulations, the Issuer has provided all information required to be provided to the FSA and the FSA has given its consent to such proposed modification, waiver, authorisation or determination.

Any such modification, waiver, authorisation or determination shall be binding on all Covered Bondholders of all Series of Covered Bonds for the time being outstanding, the related Receiptholders and the Couponholders and the other Secured Creditors, and unless the Security Trustee and the Bond Trustee otherwise agree, any such modification shall be notified by the Issuer to the Covered Bondholders of all Series of Covered Bonds for the time being outstanding and the other Secured Creditors in accordance with the relevant terms and conditions as soon as practicable thereafter.

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Bond Trustee and the Security Trustee shall have regard to the general interests of the Covered Bondholders of each Series as a class (but shall not have regard to any interests arising from circumstances particular to individual Covered Bondholders, Receiptholders or Couponholders whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Covered Bondholders, the related Receiptholders, Couponholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Bond Trustee and the Security Trustee shall not be entitled to require, nor shall any Covered Bondholder, Receiptholder or Couponholder be entitled to claim, from the Issuer, the HBOS Group Guarantor, the LLP, the Bond Trustee, the Security Trustee or any other person any indemnification or payment in respect of any tax consequences of any such exercise upon individual Covered Bondholders, Receiptholders and/or Couponholders, except to the extent already provided for in Condition 8 and/or in any undertaking or covenant given in addition to, or in substitution for, Condition 8 pursuant to the Trust Deed.

Provided that the Bond Trustee and the Security Trustee shall have received a certificate of two directors of the Issuer and the HBOS Group Guarantor and a certificate of a Designated Member of the LLP stating that immediately after giving effect to such transaction no HBOS Event of Default (in respect of the Issuer or the HBOS Group Guarantor) or LLP Event of Default, respectively and no Potential HBOS Event of Default (in respect of the Issuer or the HBOS Group Guarantor) or Potential LLP Event of Default, respectively, shall have happened and be continuing and certain other conditions as are specified in the Trust Deed are satisfied, but without the consent of the Covered Bondholders of any Series of Covered Bonds for the time being outstanding or of the holders of the Coupons and Receipts appertaining thereto, or of any other Secured Creditor, another Subsidiary (as defined in the Trust Deed) of the HBOS Group Guarantor may assume the obligations of the Issuer as principal obligor under the Trust Deed and the other Transaction Documents in respect of all Series of Covered Bonds subject to the Covered Bonds of all Series being or remaining unconditionally guaranteed by the HBOS Group Guarantor on the same basis. The Trust Deed provides that any such assumption shall be notified to the holders of all Series of Covered Bonds (in accordance with the relevant terms and conditions of such Covered Bonds).

Provided that the Bond Trustee and the Security Trustee shall have received a certificate of two directors of the Issuer and the HBOS Group Guarantor and a certificate of a Designated Member of the LLP stating that immediately after giving effect to such resignation or assumption no HBOS Event of Default (in respect of the Issuer or the relevant Guarantor) and no LLP Event of Default, respectively, and no Potential HBOS Event of Default (in respect of the Issuer or the relevant Guarantor) and no Potential LLP Event of Default, respectively, shall have happened and be continuing and certain other conditions as are specified in the Trust Deed are satisfied, but without the consent of the Covered Bondholders of any Series of Covered Bonds for the time being outstanding or of the holders of the Coupons and the Receipts appertaining thereto or any other Secured Creditor, HBOS (in its capacity as HBOS Group Guarantor) may resign as HBOS Group Guarantor provided that the long-term unsecured, unsubordinated and unguaranteed debt ratings of the Issuer (if independently rated) or any Replacement Guarantor are at least equal to the ratings (at the time of the resignation) of the HBOS Group Guarantor and for such purpose “**Replacement Guarantor**” means any other member of the HBOS Group (as defined in the Trust Deed) who assumes the obligations of the resigning Guarantor under the Trust Deed in respect of such Covered Bonds. The Trust Deed provides that any such resignation or assumption shall be notified to the holders of such Covered Bonds (in accordance with the relevant terms and conditions of such Covered Bonds).

The Issuer and the HBOS Group Guarantor may each, without the consent of the holders of the Covered Bonds of any Series or any Receipts or Coupons relating thereto, or any other Secured Creditor consolidate with, merge or amalgamate into or transfer their respective assets substantially as an entirety to, any corporation organised under the laws of the United Kingdom, or any political subdivision thereof, provided that (i) a certificate of two Directors of the Issuer and the HBOS Group Guarantor and a certificate of a Designated Member of the LLP is delivered to the Bond Trustee and the Security Trustee to the effect that immediately after giving effect to such transaction no HBOS Event of Default in respect of the Issuer or the HBOS Group Guarantor and no LLP Event of Default, respectively, and no Potential HBOS Event of Default in respect of the Issuer or the HBOS Group Guarantor and no Potential LLP Event of Default, respectively, will have happened and be continuing and (ii) unless the Issuer or the HBOS Group Guarantor, as the case may be, is the surviving entity, the Issuer or, as the case may be, the HBOS Group Guarantor shall procure that the surviving or transferee company assumes its obligations as Issuer and is admitted to the register of issuers pursuant to Regulation 14 of the RCB Regulations or, as the case may be, HBOS Group Guarantor under the Trust Deed, each other relevant Transaction Document and all of the outstanding Covered Bonds of all Series, in place of the Issuer or, as the case may be, the HBOS Group Guarantor and (iii) in the case of an assumption of the obligations of the Issuer by a successor or transferee company, the guarantee of the HBOS Group Guarantor and the guarantee of the LLP are fully effective on the same basis in relation to the obligations of such successor or transferee company and (iv) certain other

conditions set out in the Trust Deed are met. Upon the assumption of the obligations of the Issuer or the HBOS Group Guarantor by such surviving or transferee company, the predecessor Issuer or HBOS Group Guarantor, as the case may be, shall (subject to the provisions of the Trust Deed) have no further liabilities under or in respect of the Trust Deed or the outstanding Covered Bonds of each Series then outstanding or any Coupons or Receipts appertaining thereto and the other Transaction Documents. Any such assumption shall be subject to the relevant provisions of the Trust Deed. The Trust Deed provides that any such assumption shall be notified to the holders of all Series of Covered Bonds in accordance with the relevant terms and conditions of such Covered Bonds and the other Secured Creditors.

For the purposes hereof:

**“Potential HBOS Event of Default”** means any condition, event or act which, with the lapse of time and/or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition, would constitute an HBOS Event of Default.

**“Potential LLP Event of Default”** means any condition, event or act which, with the lapse of time and/or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition, would constitute an LLP Event of Default.

**“Rating Agency Confirmation”** means a confirmation in writing by the Rating Agencies that the then current ratings of the Covered Bonds will not be adversely affected by or withdrawn as a result of the relevant event or matter.

#### **16. INDEMNIFICATION OF THE BOND TRUSTEE AND/OR SECURITY TRUSTEE AND BOND TRUSTEE AND/OR SECURITY TRUSTEE CONTRACTING WITH THE ISSUER AND/OR BANK OF SCOTLAND AND/OR HBOS AND/OR THE LLP**

If, in connection with the exercise of its powers, trusts, authorities or discretions, the Bond Trustee or the Security Trustee is of the opinion that the interests of the holders of the Covered Bonds of any one or more Series would be materially prejudiced thereby, the Bond Trustee or the Security Trustee shall not exercise such power, trust, authority or discretion without the approval of such Covered Bondholders by Extraordinary Resolution or by a written resolution of such Covered Bondholders of not less than fifty per cent. of the Principal Amount Outstanding of Covered Bonds of the relevant Series then outstanding.

The Trust Deed and the Deed of Charge contain provisions for the indemnification of the Bond Trustee and the Security Trustee and for their relief from responsibility, including provisions relieving them from taking any action unless indemnified and/or secured to their satisfaction.

The Trust Deed and the Deed of Charge also contain provisions pursuant to which each of the Bond Trustee and Security Trustee, respectively, is entitled, *inter alia*, (i) to enter into business transactions with the Issuer, the HBOS Group Guarantor, the LLP and/or any of their respective Subsidiaries and affiliates and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer, the HBOS Group Guarantor, the LLP and/or any of their respective Subsidiaries and affiliates, (ii) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Covered Bondholders, Receiptholders or Couponholders or the other Secured Creditors and (iii) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.



Neither the Bond Trustee nor the Security Trustee will be responsible for any loss, expense or liability, which may be suffered as a result of any Loans or Related Security, or any deeds or documents of title thereto, being uninsured or inadequately insured or being held by clearing organisations or their operators or by intermediaries such as banks, brokers or other similar persons on behalf of the Bond Trustee and/or the Security Trustee. Neither the Bond Trustee nor the Security Trustee will be responsible for (i) supervising the performance by the Issuer or any other party to the Transaction Documents of their respective obligations under the Transaction Documents and the Bond Trustee and the Security Trustee will be entitled to assume, until they each have written notice to the contrary, that all such persons are properly performing their duties; (ii) considering the basis on which approvals or consents are granted by the Issuer or any other party to the Transaction Documents under the Transaction Documents; (iii) monitoring the Portfolio, including, without limitation, whether the Portfolio is in compliance with the Asset Coverage Test, the Pre-Maturity Liquidity Test or the Amortisation Test; or (iv) monitoring whether Loans and Related Security satisfy the Eligibility Criteria. Neither the Bond Trustee nor the Security Trustee will be liable to any Covered Bondholder or other Secured Creditor for any failure to make or to cause to be made on their behalf the searches, investigations and enquiries which would normally be made by a prudent chargee in relation to the Security and have no responsibility in relation to the legality, validity, sufficiency and enforceability of the Security and the Transaction Documents.

## **17. FURTHER ISSUES**

The Issuer shall be at liberty from time to time without the consent of the Covered Bondholders, the Receiptholders or the Couponholders to create and issue further bonds having terms and conditions the same as the Covered Bonds of any Series or the same in all respects save for the amount and date of the first payment of interest thereon, issue date and/or purchase price and so that the same shall be consolidated and form a single Series with the outstanding Covered Bonds of such Series.

## **18. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

No person shall have any right to enforce any term or condition of this Covered Bond under the Contracts (Rights of Third Parties) Act 1999, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

## **19. GOVERNING LAW AND SUBMISSION TO JURISDICTION**

### **(a) *Governing law***

Each of the Trust Deed, the Agency Agreement, the Deed Poll, the Covered Bonds, the Receipts, the Coupons and the other Transaction Documents (other than each Scottish Declaration of Trust, certain documents to be granted pursuant to the Deed of Charge and the Corporate Services Agreement) and, in each case, any non-contractual obligations arising out of or in connection with the relevant document, is governed by, and shall be construed in accordance with, English law unless specifically stated to the contrary. Each Scottish Declaration of Trust is governed by, and shall be construed in accordance with, Scots law. Certain documents to be granted pursuant to the Deed of Charge will be governed by, and construed in accordance with, Scots law. The Corporate Services Agreement is governed by, and shall be construed in accordance with, Jersey law.

### **(b) *Submission to jurisdiction***

The HBOS Group Guarantor agrees, for the exclusive benefit of the Bond Trustee, the Covered Bondholders, the Receiptholders, the Couponholders and the other Secured

Creditors, that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Trust Deed, the Covered Bonds, the Receipts, the Coupons and/or the other Transaction Documents and that accordingly any suit, action or proceedings (together referred to as “**Proceedings**”) arising out of or in connection with the Trust Deed, the Covered Bonds, the Receipts, the Coupons and the other Transaction Documents (other than each Scottish Declaration of Trust, certain documents to be granted pursuant to the Deed of Charge and the Corporate Services Agreement) may be brought in such courts.

The HBOS Group Guarantor hereby irrevocably waives any objection which it may have now or hereafter to the laying of the venue of any such Proceedings in any such court and any claim that any such Proceedings have been brought in an inconvenient forum and hereby further irrevocably agrees that a judgment in any such Proceedings brought in the English courts shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction.

Nothing contained in this Condition shall limit any right to take Proceedings against the HBOS Group Guarantor in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

(c) *Appointment of Process Agent*

Each of the Issuer and the HBOS Group Guarantor appoints Bank of Scotland, 33 Old Broad Street, London EC2N 1HZ (for the attention of the Head of Legal) as its agent for service of process, and undertakes that, in the event of Bank of Scotland ceasing so to act, it will appoint another person approved by the Trustee as its agent for service of process in England in respect of any Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

## USE OF PROCEEDS

The Sterling Equivalent of the net proceeds from each issue of Covered Bonds will be used by the Issuer to make available Term Advances to the LLP pursuant to the terms of the Intercompany Loan Agreement, which in turn shall be used by the LLP either to acquire Loans and their Related Security or to invest the same in Substitution Assets up to the prescribed limit to the extent required to meet the requirements of Regulations 23 and 24(1)(a) of the RCB Regulations and the Asset Coverage Test and thereafter may be applied by the LLP:

- (i) to acquire Loans and their Related Security or to invest the same in Substitution Assets up to the prescribed limit; and/or
- (ii) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or
- (iii) subject to complying with the Asset Coverage Test, to make a Capital Distribution to a Member; and/or
- (iv) to deposit all or part of the proceeds into the GIC Account (including, without limitation, to fund the Reserve Amount to an amount not exceeding the prescribed limit).

## SUMMARY OF THE PRINCIPAL DOCUMENTS

### Trust Deed

The Trust Deed (as modified and/or supplemented and/or restated from time to time) made between the Issuer, the Guarantors and the Bond Trustee and the Security Trustee on the Programme Date, is the principal agreement governing the Covered Bonds. The Trust Deed contains provisions relating to, *inter alia*:

- the constitution of the Covered Bonds and the terms and conditions of the Covered Bonds (as more fully set out under *Terms and Conditions of the Covered Bonds* above);
- the covenants of the Issuer and the Guarantors;
- the terms of the HBOS Group Guarantee and the Covered Bond Guarantee (as described below);
- the enforcement procedures relating to the Covered Bonds and the Guarantees; and
- the appointment, powers and responsibilities of the Bond Trustee and the circumstances in which the Bond Trustee may resign or retire or be removed.

### HBOS Group Guarantee

Under the terms of the HBOS Group Guarantee, if the Issuer defaults in the payment on the due date of any moneys due and payable under or pursuant to the Trust Deed or the Covered Bonds or any Receipts or Coupons, the HBOS Group Guarantor has agreed, to pay or procure to be paid upon demand the amount in respect of which such default has been made.

The HBOS Group Guarantor agrees that its obligations under the HBOS Group Guarantee shall be as principal debtor and not merely as surety and shall be absolute and unconditional, irrespective of, and unaffected by, any invalidity, irregularity or unenforceability of, or defect in, any provisions of the Trust Deed or the Covered Bonds or Receipts or Coupons or the absence of any action to enforce the same or the waiver, modification or consent by the Bond Trustee or any of the Covered Bondholders, Receiptholders or Couponholders in respect of any provisions of the same or the obtaining of any judgment or decree against the Issuer or any action to enforce the same or any other circumstances which might otherwise constitute a legal or equitable discharge or defence of a guarantor.

Under the Trust Deed, the HBOS Group Guarantee may be withdrawn if the Issuer becomes a rated entity and the long-term unsecured, unguaranteed and unsubordinated debt obligations of the Issuer are rated by the Rating Agencies at least equal to the then ratings of the HBOS Group Guarantor (such ratings, the “**Requisite Ratings**”) or a further guarantee is provided by another member of the HBOS Group which is on terms substantially similar to the HBOS Group Guarantee and the long-term unsecured, unguaranteed and unsubordinated debt obligations of such member providing such further guarantee are rated by the Rating Agencies at least equal to the Requisite Ratings.

In addition, the HBOS Group Guarantor may withdraw its HBOS Group Guarantee if the Issuer or any member of the HBOS Group who provides a replacement HBOS Group Guarantee as described in the previous paragraph has the Requisite Ratings.

Subject as provided above or in the Transaction Documents, the HBOS Group Guarantee will remain in force in relation to each Series of Covered Bonds until all moneys payable by the Issuer under or pursuant to the Trust Deed and the Covered Bonds of the relevant Series have been paid.

The Trust Deed also provides that all moneys received by the Bond Trustee from the Issuer or the HBOS Group Guarantor following the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice and Notice to Pay, including any moneys recovered in the liquidation, administration or winding-up of the Issuer or the HBOS Group Guarantor (the “**Excess Proceeds**”), shall be paid by the Bond Trustee on behalf of the Covered Bondholders of the relevant Series to the LLP for its own account, as soon as practicable, and shall be held by the LLP in the GIC Account and the Excess Proceeds shall thereafter form part of the Security and shall be used by the LLP in the same manner as all other money from time to time standing to the credit of the GIC Account in accordance with the Guarantee Priority of Payments. Any Excess Proceeds received by the Bond Trustee shall discharge the obligations of the Issuer in respect of the Covered Bonds, Receipts and Coupons and the obligations of the HBOS Group Guarantor under the HBOS Group Guarantee. However, the obligations of the LLP under the Covered Bond Guarantee are unconditional and irrevocable and the receipt by the Bond Trustee of any Excess Proceeds shall not reduce or discharge any of such obligations.

By subscribing for Covered Bond(s), each Covered Bondholder shall be deemed to have directed the Bond Trustee to pay the Excess Proceeds to the LLP in the manner as described above.

### **Covered Bond Guarantee**

Under the terms of the Covered Bond Guarantee, if the Issuer and HBOS Group Guarantor default in the payment on the due date subject to any grace periods of any moneys due and payable under or pursuant to the Trust Deed or the Covered Bonds or any Receipts or Coupons or if any other HBOS Event of Default occurs (other than by reason of non-payment), or if an LLP Event of Default occurs the LLP has agreed (subject as described below) on a several basis (as between the HBOS Group Guarantor on the one hand and the LLP on the other) to pay or procure to be paid (following the service of an HBOS Acceleration Notice and a Notice to Pay on the LLP, or, if earlier, the service on the Issuer and the LLP of an LLP Acceleration Notice) unconditionally and irrevocably to or to the order of the Bond Trustee (for the benefit of the Covered Bondholders), an amount equal to that portion of the Guaranteed Amounts which shall become Due for Payment but would otherwise be unpaid, as of any Scheduled Payment Date, by the Issuer or the HBOS Group Guarantor.

Following the occurrence of an HBOS Event of Default and after the Covered Bonds have been declared due and payable by the Bond Trustee as against the Issuer and the HBOS Group Guarantor and following service of an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor, the Bond Trustee will serve a notice to pay (the “**Notice to Pay**”) on the LLP. Payment by the LLP of the Guaranteed Amounts pursuant to the Covered Bond Guarantee will be made on the later of (a) the day which is two London Business Days following service of a Notice to Pay on the LLP or (b) the day on which the Guaranteed Amounts are otherwise Due for Payment.

All payments of Guaranteed Amounts by or on behalf of the LLP will be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or other governmental charges of whatever nature, unless the withholding or deduction of such taxes, assessments or other governmental charges are required by law or regulation or administrative practice of any jurisdiction. If any such withholding or deduction is required, the LLP will pay the Guaranteed Amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. **The LLP will not be obliged to pay any amount to the Bond Trustee or any holder of Covered Bonds in respect of the amount of such withholding or deduction.**

Under the terms of the Covered Bond Guarantee, the LLP agrees that its obligations under the Covered Bond Guarantee shall be as principal debtor and not merely as surety and shall be absolute and (following the occurrence of an HBOS Event of Default, service of an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor and service of a Notice to Pay on the LLP or, if earlier, service on the Issuer and the LLP of an LLP Acceleration Notice) unconditional, irrespective of, and unaffected by, any invalidity, irregularity or unenforceability of, or defect in, any provisions of the Trust Deed or the Covered Bonds or Receipts or Coupons or the absence of any action to enforce the same or the waiver, modification or consent by the Bond Trustee or any of the Covered Bondholders, Receiptholders or Couponholders in respect of any provisions of the same or the obtaining of any judgment or decree against the Issuer or any action to enforce the same or any other circumstances which might otherwise constitute a legal or equitable discharge or defence of a guarantor.

Failure by the LLP to pay the Guaranteed Amounts when Due for Payment will result in an LLP Event of Default save where such failure arises as a result of a technical default or error and the Bond Trustee is satisfied that the LLP has moneys available to make payment and payment is made within three London Business Days of the Scheduled Payment Date.

For the purposes hereof:

**“Due for Payment”** means, in relation to any Guaranteed Amount payable by the LLP, the date on which the Scheduled Payment Date in respect of such Guaranteed Amount is reached, or, if later, the day which is two London Business Days following service of a Notice to Pay on the LLP (or, if, in either case, such day is not a London Business Day, the next following London Business Day). For the avoidance of doubt, **“Due for Payment”** does not refer to any earlier date upon which payment of any Guaranteed Amount may become due under the guaranteed obligations, by reason of prepayment, acceleration of maturity, mandatory or optional redemption or otherwise.

**“Guaranteed Amounts”** means, with respect to any Scheduled Payment Date, the sum of Scheduled Interest and Scheduled Principal, in each case, payable on each Scheduled Payment Date.

**“London Business Day”** means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

**“Scheduled Interest”** means any amount in respect of scheduled interest payable under the Covered Bonds on each Interest Payment Date as specified in Condition 5 (*Interest*) falling on or after service of a Notice to Pay on the LLP (excluding any additional amounts relating to premiums, default interest or interest upon interest payable by the Issuer and/or the HBOS Group Guarantor following an HBOS Event of Default but including such amounts following an LLP Event of Default) less any additional amounts the Issuer or the HBOS Group Guarantor would be obliged to pay as a result of any gross-up in respect of any withholding or deduction made under the circumstances set out in Condition 8 (*Taxation*).

**“Scheduled Payment Date”** means each Interest Payment Date or Final Maturity Date (as applicable) on which Scheduled Interest or Scheduled Principal is due and payable.

**“Scheduled Principal”** means any amount in respect of scheduled principal payable under the Covered Bonds on each Final Maturity Date or Interest Payment Date (as the case may be) as specified in Condition 7(a) (*Redemption at maturity*) and Condition 7(e) (*Installments*) falling on or after service of a Notice to Pay on the LLP (but excluding any additional amounts relating to prepayments, early redemption, broken funding indemnities, penalties, premiums or default interest payable by the Issuer and/or the HBOS Group Guarantor following an HBOS Event of Default but including such amounts (if any) together with the Early Redemption Amount and any interest accrued

on the Guaranteed Amounts in accordance with Clause 2.2 of the Trust Deed following an LLP Event of Default).

The Trust Deed and any non-contractual obligations arising out of or in connection with it is governed by English law.

### **Intercompany Loan Agreement**

On each Issue Date, the Issuer will use the proceeds of the Covered Bonds issued under the Programme to lend an amount equal to the Sterling Equivalent of the gross proceeds of the issue of the Covered Bonds to the LLP by way of a term advance (each such term advance, a “**Term Advance**”) pursuant to a term loan agreement dated the Programme Date between the Issuer, the LLP and the Security Trustee (as amended and/or restated from time to time the “**Intercompany Loan Agreement**”). Each Term Advance will be used by the LLP (i) as consideration in part for the acquisition of Loans and their Related Security from a Seller or Sellers pursuant to the terms of the Mortgage Sale Agreement, as described under – *Mortgage Sale Agreement – Sale by Sellers of Loans and their Related Security* and/or (ii) to invest in Substitution Assets in an amount not exceeding the prescribed limit to the extent required to meet the requirements of Regulations 23 and 24(1)(a) of the RCB Regulations and the Asset Coverage Test and thereafter may be applied by the LLP: (i) as consideration in part for the acquisition of Loans and their Related Security from the Seller pursuant to the terms of the Mortgage Sale Agreement, as described under – *Mortgage Sale Agreement – Sale by the Seller of Loans and their Related Security*; and/or (ii) to invest in Substitution Assets in an amount not exceeding the prescribed limit; and/or (iii) (subject to satisfying the Asset Coverage Test), to make a Capital Distribution to a Member; and or (iv) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or (v) to make a deposit in the GIC Account (including, without limitation, to fund the Reserve Fund to an amount not exceeding the prescribed limit). Each Term Advance will bear interest at a rate of interest equal to LIBOR for one-month sterling deposits.

The Issuer will not be relying on repayment of any Term Advance in order to meet its repayment obligations under the Covered Bonds. Following payment in full of all amounts outstanding under a Series of Covered Bonds, the LLP will repay the corresponding Term Advances(s) in accordance with the relevant Priorities of Payments. Interest on each Term Advance will be paid by the LLP over the term of that Term Advance. However, the Issuer will not be relying on payment of such interest in order to meet its interest obligations under the Covered Bonds.

The amounts owed by the LLP to the Issuer under the Intercompany Loan Agreement will be reduced by the Sterling Equivalent of any amounts paid by the LLP under the terms of the Covered Bond Guarantee.

The Intercompany Loan Agreement and any non-contractual obligations arising out of or in connection with it is governed by English law.

### **Mortgage Sale Agreement**

#### **Original Seller and New Sellers**

Loans and their Related Security will be sold to the LLP from time to time pursuant to the terms of a mortgage sale agreement entered into on the Programme Date between Bank of Scotland (as successor to Halifax’s business pursuant to the HBOS Group Reorganisation Act 2006) (in its capacity as seller, the “**Original Seller**”), the LLP and the Security Trustee (as amended and/or restated from time to time, the “**Mortgage Sale Agreement**”). In addition, any other member of the

Lloyds Banking Group that wishes to sell Loans and their Related Security (each a “**New Seller**” and, together with the Original Seller, the “**Sellers**”) to the LLP will accede to, *inter alia*, the Mortgage Sale Agreement. The sale of New Loans and their Related Security by New Sellers to the LLP will be subject to certain conditions, including the following:

- each New Seller accedes to the terms of the LLP Deed as Member (with such subsequent amendments as may be agreed by the parties thereto) so that it has, in relation to those New Loans and their Related Security to be sold by the relevant New Seller, substantially the same rights and obligations as the Original Seller had in relation to those Loans and their Related Security comprised in the Initial Portfolio under the LLP Deed;
- each New Seller accedes to the terms of the Mortgage Sale Agreement (with such subsequent amendments as may be agreed by the parties thereto) so that it has, in relation to those New Loans and their Related Security to be sold by the relevant New Seller, substantially the same rights and obligations as the Original Seller had in relation to those Loans and their Related Security comprised in the Initial Portfolio under the Mortgage Sale Agreement;
- each New Seller accedes to the Programme Agreement and enters into such other documents as may be required by the Security Trustee and/or the LLP (acting reasonably) to give effect to the addition of a New Seller to the transactions contemplated under the Programme;
- any Loans and their Related Security sold by a New Seller to the LLP comply with the Eligibility Criteria set out in the Mortgage Sale Agreement;
- the Security Trustee is satisfied that any accession of a New Seller to the Programme will not prejudice the Asset Coverage Test; and
- the Security Trustee is satisfied that the accession of a New Seller to the Programme is not materially prejudicial to Covered Bondholders.

If the above conditions are met, the consent of Covered Bondholders will not be obtained to the accession of a New Seller to the Programme.

For the purposes hereof:

“**Arrears of Interest**” means, in respect of a Loan on a given date, interest and expenses which are due and payable and unpaid on that date and which are not Capitalised Arrears or Capitalised Expenses.

“**Borrower**” means, in relation to a Loan, the individual or individuals specified as such in the relevant mortgage together with the individual or individuals (if any) from time to time assuming an obligation to repay such Loan or any part of it.

“**Capitalised Arrears**” means, in relation to a Loan at any date (the “**determination date**”), the amount (if any) at such date of any interest and expenses which are due and payable and unpaid on or before that date in respect of which, at the determination date, each of the following conditions have been satisfied:

- (a) a Seller has, by arrangement with the relevant Borrower, agreed to capitalise such amounts; and
- (b) such amounts have been capitalised and added, in the accounts of a Seller (or, if the determination date occurs after the First Transfer Date, the LLP), to the aggregate Principal Amount Outstanding in respect of such Loan.



“**Capitalised Expenses**” means, in relation to a Loan, the amount of any expense, charge, fee, premium or payment (excluding, however, any Arrears of Interest) capitalised and added to the aggregate Outstanding Principal Balance in respect of such Loan in accordance with the relevant Mortgage Terms (including, for the avoidance of doubt, any High Loan-to-Value Fee (as defined in the Master Definitions and Construction Agreement)).

“**Current Balance**” means in relation to a Loan at any given date, the aggregate (without double counting) of the Outstanding Principal Balance, Accrued Interest and Arrears of Interest relating to that Loan as at that date.

“**Deferred Consideration**” means the consideration payable to the Sellers in respect of the Loans sold to the LLP from time to time, which is payable after making payments of a higher order of priority as set out in the relevant Priorities of Payments.

“**English Loans**” means Loans secured by a mortgage over a property located in England and Wales.

“**First Transfer Date**” means the date on which the Initial Portfolio is transferred to the LLP pursuant to the Mortgage Sale Agreement.

“**Loan**” means each loan referenced by its loan identifier number and comprising the aggregate of all principal sums, interest, costs, charges, expenses and other moneys (including all Additional Loan Advances) due or owing with respect to that loan under the relevant Mortgage Terms by a Borrower on the security of a Mortgage from time to time outstanding or, as the context may require, the Borrower’s obligations in respect of the same.

“**Mortgages**” means a first fixed charge by way of legal mortgage (in relation to English Loans) and first ranking standard securities (in relation to Scottish Loans), sold by the relevant Seller to the LLP pursuant to the Mortgage Sale Agreement, which secure the repayment of the relevant Loan.

“**Mortgage Conditions**” means the terms and conditions applicable to a Loan as contained in the relevant Seller’s mortgage Standard Documentation provided to Borrowers from time to time.

“**Related Security**” means, in relation to a Loan, the security for the repayment of that Loan including the relevant Mortgage and all other matters applicable thereto acquired as part of the Portfolio.

“**Scottish Loans**” means Loans secured by a standard security over a property located in Scotland.

“**Transfer Date**” means the First Transfer Date and the date of transfer of any New Portfolio to the LLP in accordance with the Mortgage Sale Agreement.

### **Sale by Sellers of Loans and Related Security**

The Portfolio will consist of Loans and their Related Security sold from time to time by Sellers to the LLP in accordance with the terms of the Mortgage Sale Agreement. The types of Loans forming part of the Portfolio will vary over time provided that, at the time the relevant Loans are sold to the LLP, the Eligibility Criteria (as described below) in respect of such Loans are met on the relevant Transfer Date. Accordingly, the Portfolio may, at any time, include Loans originated or purchased by different Sellers, Loans with characteristics that were not being offered to borrowers on previous Transfer Dates or Loans that have not yet been developed, such as Flexible Loans.

Prior to the occurrence of an HBOS Event of Default, the LLP will acquire Loans and their Related Security from the Sellers in the three circumstances described below.

- (a) First, in relation to the issue of Covered Bonds from time to time in accordance with the Programme, the Issuer will make Term Advances to the LLP, the proceeds of which may be applied in whole or in part by the LLP to acquire Loans and their Related Security from the Sellers. In exchange for the sale of the Loans and their Related Security to the LLP, the relevant Seller will receive an amount equal to the Current Balance of those Loans sold by it as at the Transfer Date, which will be satisfied by a combination of:
  - (i) a cash payment to be made by the LLP from the proceeds of the relevant Term Advance and/or from Available Principal Receipts; and/or
  - (ii) the Seller being treated as having made a Capital Contribution in an amount equal to the difference between the Current Balance of the Loans sold by the relevant Seller as at the relevant Transfer Date and the cash payment (if any) made by the LLP; and
  - (iii) Deferred Consideration.
- (b) Secondly, the LLP will use the Available Principal Receipts that are specifically attributable to Loans and their Related Security sold by a specific Seller to acquire New Loans and their Related Security from that Seller or any other Seller nominated by that Seller and/or Substitution Assets (in respect of any Substitution Assets up to the prescribed limit) on each LLP Payment Date.
- (c) Thirdly, the LLP and the Sellers are required to ensure that the Portfolio is maintained at all times in compliance with the Asset Coverage Test (as determined by the Cash Manager on each Calculation Date). If on any Calculation Date there is a breach of the Asset Coverage Test the Sellers will use all reasonable efforts to offer to sell sufficient New Loans and their Related Security to the LLP on or before the next Calculation Date in consideration of the relevant Sellers being treated as having made a Capital Contribution (in an amount equal to the Current Balance of the New Loans) sold by the relevant Seller as at the relevant Transfer Date and in consideration of the right to receive the Deferred Consideration.

If Selected Loans and their Related Security are sold by or on behalf of the LLP as described below under *LLP Deed – Requirement to sell Selected Loans following service of a Notice to Pay*, the obligations of the Sellers insofar as they relate to those Selected Loans and their Related Security will cease to apply.

Sellers will also be required to repurchase Loans and their Related Security sold to the LLP in the circumstances described below under – *Repurchase of Loans*.

“**Initial Advance**” means, in respect of any Loan, the original principal amount advanced by the relevant Seller to the relevant Borrower.

“**New Loans**” means Loans, other than the Loans comprised in the Initial Portfolio, which a Seller may assign or transfer to the LLP after the First Transfer Date pursuant to the Mortgage Sale Agreement.

“**New Portfolio Notice**” means a notice in the form set out in the Mortgage Sale Agreement served in accordance with the terms of the Mortgage Sale Agreement.

**“Outstanding Principal Balance”** in relation to a Loan at any date (the **“determination date”**), means the aggregate principal balance of the Loan at such date (but avoiding double counting) including:

- (a) the Initial Advance;
- (b) Capitalised Expenses;
- (c) Capitalised Arrears; and
- (d) any increase in the principal amount due under that Loan due to any form of Additional Loan Advance,

in each case relating to such Loan less any prepayment, repayment or payment of the foregoing made on or prior to the determination date.

### **Eligibility Criteria**

The sale of Loans and their Related Security to the LLP will be subject to various conditions (the **“Eligibility Criteria”**) being satisfied on the relevant Transfer Date or in respect of Additional Loan Advances, on the next Calculation Date, including:

- (a) no HBOS Event of Default or LLP Event of Default under the Transaction Documents shall have occurred which is continuing;
- (b) the LLP, acting on the advice of the Cash Manager, is not aware, and could not reasonably be expected to be aware, that the purchase of the Loans and their Related Security, would adversely affect the then current ratings by Moody’s, S&P or Fitch of the Covered Bonds;
- (c) the yield on the Loans in the Portfolio (including the New Loans) is at least 0.15 per cent. greater than LIBOR for one month sterling deposits after taking into account (i) the average yield on the Loans which are Variable Rate Loans, Tracker Rate Loans and Fixed Rate Loans and other Loans for which hedging is required under the Interest Rate Swaps and (ii) the margins on the Interest Rate Swaps and (iii) the average yield on any Substitution Assets held by the LLP;
- (d) no Loan has a Current Balance of more than £1,000,000; and
- (e) no Loan constitutes a New Loan Type, in respect of which no confirmation has been received, in accordance with the terms of the Mortgage Sale Agreement, that such Loan may be sold to the LLP.

On the relevant Transfer Date, the Representations and Warranties (described below in *Representations and Warranties*) will be given by the relevant Seller in respect of the Loans and their Related Security sold by that Seller to the LLP.

If a Seller accepts an application from or makes an offer (which is accepted) to a Borrower for a Product Switch or any Additional Loan Advance, then if the Eligibility Criteria referred to in paragraphs (c), (d) and (e) above relating to the Loan subject to that Product Switch or Additional Loan Advance is not satisfied on the next following Calculation Date, the LLP will be entitled to rectify the relevant breach of those Eligibility Criteria by (in the event of a breach of the Eligibility Criteria in paragraphs (c), (d) and (e) above) requiring the relevant Seller to repurchase the Loans subject to any Product Switch or Additional Loan Advance or (in the event of a breach of the

Eligibility Criteria in paragraph (c) above) by requiring the relevant Seller to transfer further Loans to the LLP in an amount sufficient to ensure that the Eligibility Criteria in paragraph (c) above is met.

For the purposes hereof:

“**Product Switch**” means a variation to the financial terms or conditions included in the Mortgage Terms applicable to a Loan other than:

- (a) any variation agreed with a Borrower to control or manage arrears on a Loan;
- (b) any variation in the maturity date of a Loan;
- (c) any variation imposed by statute; or
- (d) any variation in the frequency with which the interest payable in respect of the Loan is charged.

### **Transfer of Title to the Loans to the LLP**

English Loans will be sold by Sellers to the LLP by way of equitable assignment. Scottish Loans were sold by the Original Seller on the First Transfer Date by way of a declaration of trust and, in relation to Scottish Loans sold by the Sellers to the LLP after the First Transfer Date, were or will be sold by way of further declarations of trust (each such declaration of trust, a “**Scottish Declaration of Trust**” and, together, the “**Scottish Declarations of Trust**”) under which the beneficial interest in such Scottish Loans was or will be transferred to the LLP. In relation to Scottish Loans, references in this document to sale of Loans are to be read as references to the making of such Scottish Declarations of Trust. Such beneficial interest (as opposed to the legal title) cannot be registered in the Land Register of Scotland or the General Register of Sasines (the two Scottish property registers). As a result, legal title to both English Loans and Scottish Loans and their Related Security will remain with the Sellers until legal assignments or assignations (as appropriate) are delivered by the Sellers to the LLP and notice of the sale is given by the Sellers to the Borrowers. Legal assignment or assignation (as appropriate) of the Loans and their Related Security (including, where appropriate, their registration or recording in the relevant property register) to the LLP will be deferred and will only take place in the limited circumstances described below.

Legal assignment or assignation (as appropriate) of the Loans and their Related Security (or, where specified, the Selected Loans and their Related Security) to the LLP will be completed on or before the 20th London Business Day after the earliest of the following:

- (a) the occurrence of an HBOS Event of Default and service on the LLP of a Notice to Pay (unless the relevant Seller or Sellers has or have notified the LLP that it will accept the offer set out in the Selected Loans Offer Notice within the prescribed time);
- (b) in respect of Selected Loans only, at the request of the LLP following the acceptance of any offer to sell the Selected Loans and their Related Security to any person who is not a Seller;
- (c) a Seller and/or the LLP being required, by an order of a court of competent jurisdiction, or by a regulatory authority of which the Seller is a member or any organisation whose members comprise, but are not necessarily limited to, mortgage lenders with whose instructions it is customary for the Seller to comply, to perfect legal title to the Mortgages;
- (d) it being rendered necessary by law to take such actions;

- (e) the Security under the Deed of Charge or any material part of that Security being in jeopardy and the Security Trustee determining or being required by the Bond Trustee (on behalf of the Covered Bondholders) or the other Secured Creditors to take that action to reduce that jeopardy;
- (f) unless otherwise agreed by the Security Trustee and so long as the Rating Agencies have been notified, the termination of a Seller's role as Servicer under the relevant Servicing Agreement unless the replacement servicer, if any, is a member of the HBOS Group;
- (g) a Seller requesting a transfer by way of assignment or assignation (as appropriate) by giving notice to the LLP and the Security Trustee;
- (h) the date on which any Seller ceases to be assigned a long-term unsecured, unsubordinated unguaranteed debt obligation rating by Moody's of at least Baa3 or by S&P of at least BBB- or by Fitch of at least BBB-; and
- (i) the occurrence of an Insolvency Event in relation to a Seller.

Pending completion of the transfer, the right of the LLP to exercise the powers of the legal owner of, or (in Scotland) the heritable creditor under, the Mortgages will be secured by, or (in Scotland) supported by, an irrevocable power of attorney granted by each Seller in favour of the LLP and the Security Trustee.

The Title Deeds and Customer Files relating to the Loans in the Portfolio will be held by or to the order of the relevant Seller or relevant Servicer, as the case may be, or by solicitors, licensed conveyancers or (in Scotland) qualified conveyancers acting for the relevant Seller in connection with the creation of the Loans and their Related Security. The Sellers or relevant Servicer, as the case may be, will undertake that all the Title Deeds and Customer Files relating to the Loans in the Portfolio which are at any time in their possession or under their control or held to their order will be held to the order of the Security Trustee or as the Security Trustee may direct.

For the purposes hereof:

“**Customer Files**” means the file or files relating to each Loan containing, *inter alia*:

- (a) all material correspondence relating to that Loan; and
- (b) the completed mortgage documentation applicable to the Loan (other than the Title Deeds) including the Valuation Report (if applicable) and, to the extent available, the solicitor's or licensed conveyancer's, or (in Scotland) qualified conveyancer's, Certificate of Title,

whether original documentation, electronic form or otherwise or information provided by such documentation stored on an electronic database.

“**Insolvency Event**” means, in respect of a Seller, a Servicer or a Cash Manager (each a “**relevant entity**”):

- (a) an order is made or an effective resolution passed for the bankruptcy or liquidation or winding-up of the relevant entity; or
- (b) the relevant entity ceases to carry on its business or substantially all its business; or
- (c) proceedings shall be initiated against the relevant entity under any applicable liquidation, winding-up, insolvency, bankruptcy, composition, reorganisation or other similar laws; or a

receiver, administrator, trustee or other similar official shall be appointed in relation to the relevant entity or in relation to the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets or a distress, diligence or execution or other process shall be levied or enforced upon or sued out against the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets and, in any of the foregoing cases, it shall not be discharged within thirty days; or if the relevant entity shall initiate or consent to judicial proceedings relating to itself under any applicable liquidation, winding-up, insolvency, bankruptcy, composition, reorganisation or other similar laws or shall make a conveyance, assignment or assignation for the benefit of, or shall enter into any composition with, its creditors generally; or

- (d) the relevant entity shall be unable to pay its debts as they fall due (within the meaning of section 123(1)(b) to (e) and section 123(2) of the Insolvency Act 1986 (as those sections may be amended)) or shall admit inability to pay its debts as they fall due or shall stop payment or shall be adjudged or found bankrupt or insolvent.

**“Lending Criteria”** means the criteria applicable to the granting of an offer of a Loan to a Borrower from time to time, or such other criteria as would be acceptable to a Reasonable, Prudent Mortgage Lender.

**“Property”** means a freehold or leasehold property (or in Scotland a heritable property or a property held under a long lease) which is subject to a Mortgage.

**“Reasonable, Prudent Mortgage Lender”** means the Sellers and/or the Servicers, as applicable, acting in accordance with the standards of a reasonably prudent residential mortgage lender lending to borrowers in England, Wales and/or Scotland who generally satisfy the lending criteria of traditional sources of residential mortgage capital.

**“Standard Documentation”** means the standard documentation, annexed to the relevant exhibit of the Mortgage Sale Agreement or any update or replacement therefor as each Seller may from time to time introduce acting in accordance with the standards of a Reasonable, Prudent Mortgage Lender.

**“Title Deeds”** means, in relation to each Loan and its Related Security and the Property relating thereto, all conveyancing deeds and documents which make up the title to the Property and the security for the Loan and all searches and enquiries undertaken in connection with the grant by the Borrower of the related Mortgage.

**“Valuation Report”** means the valuation report or reports for mortgage purposes, in the form of one of the pro-forma contained in the Standard Documentation, obtained by a Seller from a Valuer in respect of each Property or a valuation report in respect of a valuation made using a methodology which would be acceptable to a Reasonable, Prudent Mortgage Lender and which has been approved by the relevant officers of the relevant Seller.

**“Valuer”** means an Associate or Fellow of the Royal Institute of Chartered Surveyors or the Incorporated Society of Valuers and Auctioneers who was at the relevant time either a member of a firm which was on the list of Valuers approved by or on behalf of the relevant Seller from time to time or an Associate or Fellow of the Royal Institute of Chartered Surveyors or the Incorporated Society of Valuers and Auctioneers employed in-house by the relevant Seller acting for the relevant Seller in respect of the valuation of a Property.

## Representations and warranties

None of the HBOS Group Guarantor, the LLP, the Security Trustee, the Bond Trustee or the Issuer has made or has caused to be made on its behalf any enquiries, searches or investigations in respect of the Loans and their Related Security to be sold to the LLP. Instead, each is relying entirely on the Representations and Warranties by the relevant Seller contained in the Mortgage Sale Agreement. The parties to the Mortgage Sale Agreement may, with the prior written consent of the Security Trustee and if confirmation has been obtained from the Rating Agencies, amend the Representations and Warranties in the Mortgage Sale Agreement. The material Representations and Warranties are as follows and are given on the relevant Transfer Date in respect of the Loans and Related Security to be sold to the LLP only on that date and on the Calculation Date following the making of any Further Advance or Product Switch in respect of the Loan to which the Further Advance or Product Switch relates only:

- each Loan was originated by a Seller or purchased by a Seller in the ordinary course of business (and kept on that entity's books for a minimum of 3 months);
- each Loan was originated in pounds sterling and is denominated in pounds sterling (or was originated and is denominated in euro if the euro has been adopted as the lawful currency of the United Kingdom);
- no Loan has a Current Balance of more than £1,000,000;
- each Loan has a remaining term of less than 50 years as at the relevant Transfer Date;
- prior to the making of each advance under a Loan, the Lending Criteria and all preconditions to the making of any Loan were satisfied in all material respects subject only to exceptions as would be acceptable to a Reasonable, Prudent Mortgage Lender;
- all of the Borrowers are individuals;
- at least two monthly payments have been made in respect of each Loan;
- the whole of the Current Balance on each Loan is secured by a Mortgage over residential property;
- subject only in certain appropriate cases to the completion of applications for registrations at the Land Registry or the Registers of Scotland each Mortgage constitutes a valid and subsisting first charge by way of legal mortgage or (in Scotland) first ranking standard security over the relevant property;
- each Loan and its Related Security is, save in relation to any Loan and Related Security which is not binding by virtue of the UTCCR, valid, binding and enforceable in accordance with its terms. To the best of the relevant Seller's knowledge, none of the Loans or their Related Security, save for any term which relates to the recovery of interest under the Standard Documentation applicable to that Loan, is not binding by virtue of its being unfair pursuant to the UTCCR;
- all of the properties are in England or Wales or Scotland;
- not more than twelve months (or a longer period as may be acceptable to a Reasonable, Prudent Mortgage Lender) prior to the granting of each Mortgage, the relevant Seller received a Valuation Report on the relevant Property (or another form of report concerning the

valuation of the relevant Property as would be acceptable to a Reasonable, Prudent Mortgage Lender), the contents of which were such as would be acceptable to a Reasonable, Prudent Mortgage Lender;

- the benefit of all Valuation Reports and Certificates of Title (if available) which were provided to the relevant Seller not more than two years prior to the date of the Mortgage Sale Agreement can be validly assigned to the LLP without obtaining the consent of the relevant Valuer, solicitor, licensed conveyancer or (in Scotland) qualified conveyancers;
- prior to the taking of each Mortgage (other than a remortgage), the relevant Seller instructed its solicitor, licensed conveyancer or (in Scotland) qualified conveyancers to carry out an investigation of title to the relevant property and to undertake other searches, investigations, enquiries and other actions on behalf of the relevant Seller in accordance with the instructions which the Seller issued to the relevant solicitor, licensed conveyancer or (in Scotland) qualified conveyancers as are set out in the case of English Loans in the CML's Lenders' Handbook for England & Wales (or, for Mortgages taken before the CML's Lenders' Handbook for England and Wales was adopted in 1999, the Seller's Mortgage Practice Notes) and, in the case of Scottish Loans, the CML Lenders' Handbook for Scotland (or, for Mortgages taken before the CML Lenders' Handbook for Scotland was adopted in 2000, the Seller's Mortgage Practice Notes) or other comparable or successor instructions and/or guidelines as may for the time being be in place, subject only to those variations as would be acceptable to a Reasonable, Prudent Mortgage Lender;
- buildings insurance cover for each property is available under either a policy arranged by the Borrower or a policy issued to Borrowers by or on behalf of the relevant Seller on behalf of an insurer who agrees with the relevant Seller to issue buildings insurance policies to Borrowers from time to time or a policy arranged by the relevant landlord or the properties in possession cover;
- the relevant Seller has good title to, and is the absolute unencumbered legal and beneficial owner of, all property, interests, rights and benefits agreed to be sold by the relevant Seller to the LLP under the Mortgage Sale Agreement;
- the relevant Seller has, since the making of each Loan, kept or procured the keeping of full and proper accounts, books and records showing clearly all transactions, payments, receipts, proceedings and notices relating to such Loan;
- there are no governmental authorisations, approvals, licences or consents required as appropriate for the relevant Seller to enter into or to perform its obligations under the Mortgage Sale Agreement or to make the Mortgage Sale Agreement legal, valid, binding and enforceable;
- each Loan and its Related Security will be "eligible property" for the purposes of Regulation 2 of the RCB Regulations; and
- interest under each Loan can at all times be set in the manner disclosed in the Mortgage Sale Agreement.

If New Loan Types are to be sold to the LLP, then the Representations and Warranties in the Mortgage Sale Agreement will be modified as required to accommodate these New Loan Types. The prior consent of the Covered Bondholders to the requisite amendments will not be required to be obtained.



For the purposes hereof:

“**Accrued Interest**” means in relation to any Loan and as at any date (the “**determination date**”) on or after the relevant Transfer Date, interest on such Loan (not being interest which is currently payable on the determination date) which has accrued from and including the Monthly Payment Date immediately prior to the determination date and including the determination date.

“**Certificate of Title**” means a solicitor’s, licensed conveyancer’s or (in Scotland) qualified conveyancer’s report or certificate of title obtained by or on behalf of the Seller in respect of each Property substantially in the form of the pro-forma set out in the Standard Documentation.

“**Flexible Loan**” means a type of Loan product that typically incorporates features that give the Borrower options to, among other things, make further drawings on the Loan account and/or to overpay or underpay interest and principal in a given month.

“**Further Advance**” means, in relation to a Loan, any advance of further money to the relevant Borrower following the making of the Initial Advance, which is secured by the same Mortgage as the Initial Advance, but which is an amount in excess of the principal amount of the Loan approved by the Seller, at the time of origination of the Loan.

“**Monthly Payment Date**” means the date on which interest (and principal in relation to a repayment mortgage) is due to be paid by a Borrower on a Loan or, if any such day is not a business day, the next following business day.

“**New Loan Type**” means on any date a type of Loan which is of a type that has not previously been comprised in the Portfolio.

“**Representations and Warranties**” means the representations and warranties set out in the Mortgage Sale Agreement.

## **Repurchase of Loans**

If a Seller receives a notice from the Cash Manager (the “**Defaulted Loans Notice**”) identifying Loans in the Portfolio which are more than 3 months in arrears (the “**Defaulted Loans**”) or if a Loan in the Portfolio does not, as at the relevant Transfer Date or relevant Calculation Date (in the case of a Further Advance), materially comply with the Representations and Warranties set out in the Mortgage Sale Agreement, then the relevant Seller will immediately notify the LLP and the LLP may, if so directed by the Cash Manager and, subject to the prior Written Consent of the Security Trustee, serve on the Seller a notice substantially in the form set out in the Mortgage Sale Agreement (the “**Loan Repurchase Notice**”) whereupon the Seller will be required (but only prior to the occurrence of an HBOS Event of Default) to repurchase any such Loans under the relevant Mortgage Account and their Related Security sold by it in an amount equal to the Current Balance thereof and expenses as at the relevant repurchase date. The repurchase proceeds received by the LLP will be applied (other than Accrued Interest) in accordance with the Pre-Acceleration Principal Priority of Payments (see *Cashflows* below).

In addition to the foregoing circumstances, the Sellers will also be required to repurchase a Loan or Loans and its or their Related Security sold by them to the LLP where an Additional Loan Advance made in respect of a Loan results in certain Eligibility Criteria being breached or if a court or other competent authority or any ombudsman makes any determination in respect of that Loan and its Related Security that any term which relates to the recovery of interest under the Standard Documentation applicable to that Loan and its Related Security is not binding on the relevant Borrower because it is unfair.

## Right of Pre-emption

Under the terms of the Mortgage Sale Agreement, each Seller has a right of pre-emption in respect of any sale, in whole or in part, of Selected Loans and their Related Security.

The LLP will serve on the Sellers a notice offering to sell those Selected Loans and their Related Security which each Seller has previously sold to the LLP (or, to such other Seller nominated by the relevant Seller) for an offer price equal to the greater of the then Current Balance of the Selected Loans and the Adjusted Required Redemption Amount, subject to the offer being accepted by the Sellers within 10 London Business Days (a “**Selected Offer Notice**”). If all of the Sellers reject or fail to accept the LLP’s offer, the LLP will offer to sell the Selected Loans and their Related Security to Purchasers (as described under – *LLP Deed Sale of Selected Loans in the Portfolio following the occurrence of an HBOS Event of Default*, below).

If any of the Sellers validly accepts the LLP’s offer to sell the Selected Loans and their Related Security, the LLP will, within three London Business Days of such acceptance, serve a further notice on the relevant Seller or Sellers (a “**Selected Loan Repurchase Notice**”). The relevant Seller or Sellers will sign and return a duplicate copy of the Selected Loan Repurchase Notice and will repurchase from the LLP free from the Security created by and pursuant to the Deed of Charge the relevant Selected Loans and their Related Security (and any other Loan secured or intended to be secured by that Related Security or any part of it) referred to in the relevant Selected Loan Repurchase Notice. Completion of the purchase of the Selected Loans and their Related Security by a Seller will take place on the LLP Payment Date after receipt of the Selected Loans Repurchase Notice(s) or such date as the LLP may direct in the Selected Loans Repurchase Notice (provided that such date is not later than the earlier to occur of the date which is (a) 10 London Business Days after returning the Selected Loan Repurchase Notice to the LLP and (b) the Final Maturity Date of as applicable, the Hard Bullet Covered Bonds or the Earliest Maturing Covered Bonds).

“**Purchaser**” means any third party or any Seller to whom the LLP offers to sell Selected Loans.

“**Required Redemption Amount**” means in respect of any relevant Series of Covered Bonds, the amount calculated as follows:

$$\text{the Principal Amount Outstanding of the relevant Series of Covered Bonds} \quad \times \quad (1+ 0.65\% \times (\text{days to maturity of the relevant Series of Covered Bonds}/365))$$

“**Selected Loans**” means Loans and their Related Security to be sold by the LLP pursuant to the terms of the LLP Deed having in aggregate the Required Outstanding Principal Balance Amount.

## Further Drawings under Loans

Each Seller is solely responsible for funding all future drawings in respect of any additional advance (including, but not limited to, Further Advances) other than the Initial Advance (each, an “**Additional Loan Advance**”) in respect of Loans sold by that Seller to the LLP, if any. The amount of the relevant Seller’s Capital Contribution will increase by the amount of the funded Additional Loan Advance as set out in the LLP Deed.

## Governing law

The Mortgage Sale Agreement and any non-contractual obligations arising out of or in connection with it is governed by English law (other than certain aspects relating to the Scottish Loans and their Related Security which are governed by Scots law).

## **Servicing Agreements**

Pursuant to the terms of a servicing agreement entered into on the Programme Date between the LLP, Bank of Scotland (as successor to Halifax's business pursuant to the HBOS Group Reorganisation Act 2006) (in its capacity as servicer, the "**Original Servicer**") and the Security Trustee (the "**Original Servicing Agreement**"), the Original Servicer has agreed to service on behalf of the LLP the Loans and their Related Security sold by the Original Seller to the LLP and the New Loans and their Related Security sold by New Sellers to the LLP, unless any New Seller and the Original Servicer agree that such New Seller shall act as servicer in relation to Loans and their Related Security sold by such New Seller to the LLP (as described below).

If it is agreed that the New Seller will service, on behalf of the LLP, the New Loans and their Related Security sold by such New Seller to the LLP then a servicing agreement will be entered into between such New Seller (in its capacity as servicer, the "**New Servicer**" and, together with the Original Servicer and any other New Servicer, a "**Servicer**"), the LLP and the Security Trustee on substantially the same terms as the Original Servicing Agreement so that each New Servicer has substantially the same rights and obligations as the Original Servicer (each a "**New Servicing Agreement**" and, together with the Original Servicing Agreement, a "**Servicing Agreement**").

Each Servicer will be required to administer the Loans in accordance with the relevant Servicing Agreement and:

- (i) in the case of the Original Servicer, as if the Loans and their Related Security sold by the Original Seller to the LLP had not been sold to the LLP but remained with the Original Seller or, in relation to New Loans and their Related Security sold by New Sellers (where the Original Servicer has agreed to service such New Loans and their Related Security), as if such New Loans and their Related Security had been Loans and their Related Security of the Original Seller which had remained with the Original Servicer;
- (ii) in the case of any New Servicer, as if the New Loans and their Related Security sold by the relevant New Seller to the LLP (where the New Servicer has agreed to service such New Loans and their Related Security) had not been sold to the LLP but remained with the relevant New Seller; and
- (iii) in the case of each Servicer, in accordance with the relevant Seller's procedures and administration and enforcement policies as they apply to those Loans.

Each Servicer's actions in servicing the Loans in accordance with its procedures will be binding on the LLP and the Secured Creditors.

Each Servicer will have the power to exercise the rights, powers and discretions and to perform the duties of the LLP in relation to the Loans and their Related Security that it is servicing pursuant to the terms of the relevant Servicing Agreement, and to do anything which it reasonably considers necessary or convenient or incidental to the administration of those Loans and their Related Security.

## **Undertakings of the Servicer**

Pursuant to the terms of the relevant Servicing Agreement, the relevant Servicer will undertake in relation to those Loans and their Related Security that it is servicing, *inter alia*, to:

- keep records and accounts on behalf of the LLP in relation to the Loans;

- keep the Customer Files and Title Deeds in its possession in safe custody and maintain records necessary to enforce each Mortgage and to provide the LLP and the Security Trustee with access to the Title Deeds and other records relating to the administration of the Loans and their Related Security;
- maintain a register in respect of the Portfolio;
- make available to the LLP and the Security Trustee a report on a monthly basis containing information about the Loans and their Related Security comprised in the Portfolio;
- provide to the FSA such information about the Loans and their Related Security contained in the Portfolio and/or such other information as the FSA may direct pursuant to the RCB Regulations in an appropriate form and manner prescribed by the RCB Sourcebook;
- assist the Cash Manager in the preparation of a monthly asset coverage report in accordance with the Cash Management Agreement;
- take all reasonable steps, in accordance with the usual procedures undertaken by a Reasonable, Prudent Mortgage Lender, to recover all sums due to the LLP, including instituting proceedings and enforcing any relevant Loan or Mortgage; and
- to enforce any Loan which is in default in accordance with the relevant Seller's enforcement procedures or, to the extent that such enforcement procedures are not applicable having regard to the nature of the default in question, with the usual procedures undertaken by a Reasonable, Prudent Mortgage Lender on behalf of the LLP.

The Servicer also undertakes that, on the Servicer ceasing to be assigned a long-term unsecured, unguaranteed and unsubordinated debt obligation rating by Moody's of at least Baa3 or by S&P of at least BBB- or by Fitch of at least BBB-, it will use reasonable efforts to enter into a master servicing agreement with a third party within 60 days.

#### **Setting of Variable Base Rates and any variable margins**

In addition to the undertakings described above, the Original Servicer has also undertaken in the Original Servicing Agreement to determine and set in relation to all the Original Seller's Loans in the Portfolio the LLP Variable Base Rate and any variable margin applicable in relation to any Tracker Rate Loan in relation to the Loans in the Portfolio except in the limited circumstances described in this sub-section headed – *Setting of Variable Base Rates and any variable margins* when the LLP will be entitled to do so. The Original Servicer will not at any time prior to service of a Notice to Pay on the LLP and/or transfer of legal title of the Portfolio (or any part thereof) to the LLP, without the prior consent of the LLP, set or maintain:

- (i) the LLP Variable Base Rate applicable to the Loans sold by the Original Seller and in the Portfolio at a rate which is higher than (although it may be lower than or equal to) the then prevailing Variable Base Rate of the Original Seller which applies to Loans beneficially owned by the Original Seller outside the Portfolio;
- (ii) a margin in respect of any Tracker Rate Loan sold by the Original Seller and in the Portfolio which, where the Offer Conditions for that Loan provide that the margin shall be the same as the margin applicable to all other Loans having the same Offer

Conditions in relation to interest rate setting, is higher or lower than the margin then applying to those Loans beneficially owned by the Original Seller outside the Portfolio; and

- (iii) a margin in respect of any other Tracker Rate Loan sold by the Original Seller and in the Portfolio which is higher than the margin which would then be set in accordance with the relevant Seller's policy from time to time in relation to that type of Loan.

In particular, the Original Servicer shall determine on each Calculation Date, having regard to the aggregate of:

- (a) the income which the LLP would expect to receive during the next succeeding Interest Period (the "**relevant Interest Period**");
- (b) the LLP Variable Base Rate, any variable margins applicable in relation to any Tracker Rate Loans and the Variable Mortgage Rates in respect of the Loans which the Original Servicer proposes to set under the Original Servicing Agreement for the relevant Interest Period; and
- (c) the other resources available to the LLP including the relevant Interest Rate Swap Agreements, the relevant Covered Bond Swap Agreements and the Reserve Fund,

whether the LLP would receive an amount of income during the relevant Interest Period which when aggregated with funds otherwise available to it is less than the amount which is the aggregate of (1) the amount of interest which would be payable under the Covered Bond Guarantee and amounts payable to the Covered Bond Swap Providers under the Covered Bond Swap Agreements in respect of all Covered Bonds on each LLP Payment Date of each Series of Covered Bonds falling at the end of each relevant Interest Period and (2) the other senior expenses payable by the LLP ranking in priority thereto in accordance with the relevant Priorities of Payments applicable prior to an LLP Event of Default and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security (the "**Interest Shortfall Test**").

If the Original Servicer determines that there will be a shortfall in the foregoing amounts, it will give written notice to the LLP and the Security Trustee, within one London Business Day, of the amount of the shortfall and the LLP Variable Base Rate and any variable margins applicable in relation to any Tracker Rate Loans which would, in the Original Servicer's opinion, need to be set in order for no shortfall to arise, having regard to the date(s) on which the change to the LLP Variable Base Rate and any variable margins would take effect and at all times acting in accordance with the standards of a Reasonable, Prudent Mortgage Lender as regards the competing interests of Borrowers with Variable Base Rate Loans and Borrowers with Tracker Rate Loans. If the LLP or the Security Trustee notify the Original Servicer that, having regard to the obligations of the LLP, the LLP Variable Base Rate and/or any variable margins should be increased, the Original Servicer will take all steps which are necessary to increase the LLP Variable Base Rate and/or any variable margins including publishing any notice which is required in accordance with the mortgage terms. In these circumstances, the Original Servicer will have the right to set the Original Seller's Variable Base Rates.

In addition, the Original Servicer shall determine on each Calculation Date following an HBOS Event of Default, having regard to the aggregate of:

- (a) the LLP Variable Base Rate, any variable margins applicable in relation to any Tracker Rate Loans and the Variable Mortgage Rates in respect of the Loans which

the Original Servicer proposes to set under the Original Servicing Agreement for the relevant Interest Period; and

- (b) the other resources available to the LLP under the relevant Interest Rate Swap Agreements,

whether the LLP would receive an aggregate amount of interest on the Loans and amounts under the relevant Interest Rate Swap Agreements during the relevant Interest Period which would give a yield on the Loans of at least LIBOR plus 0.5 per cent. (the “**Yield Shortfall Test**”).

If the Original Servicer determines that the Yield Shortfall Test will not be met, it will give written notice to the LLP and the Security Trustee, within one London Business Day, of the amount of the shortfall and the LLP Variable Base Rate and any variable margins applicable in relation to any Tracker Rate Loans which would, in the Original Servicer’s opinion, need to be set in order for no shortfall to arise, and the Yield Shortfall Test to be met, having regard to the date(s) on which the change to the LLP Variable Base Rate and any variable margins would take effect and at all times acting in accordance with the standards of a Reasonable, Prudent Mortgage Lender as regards the competing interests of Borrowers with Variable Base Rate Loans and Borrowers with Tracker Rate Loans. If the LLP or the Security Trustee notify the Original Servicer that, having regard to the obligations of the LLP, the LLP Variable Base Rate and/or any variable margins should be increased, the Original Servicer will take all steps which are necessary to increase the LLP Variable Base Rate and/or any variable margins including publishing any notice which is required in accordance with the mortgage terms. In these circumstances, the Original Servicer will have the right to set the Original Seller’s Variable Base Rates.

The LLP and the Security Trustee may terminate the authority of the Original Servicer to determine and set the LLP Variable Base Rate and any variable margins on the occurrence of a Servicer Event of Default as defined under – *Removal or resignation of the Servicer*, in which case the LLP will set the LLP Variable Base Rate and any variable margins itself in accordance with this sub-section.

Each New Seller and its relevant servicer will be bound by similar terms to those set out above in relation to Loans sold by that New Seller to the LLP. In these circumstances, the Original Servicing Agreement will be amended (including changes to the Interest Shortfall Test and/or the Yield Shortfall Test).

For the purposes hereof:

“**Capped Rate Loans**” means those Loans to the extent that and for such period that their Mortgage Terms provide that they are subject to a rate of interest which may at any time be varied in accordance with the relevant Mortgage Terms up to an agreed maximum level.

“**Fixed Rate Loans**” means those Loans to the extent that and for such time that the interest rate payable by the Borrower on all or part of the Outstanding Principal Balance does not vary and is fixed for a certain period of time by a Seller.

“**HVR 1**” means the Variable Mortgage Rate known as HVR 1 set by the Original Seller which applies to certain Loans beneficially owned by the Original Seller on the Original Seller’s residential mortgage book.

“**HVR 2**” means the Variable Mortgage Rate known as HVR 2 which applies to certain Loans beneficially owned by the Original Seller on the Original Seller’s residential mortgage book.

“**LLP Variable Base Rate**” means the variable base rates that apply to the Variable Rate Loans in the Portfolio as set, other than in limited circumstances, by the Original Servicer, in accordance with the Original Servicing Agreement.

“**Mortgage Terms**” means all the terms and conditions applicable to a Loan, including without limitation the applicable Mortgage Conditions and Offer Conditions included in the Standard Documentation from time to time.

“**Offer Conditions**” means the terms and conditions applicable to a specified Loan as set out in the relevant offer letter to the Borrower.

“**Tracker Rate Loan**” means those Loans to the extent that and for such period that their Mortgage Terms provide that they are subject to an interest rate which is linked to a variable interest rate other than the Variable Base Rates. For example, the rate on a Tracker Rate Loan may be set at a margin above Sterling LIBOR or above rates set by the Bank of England.

“**Variable Base Rates**” means HVR 1, HVR 2 or the LLP Variable Base Rate, as applicable.

“**Variable Mortgage Rate**” means the rate of interest that determines the amount of interest payable each month on a Variable Rate Loan.

“**Variable Rate Loans**” means those Loans to the extent that and for such period that their Mortgage Terms provide that they are subject to a rate of interest which may at any time be varied in accordance with the relevant Mortgage Terms (and shall, for the avoidance of doubt, exclude Loans during the period that they are Fixed Rate Loans or Tracker Rate Loans).

## **Compensation**

The LLP will pay to the Original Servicer a servicing fee of 0.05 per cent. per annum (inclusive of VAT) of the aggregate outstanding amount of the Loans serviced by the Original Servicer in accordance with the Original Servicing Agreement comprised in the Portfolio as of the beginning of the relevant Calculation Period. Fees payable to New Servicers and/or the Original Servicer acting as Servicer in respect of Loans sold by New Sellers to the LLP will be determined on the date that they accede to the Programme.

## **Removal or resignation of the Servicer**

The LLP and the Security Trustee may, upon written notice to the relevant Servicer, terminate the relevant Servicer’s rights and obligations immediately if any of the following events (each a “**Servicer Termination Event**” and, in relation to the first three events set out below, a “**Servicer Event of Default**”) occurs:

- the relevant Servicer defaults in the payment of any amount due to the LLP under the relevant Servicing Agreement and fails to remedy that default for a period of three London Business Days after becoming aware of the default;
- the relevant Servicer fails to comply with any of its other obligations under the Servicing Agreement which failure in the opinion of the Security Trustee is materially prejudicial to Covered Bondholders and does not remedy that failure within 20 London Business Days after becoming aware of the failure;
- an Insolvency Event occurs in relation to the relevant Servicer;
- the LLP resolves that the appointment of the relevant Servicer should be terminated.

Subject to the fulfilment of a number of conditions, a Servicer may voluntarily resign by giving not less than 12 months' notice to the Security Trustee and the LLP provided that a substitute servicer qualified to act as such under FSMA and with a management team with experience of administering mortgages in the United Kingdom has been appointed and enters into a servicing agreement with the LLP substantially on the same terms as the Original Servicing Agreement. The resignation of a Servicer is conditional on the resignation having no adverse effect on the then current ratings of the Covered Bonds unless the Covered Bondholders agree otherwise by extraordinary resolution.

If the appointment of a Servicer is terminated, the relevant Servicer must deliver the Title Deeds and Customer Files relating to the Loans administered by it to, or at the direction of, the LLP. The relevant Servicing Agreement will terminate at such time as the LLP has no further interest in any of the Loans or their Related Security sold to the LLP and serviced under the relevant Servicing Agreement that have been comprised in the Portfolio.

A Servicer may sub-contract or delegate the performance of its duties under the Servicing Agreement provided that it meets conditions as set out in the relevant Servicing Agreement.

Neither the Bond Trustee nor the Security Trustee are obliged to act as Servicer in any circumstances.

### **Governing Law**

The Servicing Agreement is governed by English law.

### **Asset Monitor Agreement**

Under the terms of an asset monitor agreement entered into on the Programme Date between KPMG Audit Plc (the "**Asset Monitor**"), the LLP, the Cash Manager and the Security Trustee (the "**Asset Monitor Agreement**"), the Asset Monitor has agreed, subject to due receipt of the information to be provided by the Cash Manager to the Asset Monitor, to conduct tests in respect of the calculations performed by the Cash Manager on the Calculation Date immediately preceding each anniversary of the Programme Date with a view to confirmation of compliance by the LLP with the Asset Coverage Test or the Amortisation Test, as applicable, on that Calculation Date.

If the long-term ratings of the Cash Manager or the Issuer (or for such time as the Issuer is not, as of the date thereof, independently rated, the rating of the HBOS Group Guarantor (such rating, the "**Deemed Rating**")) fall below BBB-/Baa3/BBB- (by S&P, Moody's and Fitch, respectively) the Asset Monitor will be required to conduct such tests following each Calculation Date and, following a determination by the Asset Monitor of any errors in the calculations performed by the Cash Manager such that the Asset Coverage Test has been failed on the applicable Calculation Date (where the Cash Manager had recorded it as being satisfied) or the Adjusted Aggregate Loan Amount or the Amortisation Test Aggregate Loan Amount is misstated by an amount exceeding 1 per cent. of the Adjusted Aggregate Loan Amount or the Amortisation Test Aggregate Loan Amount, as applicable, (as at the date of the relevant Asset Coverage Test or the relevant Amortisation Test), the Asset Monitor will be required to conduct such tests following each Calculation Date for a period of six months thereafter.

The Asset Monitor is entitled, in the absence of manifest error, to assume that all information provided to it by the Cash Manager for the purpose of conducting such tests is true and correct and not misleading, and is not required to conduct a test or otherwise take steps to verify the accuracy of any such information. The results of the tests conducted by the Asset Monitor will be delivered to the



Cash Manager, the LLP, the Issuer, the Bond Trustee, the Security Trustee and the Rating Agencies (the “**Asset Monitor Report**”).

Under the terms of the Asset Monitor Agreement the LLP will pay to the Asset Monitor a maximum annual fee of £2,600 per test (exclusive of VAT) for the tests to be performed by the Asset Monitor.

The LLP may, at any time, but subject to the prior written consent of the Security Trustee, terminate the appointment of the Asset Monitor by providing at least 30 days’ prior written notice to the Asset Monitor, provided that such termination may not be effected unless and until a replacement asset monitor has been found by the LLP (such replacement to be approved by the Security Trustee if the replacement is an accountancy firm of national standing) which agrees to perform the duties (or substantially similar duties) of the Asset Monitor set out in the Asset Monitor Agreement.

The Asset Monitor may, at any time, resign by giving at least 60 days’ prior written notice to the LLP and the Security Trustee (with a copy to the Rating Agencies), provided that such resignation will not take effect unless and until a replacement has been found by the LLP (such replacement to be approved by the Security Trustee if the replacement is an accountancy firm of national standing) which agrees to perform the duties (or substantially similar duties) of the Asset Monitor set out in the Asset Monitor Agreement.

If a replacement asset monitor has not been found by the LLP within 60 days of notice of termination by the LLP or notice of resignation by the Asset Monitor, the Asset Monitor may identify a replacement (such replacement to be approved by the Security Trustee, if the replacement is an accountancy firm of national standing) which agrees to perform the duties of the Asset Monitor set out in the Asset Monitor Agreement.

Neither the Bond Trustee nor the Security Trustee will be obliged to act as Asset Monitor in any circumstances.

The Asset Monitor Agreement is governed by English law.

## **LLP Deed**

The Members of the limited liability partnership incorporated under the name HBOS Covered Bonds LLP (the “**LLP**”) have agreed to operate the business of the LLP in accordance with the terms of a limited liability partnership deed entered into on the Programme Date between the LLP, the Original Seller, the Issuer, the Liquidation Member, the Bond Trustee and the Security Trustee (as amended and/or restated from time to time, the “**LLP Deed**”).

## **Members**

As at the date hereof, each of Bank of Scotland and the Liquidation Member is a member (each a “**Member**”, and together with any other members from time to time, the “**Members**”) of the LLP. Bank of Scotland is the designated member (the “**Designated Member**”, and together with any other designated members from time to time, the “**Designated Members**”) of the LLP. The Designated Members have such duties as are specified in the LLPA 2000 or otherwise at law and in the LLP Deed. The LLP Deed requires there will at all times be at least one Designated Members of the LLP.

Save as set out below, any Member admitted to the LLP after the Programme Date (a “**New Member**”) must be a Seller and accede to the terms of the Mortgage Sale Agreement. In the event that an administrator or a liquidator is appointed in respect of Bank of Scotland, the Liquidation Member has agreed to become a Designated Member of the LLP and will be registered as such.

Furthermore, for so long as Covered Bonds are outstanding, if an administrator or a liquidator is appointed to Bank of Scotland, the Liquidation Member may, by written notice to the LLP, appoint another Member as a Designated Member or may, at its sole discretion (acting on behalf of itself and the other Members), admit a New Member to the

LLP (in each case with the prior written consent of the Security Trustee). A New Member admitted in these circumstances will not be required to be a Seller or to accede to the terms of the Mortgage Sale Agreement.

### **Capital Contributions**

Each sale of Loans and their Related Security by a Seller to the LLP will constitute a Capital Contribution in Kind by the relevant Seller of those Loans in an amount equal to (a) the Current Balance of those Loans as at the relevant Transfer Date minus (b) any cash payment paid by the LLP for the Loans and their Related Security on that Transfer Date.

Any increase in the Outstanding Principal Balance of a Loan due to either Capitalised Interest accruing on that Loan or due to a Seller making an Additional Loan Advance to a Borrower, will be deemed to constitute a Capital Contribution in Kind by the relevant Seller (in its capacity as a Member) in respect of that Loan in an amount equal to the relevant increase.

If so requested by the Management Board, the Members may from time to time make cash contributions to the LLP which will constitute Cash Capital Contributions.

The Liquidation Member will not make any Capital Contributions to the LLP.

### **Calculation of Capital Contributions**

The Capital Contributions made or deemed to be made by each Member (the “**relevant Member**”) from time to time will be credited to that Member’s Capital Account Ledger and Capital Distributions will be debited to the relevant Member’s Capital Account Ledger. The Capital Contribution Balance of each Member shall represent that Member’s interest in the capital of the LLP. Any increase or decrease in the Capital Contribution Balance of a Member shall be recorded to that Member’s Capital Account Ledger on each Calculation Date. Any such Capital Contribution in Kind will be reduced in an amount equal to the Capital Distribution made to the relevant Seller on any Issue Date where the proceeds of a Term Advance are applied by the LLP to make a Capital Distribution to a Seller (in its capacity as Member) pursuant to the terms of the Intercompany Loan Agreement.

On each Calculation Date (the “**relevant Calculation Date**”) or the date that the LLP is wound up, the Capital Contribution Balance of the Original Seller in respect of the immediately preceding Calculation Period will be recalculated. The Capital Contribution Balance of the Original Seller will be an amount calculated in sterling (and to the extent that any amount is denominated in a currency other than sterling, converted into sterling at the relevant Covered Bond Swap Rate) as follows:

$$A + B - C$$

where,

A = the Current Balance of the Portfolio as of the last day of the preceding Calculation Period on the immediately preceding Calculation Date;

B = the Principal Receipts standing to the credit of the GIC Account, Substitution Assets and Authorised Investments as of the last day of the preceding Calculation Period;

C = the Principal Amount Outstanding under the Covered Bonds as of the last day of the preceding Calculation Period.

For the purposes hereof:

“**Calculation Date**” means the twelfth day of each month (or, if such day is not a London Business Day, then the immediately preceding London Business Day).

“**Calculation Period**” means the period from, and including, the first day of each month to, and including, the last day of each month preceding the relevant Calculation Date.

“**Capital Account Ledger**” means the ledger maintained by the Cash Manager on behalf of the LLP in respect of each Member to record the balance of each Member’s Capital Contributions from time to time.

“**Capital Contribution**” means in relation to each Member, the aggregate of the capital contributed by that Member to the LLP from time to time by way of Cash Capital Contributions and Capital Contributions in Kind as determined on each Calculation Date in accordance with the formula set out in the LLP Deed.

“**Capital Contribution Balance**” means the balance of each Member’s Capital Contributions as recorded from time to time in the relevant Member’s Capital Account.

“**Capital Contributions in Kind**” means a contribution of Loans and their Related Security to the LLP in an amount equal to (a) the Current Balance of those Loans as at the relevant Transfer Date minus (b) any cash payment paid by the LLP for the Loans and their Related Security on that Transfer Date.

“**Capital Distribution**” means any return on a Member’s Capital Contribution in accordance with the terms of the LLP Deed (and excluding, for the avoidance of doubt, any Deferred Consideration).

“**Capitalised Interest**” means the amount of interest that would have been paid on a Loan if not for the Borrower under that Loan taking a Payment Holiday.

“**Cash Capital Contributions**” means a Capital Contribution made in cash.

“**LLP Payment Date**” means the 16th day of each month or if not a Business Day the next following Business Day.

“**Opening Capital Contribution Balance**” means the Capital Contribution Balance of each Member on the Programme Date and, in the case of New Members, on the date any such New Member is admitted to the LLP in accordance with the LLP Deed.

The Original Seller and each other Member have agreed that they will amend the calculation above if Capital Contributions are made or deemed made by Members other than the Original Seller.

### **Asset Coverage Test**

Under the terms of the LLP Deed, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date, the Adjusted Aggregate Loan Amount is in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date (the “**Asset Coverage Test**”).

If on any Calculation Date the Adjusted Aggregate Loan Amount is less than the aggregate Principal Amount Outstanding of all Covered Bonds as calculated on the relevant Calculation Date, then the LLP (or the Cash Manager on its behalf) will notify the Members thereof and the Members (other than the Liquidation Member) will use all reasonable endeavours to sell sufficient further Loans and their Related Security to the LLP in accordance with the Mortgage Sale Agreement (see *Summary of the Principal Documents – Mortgage Sale Agreement – Sale by Sellers of Loans and their Related Security*) or provide Cash Capital Contributions to ensure that the Asset Coverage Test is met. An HBOS Event of Default shall occur if the Asset Coverage Test is breached on the next following Calculation Date.

For the purposes hereof:

“**Adjusted Aggregate Loan Amount**” means the amount calculated on each Calculation Date as follows:

$$A + B + C + D + E - (X + Y + Z)$$

where,

A = the lower of (i) and (ii), where:

(i) = the sum of the “**Adjusted Current Balance**” of each Loan in the Portfolio, which shall be the lower of (1) the actual Current Balance of the relevant Loan in the Portfolio as calculated on the relevant Calculation Date and (2) 60 per cent. of the Indexed Valuation relating to that Loan

*minus*

the aggregate sum of the following deemed reductions to the aggregate Adjusted Current Balance of the Loans in the Portfolio if any of the following occurred during the previous Calculation Period:

- (1) a Loan or its Related Security is, in the immediately preceding Calculation Period, in breach of the Representations and Warranties contained in the Mortgage Sale Agreement or subject to any other obligation of a Seller to repurchase the relevant Loan and its Related Security, and in each case the relevant Seller has not repurchased the Loan or Loans under the relevant Mortgage Account and their Related Security to the extent required by the terms of the Mortgage Sale Agreement. In this event, the aggregate Adjusted Current Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the Adjusted Current Balance of the relevant Loan or Loans (as calculated on the relevant Calculation Date) under the relevant Mortgage Account; and/or
- (2) a Seller, in any preceding Calculation Period, was in breach of any other material warranty under the Mortgage Sale Agreement and/or a Servicer was, in any preceding Calculation Period, in breach of a material term of a Servicing Agreement. In this event, the aggregate Adjusted Current Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the resulting financial loss incurred by the LLP in the immediately preceding Calculation Period (such financial loss to be calculated without double counting and to be reduced by any amount paid (in cash or in kind) to the LLP by the relevant Seller to indemnify the LLP for such financial loss);

AND

(ii) = the aggregate Current Balance of the Loans in the Portfolio as at the relevant Calculation Date;

*minus*

the aggregate sum of the following deemed reductions to the aggregate Current Balance of the Loans in the Portfolio if any of the following occurred during the previous Calculation Period:

- (1) a Loan or its Related Security is, in the immediately preceding Calculation Period, in breach of the Representations and Warranties contained in the Mortgage Sale Agreement or subject to any other obligation of a Seller to repurchase the relevant Loan and its Related Security, and in each case the relevant Seller has not repurchased the Loan or Loans under the relevant Mortgage Account and their Related Security to the extent required by the terms of the Mortgage Sale Agreement. In this event, the aggregate Current Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the Current Balance of the relevant Loan or Loans (as calculated on the relevant Calculation Date) under the relevant Mortgage Account; and/or
- (2) a Seller, in any preceding Calculation Period, was in breach of any other material warranty under the Mortgage Sale Agreement and/or a Servicer was, in the immediately preceding Calculation Period, in breach of a material term of a Servicing Agreement. In this event, the aggregate Current Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the resulting financial loss incurred by the LLP in the immediately preceding Calculation Period (such financial loss to be calculated without double counting);

*the result of which is multiplied by* the Asset Percentage (as defined below);

B = the amount of any Principal Receipts on the Loans in the Portfolio up to the end of the immediately preceding Calculation Period (as recorded in the Principal Ledger) which have not been applied as at the relevant Calculation Date to acquire further Loans and their Related Security or otherwise applied in accordance with the LLP Deed and/or the other Transaction Documents;

C = the amount of any Cash Capital Contributions made by the Members (as recorded in the Capital Account Ledger of each Member) or proceeds of Term Advances which have not been applied as at the relevant Calculation Date to acquire further Loans and their Related Security or otherwise applied in accordance with this Deed and/or the other Transaction Documents;

D = the outstanding principal balance of any Substitution Assets;

E = the amount of any Sale Proceeds standing to the credit of the GIC Account and credited to the Pre-Maturity Liquidity Ledger as at the relevant Calculation Date;

X = 5 per cent. of the aggregate Current Balance of the Loans in the Portfolio, as calculated on the relevant Calculation Date;

Y = 8 per cent. *multiplied by* the “flexible redraw capacity”, being an amount equal to the excess of (1) the maximum amount that Borrowers may draw under Flexible Loans in the Portfolio (whether or not drawn) as determined in respect of the previous Calculation Period over (2) the aggregate Current Balance of all Flexible Loans in the Portfolio on the relevant Calculation Date *multiplied by* 3; and

Z = the weighted average remaining maturity of all Covered Bonds then outstanding *multiplied by* the Sterling Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds *multiplied by* 0.65 per cent.

The “Asset Percentage” on any Calculation Date shall be the lowest of:

- (a) 92.5 per cent.;
- (b) the percentage figure as determined from time to time in accordance with the terms of the LLP Deed, being the asset percentage that is necessary to ensure the Covered Bonds maintain the then current rating assigned to them by Fitch and S&P; and
- (c) the percentage figure (as selected at the option of the LLP, by the LLP (or the Cash Manager acting on its behalf) from time to time and notified to Moody's and the Security Trustee on such Calculation Date or, where the LLP (or the Cash Manager acting on its behalf) has notified Moody's and the Security Trustee of the minimum percentage figure on the relevant Calculation Date, on the last date of such notification) if applicable, being the difference between 100 per cent. and the amount of credit enhancement required to ensure that the Covered Bonds to achieve a Aaa rating by Moody's using Moody's expected loss methodology (regardless of the actual Moody's rating of the Covered Bonds at the time).

For the avoidance of doubt, any breach of the Asset Coverage Test arising as a result of the assumption of an Asset Percentage presented to and agreed by Moody's in accordance with the LLP Deed, will not constitute an Issuer Event of Default. However, in such circumstances, prior to the service of a Notice to Pay on the LLP, Available Principal Receipts will be deposited in the GIC Account in accordance with the Pre-Acceleration Principal Priority of Payments.

“**Halifax Index**” means the index of increases in house prices issued by Halifax (prior to the Effective Date) or Bank of Scotland (on or following the Effective Date) in relation to residential properties in the United Kingdom.

“**Halifax Price Indexed Valuation**” in relation to any property at any date means the Original Valuation of that property increased or decreased as appropriate by the increase or decrease in the Halifax Index since the date of that Original Valuation.

“**Indexed Valuation**” means at any date in relation to any Loan secured over any Property:

- (a) where the Original Valuation of that Property is equal to or greater than the Halifax Price Indexed Valuation as at that date, the Halifax Price Indexed Valuation; or
- (b) where the Original Valuation of that Property is less than the Halifax Price Indexed Valuation as at that date, the Original Valuation plus 85 per cent. of the difference between the Original Valuation and the Halifax Price Indexed Valuation.

“**Mortgage Account**” means all Loans secured on the same Property and thereby forming a single mortgage account.

“**Original Valuation**” in relation to any Property means the value given to that Property by the most recent valuation addressed to the relevant Sellers of the Loan secured over that Property.

### **Amortisation Test**

The LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date following service of a Notice to Pay on the LLP (but prior to service of an LLP Acceleration Notice and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security) the Amortisation Test Aggregate Loan Amount will be in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date (the “**Amortisation Test**”).

Following an HBOS Event of Default, if on any Calculation Date the Amortisation Test Aggregate Loan Amount is less than the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date, then the Amortisation Test will be deemed to be breached and an LLP Event of Default will occur. The LLP or the Cash Manager, as the case may be, will immediately notify the Members, the Security Trustee and (whilst Covered Bonds are outstanding) the Bond Trustee of any breach of the Amortisation Test.

The “**Amortisation Test Aggregate Loan Amount**” will be calculated on each Calculation Date as follows:

$$A + B + C - Z$$

where,

A = the aggregate “**Amortisation Test Current Balance**” of each Loan, which shall be the lower of (1) the actual Current Balance of the relevant Loan as calculated on the relevant Calculation Date multiplied by M and (2) 100 per cent. of the Indexed Valuation multiplied by M,

where for all the Loans that are less than 3 months in arrears M = 1 or for all the Loans that are 3 months or more in arrears M = 0.7;

B = the amount of any cash standing to the credit of the GIC Account and the principal amount of any Authorised Investments (excluding any Revenue Receipts received in the immediately preceding Calculation Period);

C = the outstanding principal balance of any Substitution Assets;

Z = the weighted average remaining maturity of all Covered Bonds then outstanding **multiplied by** the Sterling Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds **multiplied by** 0.65 per cent.

### **Sale of Selected Loans and their Related Security if the Pre-Maturity Test is breached**

The LLP Deed provides for sales of Selected Loans and their Related Security in circumstances where the Pre-Maturity Test has been breached. The Pre-Maturity Test will be breached if the ratings or Deemed Ratings, as applicable, of the Issuer fall below a specified level and a Hard Bullet Covered Bond is due for repayment within a specified period of time thereafter (see further *Credit Structure – Pre-Maturity Liquidity* below). The LLP will be obliged to sell the Selected Loans and their Related Security to Purchasers, subject to the rights of pre-emption enjoyed by the Sellers to buy the Selected Loans and their Related Security pursuant to the terms of the Mortgage Sale Agreement, in accordance with the procedure summarised in *Method of Sale of Selected Loans*

below and subject to any Cash Capital Contribution made by the Members. If the Issuer and the HBOS Group Guarantor fail to repay any Series of Hard Bullet Covered Bonds on the Final Maturity Date thereof, then following the service of a Notice to Pay on the LLP, the proceeds from any sale of Selected Loans or the Cash Capital Contributions standing to the credit of the Pre-Maturity Liquidity Ledger will be applied to repay the relevant Series of Hard Bullet Covered Bonds. Otherwise, the proceeds will be applied as set out in *Credit Structure – Pre-Maturity Liquidity* below.

### **Sale of Selected Loans and their Related Security following service of a Notice to Pay**

After a Notice to Pay has been served on the LLP following the occurrence of an HBOS Event of Default, but prior to service of an LLP Acceleration Notice and/or the commencement of winding-up proceedings against the LLP and/or the realisation of the Security, the LLP will be obliged to sell Selected Loans and their Related Security in the Portfolio in accordance with the LLP Deed (as described below), subject to the rights of pre-emption enjoyed by the Sellers to buy the Selected Loans and their Related Security pursuant to the Mortgage Sale Agreement. The proceeds from any such sale will be credited to the GIC Account and applied as set out in the Priorities of Payments.

### **Method of Sale of Selected Loans**

If the LLP is required to sell Selected Loans and their Related Security to Purchasers following a breach of the Pre-Maturity Test or the occurrence of an HBOS Event of Default, the LLP will be required to ensure that before offering Selected Loans for sale:

- (a) the Selected Loans have been selected from the Portfolio on a random basis as described in the LLP Deed; and
- (b) the Selected Loans have an aggregate Current Balance in an amount (the Required Current Balance Amount) which is as close as possible to the amount calculated as follows:

$$N \times \frac{\text{Current Balance of all the Loans in the Portfolio}}{\text{Required Redemption Amount in respect of each Series of Covered Bonds}}$$

then outstanding

where N is an amount equal to:

- (i) in respect of Selected Loans being sold following a breach of the Pre-Maturity Test, the Required Redemption Amount of the relevant Series of Hard Bullet Covered Bonds less amounts standing to the credit of the Pre-Maturity Liquidity Ledger that are not otherwise required to provide liquidity for any Series of Hard Bullet Covered Bonds which mature prior to or on the same date as the relevant Series of Hard Bullet Covered Bonds; or
- (ii) in respect of Selected Loans being sold following service of a Notice to Pay, the Required Redemption Amount of the Earliest Maturing Covered Bonds less amounts standing to the credit of the GIC Account and the principal amount of any Authorised Investments (excluding all amounts to be applied on the next following LLP Payment Date to repay higher ranking amounts in the Guarantee Priority of Payments and those amounts that are required to repay any Series of Covered Bonds which mature prior to or on the same date as the relevant Series of Covered Bonds).



The LLP will offer the Selected Loans and their Related Security for sale to Purchasers for the best price reasonably available but in any event for an amount not less than the Adjusted Required Redemption Amount. The “**Adjusted Required Redemption Amount**” means the Required Redemption Amount, plus or minus any swap termination amounts payable to or by the LLP in respect of the relevant Series of Covered Bonds less (where applicable):

- (i) amounts standing to the credit of the Pre-Maturity Liquidity Ledger that are not otherwise required to provide liquidity for any Series of Hard Bullet Covered Bonds which mature prior to or on the same date as the relevant Series of Hard Bullet Covered Bonds; or
- (ii) amounts standing to the credit of the GIC Account and the principal balance of any Authorised Investments (excluding all amounts to be applied on the next following LLP Payment Date to repay higher ranking amounts in the Guarantee Priority of Payments and those amounts that are required to repay any Series of Covered Bonds which mature prior to or on the same date as the relevant Series of Covered Bonds).

If the Selected Loans have not been sold (in whole or in part) in an amount equal to the Adjusted Required Redemption Amount by the date which is six months prior to the Final Maturity Date of (in respect of a sale in connection with the Pre-Maturity Test) the relevant Series of Hard Bullet Covered Bonds or (in respect of a sale following service of a Notice to Pay) the Earliest Maturing Covered Bonds (after taking into account all payments, provisions and credits to be made in priority thereto), then the LLP will offer the Selected Loans for sale for the best price reasonably available notwithstanding that such amount may be less than the Adjusted Required Redemption Amount.

In respect of the sale of Selected Loans following service of a Notice to Pay on the LLP, in addition to offering Selected Loans for sale to Purchasers in respect of the Earliest Maturing Covered Bonds, the LLP (subject to the rights of pre-emption enjoyed by the Sellers pursuant to the Mortgage Sale Agreement) is permitted to offer to sell a portfolio of Selected Loans, in accordance with the provisions summarised above, in respect of other Series of Covered Bonds.

The LLP is also permitted to offer for sale to Purchasers part of any portfolio of Selected Loans (a “**Partial Portfolio**”). Except in circumstances where the portfolio of Selected Loans is being sold within six months of the Final Maturity Date of the Series of Covered Bonds to be repaid from such proceeds, the sale price of the Partial Portfolio (as a proportion of the Adjusted Required Redemption Amount) shall be at least equal to the proportion that the Partial Portfolio bears to the relevant portfolio of Selected Loans.

The LLP will through a tender process appoint a portfolio manager of recognised standing on a basis intended to incentivise the portfolio manager to achieve the best price for the sale of the Selected Loans (if such terms are commercially available in the market) to advise it in relation to the sale of the Selected Loans to Purchasers (except where the Sellers are buying the Selected Loans in accordance with their right of pre-emption in the Mortgage Sale Agreement). The terms of the agreement giving effect to the appointment in accordance with such tender shall be approved by the Security Trustee.

In respect of any sale of Selected Loans and their Related Security following service of a Notice to Pay, the LLP will instruct the portfolio manager to use all reasonable endeavours to procure that Selected Loans are sold as quickly as reasonably practicable (in accordance with the recommendations of the portfolio manager) taking into account the market conditions at that time and the scheduled repayment dates of the Covered Bonds and the terms of the LLP Deed.

The terms of any sale and purchase agreement with respect to the sale of Selected Loans (which shall give effect to the recommendations of the portfolio manager) will be subject to the prior written approval of the Security Trustee. The Security Trustee will not be required to release the Selected Loans from the Security unless the conditions relating to the release of the Security (as described under *Deed of Charge – Release of Security*, below) are satisfied.

If Purchasers accept the offer or offers from the LLP so that some or all of the Selected Loans shall be sold prior to the next following Final Maturity Date of the Hard Bullet Covered Bonds or, as applicable, the Earliest Maturing Covered Bonds, then the LLP will, subject to the foregoing paragraph, enter into a sale and purchase agreement with the relevant Purchasers which will require *inter alia* a cash payment from the relevant Purchasers. Any such sale will not include any Representations and Warranties from the LLP in respect of the Loans and the Related Security unless expressly agreed by the Security Trustee or otherwise agreed with the Sellers.

### **Covenants of the LLP and the Members**

Each of the Members covenants that, subject to the terms of the Transaction Documents, it will not sell, transfer or otherwise dispose of its interest in the LLP without the prior written consent of the LLP and, whilst the Covered Bonds are outstanding, the Security Trustee. Whilst any amounts are outstanding in respect of the Covered Bonds, each of the Members undertakes not to terminate or purport to terminate the LLP or institute any winding-up, administration, insolvency or similar proceedings against the LLP.

The LLP covenants that it will not, save with the prior written consent of the Management Board (and, for so long as any Covered Bonds are outstanding, the consent of the Security Trustee) or as envisaged by the Transaction Documents:

- (a) create or permit to subsist any security interest over the whole or any part of its assets or undertakings, present or future;
- (b) dispose of, deal with or grant any option or present or future right to acquire any of its assets or undertakings or any interest therein or thereto;
- (c) have an interest in a bank account other than as set out in the Transaction Documents;
- (d) incur any indebtedness or give any guarantee or indemnity in respect of any such indebtedness;
- (e) consolidate or merge with or transfer any of its property or assets to another person;
- (f) have any employees, premises or subsidiaries;
- (g) acquire assets other than pursuant to the Mortgage Sale Agreement, the Cash Management Agreement and the LLP Deed;
- (h) engage in any activities or derive income from any activities within the United States or hold any property if doing so would cause it to be engaged or deemed to be engaged in a trade or business within the United States;
- (i) enter into any contracts, agreements or other undertakings;
- (j) compromise, compound or release any debt due to it; or

- (k) commence, defend, settle or compromise any litigation or other claims relating to it or any of its assets.

Each of the LLP and each of the Members further covenants that it will:

- (i) ensure that the Asset Pool will only comprise of those assets set out in items (a) to (h) of Regulation 3(1) (*Asset Pool*) of the RCB Regulations;
- (ii) ensure that the Loans and the Related Security, the Substitution Assets and the Authorised Investments contained in the Asset Pool comply with the definition of “eligible property” in Regulation 2 (*Eligible Property*) of the RCB Regulations;
- (iii) keep a record of those assets that form part of the Asset Pool which, for the avoidance of doubt, shall not include any Swap Collateral; and
- (iv) at all times comply with its obligations under the RCB Regulations and/or the FSA Regulated Covered Bond Sourcebook.

### **Limit on Investing in Substitution Assets**

Prior to the service of a Notice to Pay on the LLP, the LLP will be permitted to invest Available Revenue Receipts, Available Principal Receipts and the proceeds of Term Advances in Substitution Assets, provided that the aggregate amount so invested does not exceed 10 per cent. of the total assets of the LLP at any one time and provided that such investments are made in accordance with the terms of the Cash Management Agreement.

Following service of a Notice to Pay on the LLP, all Substitution Assets must be sold by the LLP (or the Cash Manager on its behalf) as quickly as reasonably practicable and the proceeds credited to the GIC Account and the LLP will be permitted to invest all available moneys in Authorised Investments, provided that such investments are made in accordance with the terms of the Cash Management Agreement and that the amount invested in Authorised Investments and, if applicable, Substitution Assets, shall not exceed 10 per cent. of the total assets of the LLP at any time.

For the purposes hereof:

“**Authorised Investments**” means:

- (a) Sterling gilt-edged securities; and
- (b) Sterling demand or time deposits, certificates of deposit and short-term debt obligations (including commercial paper) provided that in all cases such investments have a remaining maturity date of 30 days or less and mature on or before the next following LLP Payment Date and the short-term unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the demand or time deposits are made (being an authorised person under FSMA) are rated at least A- 1+ by Standard & Poor’s, P-1 by Moody’s and F1+ by Fitch or their equivalents by three other internationally recognised rating agencies provided such Authorised Investments comply with the requirements of Regulation 2(1)(a) of the RCB Regulations.

“**Substitution Assets**” means:

- (a) Sterling gilt-edged securities;

- (b) Sterling demand or time deposits, certificates of deposit, long-term debt obligations and short-term debt obligations (including commercial paper) provided that in all cases such investments have a remaining period to maturity of one year or less and the short-term unsecured, unguaranteed and unsubordinated debt obligations or, as applicable, the long-term unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the demand or time deposits are made (being an authorised person under the FSMA) are rated at least P-1/Aa3 by Moody's, A1+/AA- by S&P and F1+/AA- by Fitch or their equivalents by three other internationally recognised rating agencies;
- (c) Sterling denominated government and public securities, as defined from time to time by the FSA, provided that such investments have a remaining period to maturity of one year or less and which are rated at least Aaa by Moody's, AAA by S&P and AAA by Fitch or their equivalents by three other internationally recognised rating agencies; and
- (d) Sterling denominated residential mortgage backed securities provided that such investments have a remaining period to maturity of one year or less, are actively traded in a continuous, liquid market on a recognised stock exchange, are held widely across the financial system, are available in an adequate supply and which are rated at least Aaa by Moody's, AAA by S&P and AAA by Fitch or their equivalents by three other internationally recognised rating agencies,

provided that the aggregate value of the Substitution Assets, at any time, shall not exceed in aggregate an amount equal to 10 per cent. of the total assets of the LLP and provided such Substitution Assets comply with the requirements of Regulation 2(1)(a) of the RCB Regulations.

### **Other provisions**

The allocation and distribution of Revenue Receipts, Principal Receipts and all other amounts received by the LLP is described under *Cashflows* below.

A management board comprised as at the Programme Date of directors, officers and/or employees of Bank of Scotland (the "**Management Board**") will act on behalf of the LLP to which (other than any decision to approve the audited accounts of the LLP or to make a resolution for the voluntary winding-up of the LLP, which require a unanimous decision of the Members) the Members delegate all matters. Any decision by the Management Board relating to the admission of a New Member, any change in the LLP's business, any change to the LLP's name and any amendment to the LLP Deed, will be made, whilst any Covered Bonds are outstanding, with the consent of the Security Trustee.

For so long as any Covered Bonds are outstanding, each Member has agreed that it will not terminate or purport to terminate the LLP or institute any winding-up, administration, insolvency or other similar proceedings against the LLP. Furthermore, the Members have agreed *inter alia* not to demand or receive payment of any amounts payable by the LLP (or the Cash Manager on its behalf) or the Security Trustee unless all amounts then due and payable by the LLP to all other creditors ranking higher in the relevant Priorities of Payments have been paid in full.

Each Member will be responsible for the payment of its own tax liabilities and will be required to indemnify the LLP and the other Members from any liabilities which they incur as a result of the relevant Member's non-payment.

Following the appointment of a liquidator to any Member (other than the Liquidation Member), any decisions of the LLP that are reserved to the Members in the LLP Deed shall be made by the Liquidation Member only.

### **Governing Law**

The LLP Deed and any non-contractual obligations arising out of or in connection with it is governed by English law.

### **Cash Management Agreement**

The Cash Manager will provide certain cash management services to the LLP pursuant to the terms of a cash management agreement entered into on the Programme Date between the LLP, Bank of Scotland in its capacity as the Cash Manager (the “**Cash Manager**”) and the Security Trustee (as amended and/or restated from time to time, the “**Cash Management Agreement**”).

The Cash Manager’s services include but are not limited to:

- (a) maintaining the Ledgers on behalf of the LLP;
- (b) maintaining records of all Authorised Investments and/or Substitution Assets including, without limitation in accordance with Regulation 3(2) of the RCB Regulations, as applicable;
- (c) distributing the Revenue Receipts and the Principal Receipts in accordance with the Priorities of Payment described under *Cashflows*, below;
- (d) determining whether the Asset Coverage Test is satisfied on each Calculation Date in accordance with the LLP Deed, as more fully described under *Credit Structure – Asset Coverage Test*, below;
- (e) determining whether the Amortisation Test is satisfied on each Calculation Date following an HBOS Event of Default in accordance with the LLP Deed, as more fully described under *Credit Structure – Amortisation Test*, below;
- (f) on each London Business Day, determining whether the Pre-Maturity Test for each Series of Hard Bullet Covered Bonds is satisfied as more fully described under *Credit Structure – Pre-Maturity Liquidity*, below; and
- (g) providing the FSA with information on the composition of any Substitute Assets and/or Authorised Investments comprised in the assets of the LLP and or such other information as may be required by the FSA in accordance with the RCB Regulations and the RCB Sourcebook.

For purposes hereof:

“**Capital Account Ledgers**” means the ledgers maintained by the LLP to record the Capital Contributions of each of the Members.

“**Ledgers**” includes the Revenue Ledger, the Principal Ledger, the Capital Account Ledger, the Pre-Maturity Liquidity Ledger and the Reserve Ledger.

“**Losses**” means all realised losses on the Loans.

“**Pre-Maturity Liquidity Ledger**” means the ledger on the GIC Account maintained by the Cash Manager pursuant to the Cash Management Agreement to record the credits and debits of moneys available to repay any Series of Hard Bullet Covered Bonds on the Final Maturity Date thereof if the Pre-Maturity Test has been breached.

“**Principal Ledger**” means the ledger on the GIC Account of such name maintained by the Cash Manager pursuant to the Cash Management Agreement to record the credits and debits of Principal Receipts in accordance with the terms of the LLP Deed.

“**Reserve Ledger**” means the ledger on the GIC Account of such name maintained by the Cash Manager pursuant to the Cash Management Agreement, to record the crediting of Revenue Receipts to the Reserve Fund and the debiting of such Reserve Fund in accordance with the terms of the LLP Deed.

“**Revenue Ledger**” means the ledger on the GIC Account maintained by the Cash Manager pursuant to the Cash Management Agreement to record credits and debits of Revenue Receipts in accordance with the terms of the LLP Deed.

The Cash Management Agreement is governed by English law.

### **Interest Rate Swap Agreements**

Some of the Loans in the Portfolio pay a variable rate of interest for a period of time that may either be linked to the LLP Variable Base Rate or linked to an interest rate other than the LLP Variable Base Rate, such as a rate set by the Bank of England. Other Loans pay a fixed rate of interest for a period of time. However, the interest rate payable by the LLP with respect to the Term Advances is calculated based on LIBOR for one-month sterling deposits. To provide a hedge against the possible variance between:

- (1) the LLP Variable Base Rate payable on the variable rate loans, the rates of interest payable on the Tracker Rate Loans, the fixed rates of interest payable on the Fixed Rate Loans and the rates of interest payable on the Capped Rate Loans (together the “**Loan Rates of Interest**”) in respect of those Loans sold by the Original Seller to the LLP; and
- (2) LIBOR for one-month sterling deposits,

the LLP, Bank of Scotland (in its capacity as interest rate swap provider, the “**Original Interest Rate Swap Provider**”) and the Security Trustee have entered into an interest rate swap (the “**Original Interest Rate Swap**”) governed by an ISDA master agreement, including a schedule and confirmation thereto (the “**Original Interest Rate Swap Agreement**”) on the Programme Date.

Each New Seller (in its capacity as interest rate swap provider, a “**New Interest Rate Swap Provider**”) and, together with the Original Interest Rate Swap Provider and any other New Interest Rate Swap Provider, the “**Interest Rate Swap Providers**”) will also enter into an interest rate swap (the “**New Interest Rate Swap**”) and, together with the Original Interest Rate Swap, the “**Interest Rate Swaps**”) with the LLP and the Security Trustee in respect of those Loans sold by the relevant New Seller on substantially the same terms as the Original Interest Rate Swap Agreement (each, a “**New Interest Rate Swap Agreement**”) and, together with the Original Interest Rate Swap Agreement and any other New Interest Rate Swap Agreement, the “**Interest Rate Swap Agreements**”).

In the event that the relevant ratings of an Interest Rate Swap Provider, or any guarantor, as applicable, is or are, as applicable, downgraded by a Rating Agency below the ratings specified in the

relevant Interest Rate Swap Agreement (in accordance with the requirements of the Rating Agencies) for such Interest Rate Swap Provider, and, as a result of the downgrade, the then current ratings of the Covered Bonds would or may, as applicable, be adversely affected, such Interest Rate Swap Provider will be required to take certain remedial measures which may include providing collateral for its obligations, arranging for its obligations to be transferred to an entity with ratings required by the relevant Rating Agency, procuring another entity with rating(s) required by the relevant Rating Agency to become co-obligor in respect of its obligations, or taking such other action in respect of which a Rating Agency Confirmation is obtained. A failure to take such steps will allow the LLP to terminate the relevant Interest Rate Swap Agreement.

Each Interest Rate Swap Agreement may also be terminated in certain other circumstances (each referred to as an “**Interest Rate Swap Early Termination Event**”), including:

- at the option of any party to an Interest Rate Swap Agreement, if there is a failure by the other party to pay any amounts due under the relevant Interest Rate Swap Agreement; and
- upon the occurrence of an insolvency of an Interest Rate Swap Provider, or any guarantor, or the merger of one of the parties without an assumption of the obligations under the relevant Interest Rate Swap Agreement (except in respect of a transfer by the LLP to the Security Trustee in its fiduciary capacity).

Upon the termination of an Interest Rate Swap pursuant to an Interest Rate Swap Early Termination Event, the LLP or the relevant Interest Rate Swap Provider may be liable to make a termination payment to the other in accordance with the provisions of the relevant Interest Rate Swap Agreement.

If withholding taxes are imposed on payments made by an Interest Rate Swap Provider under an Interest Rate Swap, the Interest Rate Swap Provider shall always be obliged to gross up these payments. If withholding taxes are imposed on payments made by the LLP to the Interest Rate Swap Provider under an Interest Rate Swap, the LLP shall not be obliged to gross up those payments.

If the LLP is required to sell Selected Loans in the Portfolio in order to provide liquidity in respect of Hard Bullet Covered Bonds following a breach of the Pre-Maturity Test or in respect of the Earliest Maturing Covered Bonds following an HBOS Event of Default and service of a Notice to Pay on the LLP, then to the extent that such Selected Loans include Fixed Rate Loans, either:

- (a) the Interest Rate Swap(s) in connection with such Fixed Rate Loans will partially terminate and any breakage costs payable by or to the LLP in connection with such termination will be taken into account in calculating the Adjusted Required Redemption Amount for the sale of the Selected Loans; or
- (b) such Interest Rate Swap(s) will be partially novated to the purchaser of such Fixed Rate Loans, and such purchaser will thereby become party to a separate interest rate swap transaction with the relevant Interest Rate Swap Provider.

The Interest Rate Swap Agreements are (or, as applicable, will be) governed by English law.

### **Covered Bond Swap Agreements**

Bank of Scotland (in its capacity as swap provider, the “**Covered Bond Swap Provider**”) will enter into swap transactions (the “**Covered Bond Swaps**”, and together with the Interest Rate Swaps, the “**Swaps**”) with the LLP and the Security Trustee in its fiduciary capacity, each such Covered Bond Swap governed by an ISDA master agreement, including a schedule and confirmation

(the “**Covered Bond Swap Agreements**”), to hedge (after service on the LLP of a Notice to Pay) certain interest rate, currency and/or other risks in respect of amounts received by the LLP under the Loans and the Interest Rate Swaps and amounts payable by the LLP under the Covered Bond Guarantee in respect of Covered Bonds. Where required to hedge such risks, there will be one Covered Bond Swap Agreement and Covered Bond Swap in relation to each Series of Covered Bonds. Under the Covered Bond Swaps, after service on the LLP of a Notice to Pay, the Covered Bond Swap Provider will pay to the LLP amounts equivalent to the amounts that would be payable by the LLP under the Covered Bond Guarantee in respect of interest and principal payable under the Covered Bonds and, in return, the LLP will pay to the Covered Bond Swap Provider on each LLP Payment Date an amount in sterling calculated by reference to LIBOR for one-month sterling deposits for the relevant Interest Period plus a spread.

Under the terms of each Covered Bond Swap, in the event that the relevant rating of the Covered Bond Swap Provider (or for such time as the Covered Bond Swap Provider is the Issuer, its Deemed Ratings) or any guarantor, as applicable is downgraded by a Rating Agency below the rating(s) specified in the relevant Covered Bond Swap Agreement (in accordance with the requirements of the Rating Agencies) for the Covered Bond Swap Provider, and, where applicable, as a result of the downgrade, the then current ratings of the Covered Bonds would or may, as applicable, be adversely affected, the Covered Bond Swap Provider will, in accordance with the relevant Covered Bond Swap Agreement, be required to take certain remedial measures which may include providing collateral for its obligations under the Covered Bond Swap, arranging for its obligations under the Covered Bond Swap to be transferred to an entity with the ratings required by the relevant Rating Agency, procuring another entity with the ratings required by the relevant Rating Agency to become co-obligor in respect of its obligations under the Covered Bond Swap, or taking such other action in respect of which a Rating Agency Confirmation is obtained. A failure to take such steps will allow the LLP to terminate the Covered Bond Swap.

A Covered Bond Swap Agreement may also be terminated in certain other circumstances (each referred to as a “**Covered Bond Swap Early Termination Event**”), including:

- at the option of any party to the Covered Bond Swap Agreement, if there is a failure by the other party to pay any amounts due under such Covered Bond Swap Agreement; and
- upon the occurrence of an insolvency of the Covered Bond Swap Provider, or any guarantor, or the merger of one of the parties without an assumption of the obligations under the relevant Covered Bond Swap Agreement (except in respect of a transfer by the LLP to the Security Trustee in its fiduciary capacity).

Upon the termination of a Covered Bond Swap, the LLP or the Covered Bond Swap Provider may be liable to make a termination payment to the other in accordance with the provisions of the relevant Covered Bond Swap Agreement. The amount of this termination payment will be calculated and made in sterling.

If withholding taxes are imposed on payments made by the Covered Bond Swap Provider to the LLP under a Covered Bond Swap, the Covered Bond Swap Provider shall always be obliged to gross up those payments. If withholding taxes are imposed on payments made by the LLP to the Covered Bond Swap Provider under a Covered Bond Swap, the LLP shall not be obliged to gross up those payments.

The Covered Bond Swap Agreements are (or, as applicable, will be) governed by English law.



## Bank Account Agreement

Pursuant to the terms of a bank account agreement entered into on the Programme Date between the LLP, Bank of Scotland as account bank (in such capacity, the “**Account Bank**”), the Cash Manager and the Security Trustee (the “**Bank Account Agreement**”), the LLP will maintain with the Account Bank the accounts described below, which will be operated in accordance with the Cash Management Agreement, the LLP Deed and the Deed of Charge:

- (a) the GIC Account into which are paid all amounts received from Borrowers in respect of Loans in the Portfolio. On each LLP Payment Date as applicable, amounts required to meet the LLP’s various creditors and amounts to be distributed to the Members under the LLP Deed will be transferred to the Transaction Account; and
- (b) the Transaction Account into which moneys standing to the credit of the GIC Account will be transferred on each LLP Payment Date and applied by the Cash Manager in accordance with the Priorities of Payments described below under Cashflows.

If the short term, unsecured, unsubordinated and unguaranteed debt obligations of the Account Bank cease to be rated at least A-1+ by S&P, P-1 by Moody’s, or F1 by Fitch (the “**Account Bank Ratings**”) then within 30 London Business Days of such occurrence either:

- the GIC Account and the Transaction Account will be closed and new accounts opened under the terms of a new bank account agreement substantially on the same terms as the Bank Account Agreement opened with a financial institution (i) whose short term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least A-1+ by S&P, P-1 by Moody’s, and F1 by Fitch and (ii) which is an authorised person under FSMA; or
- the Account Bank will obtain a guarantee of its obligations under the Bank Account Agreement on terms acceptable to the Security Trustee, acting reasonably, from a financial institution whose short term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least A-1+ by S&P, P-1 by Moody’s, and F1 by Fitch,

(in each case, provided that the Rating Agencies then rating the Covered Bonds confirm that the then current ratings of the Covered Bonds would not be adversely affected thereby) unless each Rating Agency confirms that its then current rating of the Covered Bonds will not be adversely affected as a result of the Account Bank Ratings falling below A-1+/ P-1/F1 (or the reason for this having occurred) within 15 days of such downgrade. If the Rating Agency Confirmations are given as above, reference to the “**Account Bank Ratings**” shall be deemed to be instead the relevant rating of the Account Bank at the time of such confirmations, but the original rating shall be reinstated if the relevant rating of the Account Bank is subsequently upgraded to the original level.

For the purposes hereof:

“**GIC Account**” means the account in the name of the LLP held with the Account Bank and maintained subject to the terms of the Guaranteed Investment Contract, the Bank Account Agreement and the Deed of Charge or such additional or replacement account as may be for the time being in place with the prior consent of the Security Trustee.

“**Transaction Account**” means the account in the name of the LLP held with the Account Bank and maintained subject to the terms of the Bank Account Agreement and the Deed of Charge or

such other account as may for the time being be in place with the prior consent of the Security Trustee and designated as such.

The Bank Account Agreement is governed by English law.

### **Stand-by Bank Account Agreement**

Pursuant to the terms of a stand-by bank account agreement entered into on the Programme Date between the LLP, Citibank, N.A. (the “**Stand-by Account Bank**”), the Cash Manager and the Security Trustee (the “**Stand-by Bank Account Agreement**”), the LLP will open with the Stand-by Account Bank a stand-by GIC account (the “**Stand-by GIC Account**”) and a stand-by transaction account (the “**Stand-by Transaction Account**”) if the LLP cannot find a replacement account bank in accordance with the terms of the Bank Account Agreement or the Account Bank cannot obtain a guarantee of its obligations, in each case if the ratings of the Account Bank fall below the Account Bank Ratings, and the Bank Account Agreement is subsequently terminated or if the Bank Account Agreement is terminated for other reasons. The Stand-by GIC Account and the Stand-by Transaction Account will be operated in accordance with the Cash Management Agreement, the LLP Deed and the Deed of Charge.

References in this Offering Circular to the GIC Account or the Transaction Account include references to the Stand-by GIC Account or the Stand-by Transaction Account when the Stand-by GIC Account and the Stand-by Transaction Account become operative.

References to the “**LLP Accounts**” mean the GIC Account, the Transaction Account and any additional or replacement accounts opened in the name of the LLP, including the Stand-by GIC Account and the Stand-by Transaction Account.

The Stand-by Bank Account Agreement is governed by English law.

### **Guaranteed Investment Contract**

The LLP has entered into a guaranteed investment contract with Bank of Scotland (in its capacity as GIC provider, the “**GIC Provider**”) and the Cash Manager on the Programme Date (the “**Guaranteed Investment Contract**” or “**GIC**”), pursuant to which the GIC Provider has agreed to pay interest on the moneys standing to the credit thereof at specified rates determined in accordance with the GIC.

The Guaranteed Investment Contract is governed by English law.

### **Stand-by Guaranteed Investment Contract**

The LLP has entered into a stand-by guaranteed investment contract with Citibank, N.A. (the “**Standby GIC Provider**”) on the Programme Date (the “**Stand-by Guaranteed Investment Contract**”), pursuant to which the Stand-by GIC Provider has agreed to pay interest on the Stand-by GIC Account at specified rates determined in accordance with the Stand-by Guaranteed Investment Contract.

The Stand-by Guaranteed Investment Contract is governed by English law.

### **Corporate Services Agreement**

The Liquidation Member, Holdings, Bank of Scotland (as successor to Halifax’s business pursuant to the HBOS Group Reorganisation Act 2006) and the LLP have entered into a corporate services agreement with Structured Finance Management Offshore Limited (the “**Corporate Services**”).

**Provider**) on the Programme Date (the “**Corporate Services Agreement**”), pursuant to which the Corporate Services Provider has agreed to provide corporate services to the Liquidation Member and Holdings.

The Corporate Services Agreement is governed by Jersey law.

### **Deed of Charge**

Pursuant to the terms of a deed of charge entered into on the Programme Date by the LLP, the Security Trustee and the other Secured Creditors (the “**Deed of Charge**”), the secured obligations of the LLP and all other obligations of the LLP under or pursuant to the Transaction Documents to which it is a party are secured, *inter alia*, by the following security (the “**Security**”) over the following property, assets and rights (the “**Charged Property**”):

- (a) a first fixed charge (which may take effect as a floating charge) over the LLP’s interest in the English Loans and their Related Security and other related rights comprised in the Portfolio;
- (b) an assignment by way of first fixed charge over the rights of the LLP in and to the mortgage indemnity guarantee policies;
- (c) an assignation in security of the LLP’s interest in the Scottish Loans and their Related Security (comprising the LLP’s beneficial interest under the trusts declared by the Sellers pursuant to the Scottish Declarations of Trust);
- (d) an assignment by way of first fixed security over all of the LLP’s interests, rights and entitlements under and in respect of any Transaction Document to which it is a party;
- (e) a first fixed charge (which may take effect as a floating charge) over the rights and benefits of the LLP in the LLP Accounts (including the Excess Proceeds) and any other account of the LLP and all amounts standing to the credit of the LLP Accounts and such other accounts;
- (f) a first fixed charge (which may take effect as a floating charge) over the rights and benefits of the LLP in respect of all Authorised Investments and Substitution Assets purchased from time to time from amounts standing to the credit of the LLP Accounts; and
- (g) a first floating charge over (a) all the assets and undertaking of the LLP governed by English law and not, from time to time, subject to any fixed charge in favour of the Security Trustee pursuant to the Deed of Charge and (b) all the assets and undertaking of the LLP located in or governed by the law of Scotland.

In respect of the property, rights and assets referred to in (c) above, fixed security will be created over such property, rights and assets sold to the LLP after the Programme Date by means of deeds supplemental to the Deed of Charge.

“**Secured Creditors**” means the Security Trustee (in its own capacity and on behalf of the other Secured Creditors), the Bond Trustee (in its own capacity and on behalf of the Covered Bondholders), the Covered Bondholders, the Receiptholders, the Couponholders, the Issuer, the Sellers, the Servicers, the Account Bank, the GIC Provider, the Stand-by Account Bank, the Stand-by GIC Provider, the Cash Manager, the Swap Providers, the Corporate Services Provider, the Paying Agents and any other person which becomes a Secured Creditor pursuant to the Deed of Charge.

## **Release of Security**

In the event of any sale of Loans (including Selected Loans) and their Related Security by the LLP pursuant to and in accordance with the Transaction Documents, the Security Trustee will (subject to the written request of the LLP), release those Loans from the Security created by and pursuant to the Deed of Charge on the date of such sale but only if:

- (i) the Security Trustee provides its prior written consent to the terms of such sale as described under *LLP Deed – Method of Sale of Selected Loans* above; and
- (ii) the LLP provides to the Security Trustee a certificate confirming that the Selected Loans being sold have been selected on a random basis.

## **Enforcement**

If an LLP Acceleration Notice is served on the Issuer and the LLP, the Security Trustee shall be entitled to appoint a Receiver, and/or enforce the Security constituted by the Deed of Charge (including selling the Portfolio), and/or take such steps as it shall deem necessary, subject in each case to being indemnified and/or secured to its satisfaction. All proceeds received by the Security Trustee from the enforcement or realisation of the Security will be applied in accordance with the Post-Enforcement Priority of Payments described under *Cashflows*.

## **Governing Law**

The Deed of Charge and any non-contractual obligations arising out of or in connection with it is governed by English law (other than the assignation in security referred to above and any assignation in security granted after the Programme Date pursuant and supplemental to the Deed of Charge which will be governed by Scots law).

## CREDIT STRUCTURE

The Covered Bonds will be direct, unsecured and unconditional obligations of the Issuer and the HBOS Group Guarantor only. The LLP has no obligation to pay the Guaranteed Amounts under the Covered Bond Guarantee until the occurrence of an HBOS Event of Default, service by the Bond Trustee on the Issuer and the HBOS Group Guarantor of an HBOS Acceleration Notice and on the LLP of a Notice to Pay or, if earlier, following the occurrence of an LLP Event of Default, service by the Bond Trustee of an LLP Acceleration Notice on the Issuer and the LLP. The Issuer will not be relying on payments by the LLP in respect of the Term Advances or receipt of Revenue Receipts or Principal Receipts from the Portfolio in order to pay interest or repay principal under the Covered Bonds.

There are a number of features of the Programme which enhance the likelihood of timely and, as applicable, ultimate payments to Covered Bondholders, as follows:

- the HBOS Group Guarantee and the Covered Bond Guarantee provide credit support to the Issuer;
- the Pre-Maturity Test is intended to provide liquidity to the LLP in respect of principal due on the Final Maturity Date of Hard Bullet Covered Bonds;
- the Asset Coverage Test is intended to ensure that the ratio of the LLP's assets to the Covered Bonds is maintained at a certain level;
- the Amortisation Test is intended to test the asset coverage of the LLP's assets in respect of the Covered Bonds following the occurrence of an HBOS Event of Default and service of a Notice of Pay on the LLP;
- a Reserve Fund will be established in the GIC Account to trap Available Revenue Receipts if the Issuer's short-term ratings or Deemed Rating, as applicable, fall below A-1+ by S&P, F1+ by Fitch or P-1 by Moody's;
- under the terms of the Guaranteed Investment Contract, the GIC Provider has agreed to pay a variable rate of interest on all amounts held by the LLP in the GIC Account at a rate of 0.25 per cent. per annum below LIBOR for one-month sterling deposits; and
- under the terms of the Stand-by Guaranteed Investment Contract, the Stand-by GIC Provider has agreed to pay a variable rate of interest on all amounts held by the LLP in the Stand-by GIC Account at a rate of 0.25 per cent. per annum below LIBOR for one-month sterling deposits.

Certain of these factors are considered more fully in the remainder of this section.

### Guarantees

Under the terms of the HBOS Group Guarantee, if the Issuer defaults in the payment on the due date of any moneys due and payable under the Trust Deed or the Covered Bonds, the HBOS Group Guarantor has agreed to unconditionally pay or procure to be paid unconditionally upon demand the amount in respect of which such default has been made.

The Covered Bond Guarantee provided by the LLP under the Trust Deed guarantees payment of Guaranteed Amounts when the same become Due for Payment in respect of all Covered Bonds issued under the Programme. The Covered Bond Guarantee will not guarantee any amount becoming

payable in respect of the Covered Bonds for any other reason, including any accelerated payment pursuant to Condition 10 (Events of Default and Enforcement) following the occurrence of an HBOS Event of Default. In this circumstance (and until an LLP Event of Default occurs and an LLP Acceleration Notice is served), the LLP's obligations will only be to pay the Guaranteed Amounts as they fall Due for Payment on each Scheduled Payment Date.

See further *Summary of the Principal Documents – Trust Deed* as regards the terms of the Guarantees. See further *Cashflows – Guarantee Priority of Payments* as regards the payment of amounts payable by the LLP to Covered Bondholders and other Secured Creditors following the occurrence of an HBOS Event of Default.

### **Pre-Maturity Liquidity**

Certain Series of Covered Bonds are scheduled to be redeemed in full on the Final Maturity Date therefor without any provision for scheduled redemption other than on the Final Maturity Date (the “**Hard Bullet Covered Bonds**”). The applicable Final Terms will identify whether any Series of Covered Bonds is a Series of Hard Bullet Covered Bonds. The Pre-Maturity Test is intended to provide liquidity for the Hard Bullet Covered Bonds when the Issuer's credit ratings or Deemed Ratings, as applicable, fall to a certain level. On each London Business Day (each the “**Pre-Maturity Test Date**”) prior to the occurrence of an HBOS Event of Default or the occurrence of an LLP Event of Default, the LLP or the Cash Manager on its behalf will determine if the Pre-Maturity Test has been breached, and if so, it shall immediately notify the Members and the Security Trustee thereof.

The Issuer will fail and be in breach of the “**Pre-Maturity Test**” on a Pre-Maturity Test Date if:

- (a) the Issuer's short-term credit rating or Deemed Rating, as applicable, from S&P falls to A-1 (or lower) and the Final Maturity Date of the Series of Hard Bullet Covered Bonds will fall within 6 months from the relevant Pre-Maturity Test Date; or
- (b) the Issuer's (i) long-term credit rating or Deemed Rating, as applicable, from Moody's falls to A2 (or lower) and the Final Maturity Date of the Series of Hard Bullet Covered Bonds will fall within 6 months from the relevant Pre-Maturity Test Date or (ii) short-term credit rating or Deemed Rating, as applicable, from Moody's falls to P-2 (or lower) and the Final Maturity Date of the Series of Hard Bullet Covered Bonds will fall within 12 months from the relevant Pre-Maturity Test Date; or
- (c) the Issuer's short-term credit rating or Deemed Rating, as applicable, from Fitch falls to F1 (or lower) and the Final Maturity Date of the Series of Hard Bullet Covered Bonds will fall within 12 months from the relevant Pre-Maturity Test Date.

Following a breach of the Pre-Maturity Test in respect of a Series of Covered Bonds, the LLP shall offer to sell Selected Loans and their Related Security to Purchasers, subject to:

- (a) any Cash Capital Contribution made by the Members (other than the Liquidation Member) from time to time; and
- (b) any right of pre-emption enjoyed by the Sellers pursuant to the terms of the Mortgage Sale Agreement,

provided that an HBOS Event of Default shall occur if the Pre-Maturity Test in respect of any Series of Hard Bullet Covered Bonds is breached less than six months prior to the Final Maturity Date of that Series of Hard Bullet Covered Bonds, and the relevant parties have not taken the required action (as described above) following the breach within the earlier to occur of (i) 10 Business Days

from the date that the Sellers are notified of the breach of the Pre-Maturity Test and (ii) the Final Maturity Date of that Series of Hard Bullet Covered Bonds such that by the end of such period, there shall be an amount equal to the Required Redemption Amount of that Series of Hard Bullet Covered Bonds standing to the credit of the Pre-Maturity Liquidity Ledger (after taking into account the Required Redemption Amount of all other Series of Hard Bullet Covered Bonds which mature prior to or on the same date as the relevant Series of Hard Bullet Covered Bonds). The method for selling Selected Loans and their Related Security is described in *Summary of Principal Documents – The LLP Deed – Sales of Selected Loans and their Related Security if the Pre-Maturity Test is breached* above. The proceeds of sale of Selected Loans and their Related Security and/or the proceeds of any Cash Contribution as described above, will be recorded to the Pre-Maturity Liquidity Ledger on the GIC Account.

In certain circumstances, Revenue Receipts will also be available to repay a Hard Bullet Covered Bond, as described in *Cashflows – Pre-Acceleration Revenue Priority of Payments* below.

Failure by the Issuer and/or the HBOS Group Guarantor to pay the full amount due in respect of a Series of Hard Bullet Covered Bonds on the Final Maturity Date thereof will constitute an HBOS Event of Default. Following service of a Notice to Pay on the LLP, the LLP shall apply funds standing to the Pre-Maturity Liquidity Ledger to repay the relevant Series of Hard Bullet Covered Bonds.

If the Issuer and/or the HBOS Group Guarantor fully repay the relevant Series of Hard Bullet Covered Bonds on the Final Maturity Date thereof, cash standing to the credit of the Pre-Maturity Liquidity Ledger on the GIC Account shall be applied by the LLP in accordance with the Pre-Acceleration Principal Priority of Payments, unless:

- (a) the Issuer is failing the Pre-Maturity Test in respect of any other Series of Hard Bullet Covered Bonds, in which case the cash will remain on the Pre-Maturity Liquidity Ledger in order to provide liquidity for that other Series of Hard Bullet Covered Bonds; or
- (b) the Issuer is not failing the Pre-Maturity Test, but the Management Board elects to retain the cash on the Pre-Maturity Liquidity Ledger in order to provide liquidity for any future Series of Hard Bullet Covered Bonds.

Amounts standing to the credit of the Pre-Maturity Liquidity Ledger following the repayment of the Hard Bullet Covered Bonds as described above may, except where the Management Board has elected or is required to retain such amounts on the Pre-Maturity Liquidity Ledger, also be used to repay the corresponding Term Advance and distribute any excess Available Principal Receipts back to the Members on dates other than LLP Payment Dates, subject to the LLP making provision for higher ranking items in the Pre-Acceleration Principal Priority of Payments.

### **Asset Coverage Test**

The Asset Coverage Test is intended to ensure that the LLP can meet its obligations under the Covered Bond Guarantee and senior ranking expenses which will include costs relating to the maintenance and winding-up of the Asset Pool whilst the Covered Bonds are outstanding. Under the LLP Deed, the LLP and its Members (other than the Liquidation Member) must ensure that on each Calculation Date the Adjusted Aggregate Loan Amount will be in an amount equal to or in excess of the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date. If the Asset Coverage Test is failed on any Calculation Date, and such failure is not remedied on or before the next following Calculation Date, then an HBOS Event of Default will occur. The Asset Coverage Test is a formula which adjusts the Current Balance of each Loan in the Portfolio and has further adjustments to take account of set-off on a Borrower's current or deposit

accounts held with each Seller, set-off associated with drawings made by Borrowers under Flexible Loans and Defaulted Loans that are not repurchased or failure by Sellers, in accordance with the Mortgage Sale Agreement to repurchase or Loans that do not materially comply with the Representations and Warranties on the relevant Transfer Date. See further *Summary of the Principal Loans – LLP Deed – Asset Coverage Test*, above.

### **Amortisation Test**

The Amortisation Test is intended to ensure that if, following an HBOS Event of Default and the service of a Notice to Pay on the LLP (but prior to service on the LLP and the Issuer of an LLP Acceleration Notice and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security), the assets of the LLP available to meet its obligations under the Covered Bond Guarantee fall to a level where Covered Bondholders may not be repaid, an LLP Event of Default will occur and all amounts owing under the Covered Bonds may be accelerated. Under the LLP Deed, the LLP and its Members (other than the Liquidation Member) must ensure that on each Calculation Date following an HBOS Event of Default the Amortisation Test Aggregate Loan Amount will be in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date. The Amortisation Test is a formula which adjusts the Current Balance of each Loan in the Portfolio and has further adjustments to take account of Loans in arrears. See further *Summary of the Principal Documents – LLP Deed Amortisation Test*, above.

### **Reserve Fund**

If at any time prior to an HBOS Event of Default the Issuer's short-term, unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings, as applicable, cease to be rated A-1+ by S&P, P-1 by Moody's or F1+ by Fitch, the LLP will be required to establish a reserve fund (the "**Reserve Fund**") on the GIC Account which will be credited with Available Revenue Receipts up to an amount equal to the Scheduled Interest due on the next following Interest Payment Date on each Series of Covered Bonds (the "**Reserve Fund Required Amount**"). The LLP will not be required to maintain the Reserve Fund following the occurrence of an HBOS Event of Default.

The Reserve Fund will be funded from Available Revenue Receipts after the LLP has paid all of its obligations in respect of items ranking higher than the Reserve Ledger falling at item (c) of the Pre-Acceleration Revenue Priority of Payments on each LLP Payment Date.

A Reserve Ledger will be maintained by the Cash Manager to record the balance from time to time of the Reserve Fund. Following the occurrence of an HBOS Event of Default and service of a Notice to Pay on the LLP, amounts standing to the credit of the Reserve Fund will be added to certain other income of the LLP in calculating Available Revenue Receipts.



## CASHFLOWS

As described above under “**Credit Structure**”, until a Notice to Pay is served on the LLP, the Covered Bonds will be obligations of the Issuer and the HBOS Group Guarantor only. Neither the Issuer nor the HBOS Group Guarantor is reliant, in any way, on the cashflows of the LLP to satisfy their respective obligations under the Covered Bonds.

This section summarises the cashflows of the LLP only, as to the allocation and distribution of amounts standing to the credit of the LLP Accounts and their order of priority (all such orders of priority, the “**Priorities of Payments**”) (i) prior to an HBOS Event of Default and an LLP Event of Default, (ii) following an HBOS Event of Default (but prior to an LLP Event of Default) and (iii) following an LLP Event of Default in accordance with the LLP Deed or the Deed of Charge, as applicable.

### Definitions

For the purposes hereof:

“**Available Principal Receipts**” means on a relevant Calculation Date an amount equal to the aggregate of (without double counting):

- (a) the amount of Principal Receipts received during the immediately preceding Calculation Period and credited to the Principal Ledger on the GIC Account (**but excluding** any Principal Receipts received in the Calculation Period beginning in the month in which the relevant Calculation Date falls);
- (b) any other amount standing to the credit of the Principal Ledger including (i) the proceeds of any Term Advance (where such proceeds have not been applied to acquire New Portfolios, refinance an existing Term Advance, invest in Substitution Assets or make a Capital Distribution to a Member), (ii) any Cash Capital Contributions received from a Member and (iii) the proceeds from any sale of Selected Loans pursuant to the terms of the LLP Deed or the Mortgage Sale Agreement;
- (c) following repayment of any Hard Bullet Covered Bonds by the Issuer and the HBOS Group Guarantor on the Final Maturity Date thereof, any amounts standing to the credit of the Pre-Maturity Liquidity Ledger in respect of such Series of Hard Bullet Covered Bonds (except where the LLP has elected to or is required to retain such amounts on the Pre-Maturity Liquidity Ledger); and
- (d) all amounts in respect of principal (if any) received by the LLP under the Covered Bond Swap Agreement on the relevant LLP Payment Date (other than any termination payments or Swap Collateral Excluded Amounts).

“**Available Revenue Receipts**” means on a relevant Calculation Date, an amount equal to the aggregate of:

- (a) the amount of Revenue Receipts received during the previous Calculation Period and credited to the Revenue Ledger on the GIC Account (**but excluding** any Revenue Receipts received in the Calculation Period beginning in the month in which the relevant Calculation Date falls);
- (b) prior to the service of a Notice to Pay, amounts standing to the credit of the Reserve Fund in excess of the Reserve Fund Required Amount;

- (c) other net income of the LLP including all amounts of interest received on the LLP Accounts, the Substitution Assets and Authorised Investments in the preceding Calculation Period and amounts received by the LLP under the Interest Rate Swap Agreements and in respect of interest received by the LLP under the Covered Bond Swap Agreements on the relevant LLP Payment Date (other than any termination payments or Swap Collateral Excluded Amounts);
- (d) any other Revenue Receipts not referred to in paragraphs (a) to (d) received during the previous Calculation Period and standing to the credit of the Revenue Ledger on the GIC Account; and
- (e) following the service on the LLP of a Notice to Pay, amounts standing to the credit of the Reserve Fund;

*less*

- (f) Third Party Amounts, which shall be paid on receipt in cleared funds to each Seller (to the extent that the Third Party Amounts relate to Loans serviced by that Seller).

“**Covered Bond Swap Rate**” means in relation to a Covered Bond or Series of Covered Bonds, the exchange rate specified in the Covered Bond Swap Agreement relating to such Covered Bond or Series of Covered Bonds or, if the Covered Bond Swap Agreement has terminated, the applicable spot rate.

“**Earliest Maturing Covered Bonds**” means at any time the relevant Series of the Covered Bonds that has the earliest Final Maturity Date as specified in the applicable Final Terms (ignoring any acceleration of amounts due under the Covered Bonds prior to the occurrence of an LLP Event of Default).

“**Excluded Swap Termination Amount**” means in relation to a Swap Agreement, an amount equal to the amount of any termination payment due and payable (i) to the relevant Swap Provider as a result of a Swap Provider Default with respect to such Swap Provider or (ii) to the relevant Swap Provider following a Swap Provider Downgrade Event with respect to such Swap Provider.

“**Final Maturity Date**” means the Interest Payment Date on which each Series of Covered Bonds will be redeemed at their Principal Amount Outstanding in accordance with the Conditions.

“**Interest Payment Date**” means in relation to any Fixed Rate Covered Bond, such date or dates as indicated in the applicable Final Terms and, in relation to any Floating Rate Covered Bond or Index Linked Interest Covered Bond, either:

- (a) the date which falls the number of months or other period specified as the “**Specified Period**” in the applicable Final Terms after the preceding Interest Payment Date or the Interest Commencement Date (in the case of the first Interest Payment Date); or
- (b) such date or dates as are indicated in the applicable Final Terms.

“**LLP Payment Period**” means the period from and including an LLP Payment Date to but excluding the next following LLP Payment Date.

“**Principal Receipts**” means:

- (a) principal repayments under the Loans (including payments of arrears, Accrued Interest and Arrears of Interest as at the relevant Transfer Date of a Loan);

- (b) recoveries of principal from defaulting Borrowers under Loans being enforced (including the proceeds of sale of the relevant Property);
- (c) any payment pursuant to any insurance policy in respect of a property the subject of a Mortgage in connection with a Loan in the Portfolio; and
- (d) the proceeds of the repurchase of any Loan by any Seller from the LLP pursuant to the Mortgage Sale Agreement (including, for the avoidance of doubt, amounts attributable to Accrued Interest and Arrears of Interest thereon as at the relevant repurchase date).

“**Reserve Fund Required Amount**” means zero unless the Issuer is rated less than A-1+ by S&P or less than P-1 by Moody’s or less than F1+ by Fitch, in which case it is the aggregate of the Scheduled Interest due on the next following Interest Payment Date on each Series of Covered Bonds.

“**Revenue Receipts**” means:

- (a) payments of interest (excluding Accrued Interest and Arrears of Interest as at the relevant Transfer Date of a Loan) and other fees due from time to time under the Loans and other amounts received by the LLP in respect of the Loans other than the Principal Receipts;
- (b) recoveries of interest and outstanding fees from defaulting Borrowers under Loans being enforced; and
- (c) recoveries of interest and/or principal from defaulting Borrowers under Loans in respect of which enforcement procedures have been completed.

“**Sale Proceeds**” means the cash proceeds realised from the sale of Selected Loans and their Related Security.

“**Swap Collateral**” means, at any time, any asset (including, without limitation, cash and/or securities) which is paid or transferred by a Swap Provider to the LLP as collateral to secure the performance by such Swap Provider of its obligations under the relevant Swap Agreement together with any income or distributions received in respect of such asset and any equivalent of such asset into which such asset is transformed.

“**Swap Collateral Excluded Amounts**” means, at any time, the amount of Swap Collateral which may not be applied at that time in satisfaction of the relevant Swap Provider’s obligations to the LLP under the terms of the relevant Swap Agreement.

“**Swap Provider Default**” means the occurrence of an Event of Default or Termination Event (each as defined in each of the Swap Agreements) where the relevant Swap Provider is the Defaulting Party or the sole Affected Party (each as defined in the relevant Swap Agreement), as applicable, other than a Swap Provider Downgrade Event.

“**Swap Provider Downgrade Event**” means the occurrence of an Additional Termination Event or an Event of Default (each as defined in the relevant Swap Agreement) following a failure by the Swap Provider to comply with the requirements of the ratings downgrade provisions set out in the relevant Swap Agreement.

The “**Sterling Equivalent**” of any amount means (a) in relation to a Covered Bond or Series of Covered Bonds which is denominated in a currency other than sterling, the sterling equivalent of such amount ascertained using the Covered Bond Swap Rate relating to such Covered Bonds and (b) in relation to a Covered Bond or Series of Covered Bonds denominated in sterling, the applicable amount in sterling.

“**Third Party Amounts**” include:

- (a) payments of insurance premiums due to any provider of mortgage indemnity guarantees;
- (b) amounts under a direct debit which are repaid to the bank making the payment if such bank is unable to recoup that amount itself from its customer account;
- (c) payments by the Borrower of any fees (including Early Repayment Fees) and other charges which are due to the relevant Seller; and
- (d) any amount received from a Borrower for the express purpose of payment being made to a third party for the provision of a service (including giving insurance cover) to either that Borrower or the Seller (in relation to Loans sold by that Seller) or the LLP,

which amounts may be paid daily from moneys on deposit in the GIC Account.

### **Allocation and Distribution of Revenue Receipts prior to the service of a Notice to Pay**

Prior to service of a Notice to Pay or an LLP Acceleration Notice on the Issuer and the LLP and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security, Revenue Receipts will be allocated and distributed as described below.

On the Calculation Date immediately preceding each LLP Payment Date, the LLP or the Cash Manager on its behalf shall calculate:

- (a) the amount of Available Revenue Receipts available for distribution on the immediately following LLP Payment Date;
- (b) the Reserve Fund Required Amount; and
- (c) where the Pre-Maturity Test has been breached in respect of a Series of Hard Bullet Covered Bonds, on each Calculation Date falling in the five months prior to the Final Maturity Date of the relevant Series of Hard Bullet Covered Bonds, whether or not the amount standing to the credit of the Pre-Maturity Liquidity Ledger at such date is less than the Required Redemption Amount for the relevant Series of Hard Bullet Covered Bonds at such date (together with the Required Redemption Amount of all other Series of Hard Bullet Covered Bonds which mature prior to or on the same date as the relevant Series of Hard Bullet Covered Bonds).

If an LLP Payment Date is the same as an Interest Payment Date, then the distribution of Available Revenue Receipts under the Pre-Acceleration Revenue Priority of Payments will be delayed until the Issuer and/or the HBOS Group Guarantor have made the scheduled interest and/or principal payments on that Interest Payment Date.

### **Pre-Acceleration Revenue Priority of Payments**

On each LLP Payment Date, the LLP or the Cash Manager on its behalf will transfer funds from the GIC Account to the Transaction Account, in an amount equal to the amount of Available Revenue Receipts.

Prior to service of a Notice to Pay or service of an LLP Acceleration Notice on the Issuer and the LLP and/or the commencement of winding-up proceedings against the LLP and/or realisation of the security, Available Revenue Receipts will be applied by or on behalf of the LLP on each LLP Payment Date (except for amounts due to third parties by the LLP under paragraphs (a) and (b), which shall be paid when due) in making the following payments and provisions (the “**Pre-Acceleration**

**Revenue Priority of Payments**”) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction of any amounts due and payable by the LLP to third parties and incurred without breach by the LLP of the Transaction Documents to which it is a party (and for which payment has not been provided for elsewhere in the relevant Priorities of Payments) and to provide for any such amounts expected to become due and payable by the LLP in the immediately succeeding LLP Payment Period and to pay and discharge any liability of the LLP for taxes;
- (b) *second*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof of:
  - (i) any remuneration then due and payable to the Servicers and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicers under the provisions of the Servicing Agreements in the immediately succeeding LLP Payment Period, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager under the provisions of the Cash Management Agreement in the immediately succeeding LLP Payment Period, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) amounts (if any) due and payable to the Account Bank (including costs) pursuant to the terms of the Bank Account Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iv) amounts due and payable to the Corporate Services Provider pursuant to the terms of the Corporate Services Agreement;
  - (v) amounts (if any) due and payable to the FSA in respect of fees owed to the FSA under the RCB Sourcebook (other than the initial registration fees); and
  - (vi) amounts due and payable to the Asset Monitor pursuant to the terms of the Asset Monitor Agreement (other than the amounts referred to in paragraph (j) below), together with applicable VAT (or similar taxes) thereon as provided therein;
- (c) *third*, to pay *pro rata* and *pari passu* any amount due to the Interest Rate Swap Providers (including any termination payment due and payable by the LLP under the relevant Interest Rate Swap Agreement (but excluding any Excluded Swap Termination Amount)) pursuant to the terms of the relevant Interest Rate Swap Agreements;
- (d) *fourth*, towards a credit to the Reserve Ledger on the GIC Account of an amount up to but not exceeding the amount by which the Reserve Fund Required Amount exceeds the existing balance on the Reserve Ledger as calculated on the immediately preceding Calculation Date;
- (e) *fifth*, if the LLP is required to make a deposit to the Pre-Maturity Liquidity Ledger in accordance with the LLP Deed, towards a credit to the GIC Account with a corresponding credit to that Ledger of an amount up to but not exceeding the difference between:
  - (i) the Required Redemption Amount as calculated on the immediately preceding Calculation Date for the relevant Series of Hard Bullet Covered Bonds; and

- (ii) any amounts standing to the credit of the Pre-Maturity Liquidity Ledger on the immediately preceding Calculation Date after deducting from that Ledger the Required Redemption Amounts of all other Series of Hard Bullet Covered Bonds as calculated on that Calculation Date which mature prior to or on the same date as the relevant Series of Hard Bullet Covered Bonds;
- (f) *sixth*, if a Servicer Event of Default has occurred, all remaining Available Revenue Receipts to be credited to the GIC Account (with a corresponding credit to the Revenue Ledger) until such Servicer Event of Default is either remedied or waived by the Security Trustee or a New Servicer is appointed to service the Portfolio (or the relevant part thereof);
- (g) *seventh*, in or towards payment *pro rata* and *pari passu* in accordance with the respective amounts thereof of any Excluded Swap Termination Amount due and payable by the LLP under the relevant Interest Rate Swap Agreements;
- (h) *eighth*, towards payment of any amounts due and payable (excluding principal amounts due and payable) to the Issuer pursuant to the terms of the Intercompany Loan Agreement;
- (i) *ninth*, towards payment of any indemnity amount due to the Members pursuant to the LLP Deed;
- (j) *tenth*, towards payment of any indemnity amount due to the Asset Monitor pursuant to the Asset Monitor Agreement;
- (k) *eleventh*, in respect of Deferred Consideration due to the Sellers for the transfer of the Loans and their Related Security to the LLP, to pay all remaining Available Revenue Receipts (except for an amount equal to the profit to be paid to the Members in accordance with (l) below) to the Sellers *pari passu*, but so that only Available Revenue Receipts that are specifically attributable to Loans sold by a relevant Seller shall be paid to that Seller; and
- (l) *twelfth*, towards payment *pro rata* and *pari passu* to the Members of the sum of £3,000 (or such other sum as may be agreed by the Members from time to time) in aggregate, to be allocated and paid to each Member in proportion to their respective Capital Contribution Balances as at the relevant Calculation Date subject to a minimum of £1.00 each, as their profit for their respective interests as Members in the LLP.

#### **Allocation and Distribution of Principal Receipts prior to service of a Notice to Pay**

Prior to service of a Notice to Pay on the LLP or the service of an LLP Acceleration Notice on the Issuer and the LLP and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security, Principal Receipts will be allocated and distributed as described below.

On each Calculation Date, the LLP or the Cash Manager on its behalf will calculate the amount of Available Principal Receipts available for distribution on the immediately following LLP Payment Date.

On each LLP Payment Date, the LLP or the Cash Manager on its behalf will transfer funds from the GIC Account to the Transaction Account in an amount equal to the lower of (a) the amount required to make the payments described below and (b) the amount of all Available Principal Receipts.

If an LLP Payment Date is the same as an Interest Payment Date or Final Maturity Date, then the distribution of Available Principal Receipts under the Pre-Acceleration Principal Priority of

Payments will be delayed until the Issuer and/or HBOS Group Guarantor have made scheduled interest and/or principal payments on that Interest Payment Date.

### **Pre-Acceleration Principal Priority of Payments**

Prior to service of a Notice to Pay or an LLP Acceleration Notice on the Issuer and the LLP and/or the commencement of winding-up proceedings against the LLP and/or realisation of the Security, all Available Principal Receipts (other than Cash Capital Contributions made from time to time by the Issuer, which shall (subject to complying with the Asset Coverage Test) be distributed to the Issuer as a Capital Distribution) will be applied by or on behalf of the LLP on each LLP Payment Date in making the following payments and provisions (the “**Pre-Acceleration Principal Priority of Payments**”):

- (a) *first*, if the Pre-Maturity Test has been failed by the Issuer in respect of any Series of Hard Bullet Covered Bonds, to credit all Principal Receipts to the Pre-Maturity Liquidity Ledger in an amount up to but not exceeding the difference between:
  - (i) the Required Redemption Amount calculated on the immediately preceding Calculation Date for the relevant Series of Hard Bullet Covered Bonds; and
  - (ii) any amounts standing to the credit of the Pre-Maturity Liquidity Ledger on the immediately preceding Calculation Date after deducting from that Ledger the Required Redemption Amount of all other Hard Bullet Covered Bonds, as calculated on that Calculation Date, which mature prior to or on the same date as the relevant Series of Hard Bullet Covered Bonds;
- (b) *second*, to acquire New Loans and their Related Security offered to the LLP by the Sellers in accordance with the terms of the Mortgage Sale Agreement in an amount sufficient to ensure that taking into account the other resources available to the LLP, the LLP is in compliance with the Asset Coverage Test, but so that only Available Principal Receipts that are specifically attributable to Loans sold by a specific Seller shall be firstly applied to acquire New Loans and their Related Security from that Seller and thereafter to the extent that such Seller fails or declines to sell New Loans to the LLP, to acquire New Loans from any Seller and/or to acquire Substitution Assets;
- (c) *third*, to deposit the remaining Principal Receipts in the GIC Account (with a corresponding credit to the Principal Ledger) in an amount sufficient to ensure that taking into account the other resources available to the LLP, the LLP is in compliance with the Asset Coverage Test;
- (d) *fourth*, provided that all amounts outstanding under a Series of Covered Bonds have been repaid in full, in or towards repayment of the corresponding Term Advance related to such Series of Covered Bonds; and
- (e) *fifth*, subject to complying with the Asset Coverage Test, to make a Capital Distribution *pari passu* to each Member (other than the Liquidation Member) by way of distribution of that Member’s equity in the LLP in an amount equal to any remaining Available Principal Receipts but so that only Available Principal Receipts that are specifically attributable to Loans sold by a specific Member (in its capacity as a Seller) shall be paid to that Member.

### **Allocation and Distribution of moneys following service of a Notice to Pay**

At any time after the occurrence of an HBOS Event of Default, service of an HBOS Acceleration Notice on the Issuer and the HBOS Group Guarantor and service of a Notice to Pay on the LLP, but prior to service of an LLP Acceleration Notice on the Issuer and the LLP and/or the

commencement of winding-up proceedings against the LLP, all moneys (other than Third Party Amounts and Swap Collateral Excluded Amounts) will be applied as described below.

On each LLP Payment Date, the LLP or the Cash Manager on its behalf will transfer funds from the GIC Account to the Transaction Account, in an amount equal to the lower of (a) the amount required to make the payments set out in the Guarantee Priority of Payments and (b) the amount standing to the credit of the GIC Account.

The LLP will create and maintain ledgers for each Series of Covered Bonds and record amounts allocated to such Series of Covered Bonds in accordance with paragraph (e) below (see *Guarantee Priority of Payments*), and such amounts, once allocated, will only be available to pay amounts due under the Covered Bond Guarantee and amounts due under the Covered Bond Swap relevant in respect of the relevant Series of Covered Bonds on the scheduled repayment date thereof.

### **Guarantee Priority of Payments**

If a Notice to Pay is served on the LLP in connection with the Pre-Maturity Test (as set out in the LLP Deed), the LLP shall on the relevant Final Maturity Date apply all moneys standing to the credit of the Pre-Maturity Liquidity Ledger (and transferred to the Transaction Account on the relevant LLP Payment Date) to repay the relevant Series of Hard Bullet Covered Bonds in accordance with the LLP Deed (as described in *Credit Structure — Pre-Maturity Liquidity*). Subject thereto, on each LLP Payment Date after the service of a Notice to Pay on the LLP (but prior to the occurrence of an LLP Event of Default), the LLP or the Cash Manager on its behalf will apply moneys standing to the credit of the Transaction Account to make the following payments and provisions in the following order of priority (the “**Guarantee Priority of Payments**”) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:
  - (i) all amounts due and payable or to become due and payable to the Bond Trustee in the immediately succeeding LLP Payment Period under the provisions of the Trust Deed together with interest and applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) all amounts due and payable or to become due and payable to the Security Trustee in the immediately succeeding LLP Payment Period under the provisions of the Deed of Charge together with interest and applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) any remuneration then due and payable to the Agent Bank and the Agents under the provisions of the Agency Agreement together with applicable VAT (or similar taxes) thereon as provided therein; and
  - (iv) any amounts then due and payable by the LLP to third parties and incurred without breach by the LLP of the Transaction Documents to which it is a party (and for which payment has not been provided for elsewhere) and to provide for any such amounts expected to become due and payable by the LLP in the immediately succeeding LLP Payment Period and to pay or discharge any liability of the LLP for taxes;
- (b) *second*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:
  - (i) any remuneration then due and payable to the Servicers and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicers in the immediately succeeding LLP Payment Period under the provisions of the Servicing



Agreements together with applicable VAT (or similar taxes) thereon as provided therein;

- (ii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager in the immediately succeeding LLP Payment Period under the provisions of the Cash Management Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) amounts (if any) due and payable to the Account Bank (including costs) pursuant to the terms of the Bank Account Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iv) amounts due and payable to the Corporate Services Provider pursuant to the Corporate Services Agreement;
  - (v) amounts (if any) due and payable to the FSA under the RCB Sourcebook (other than the initial registration fees) together with applicable VAT (or other similar taxes) thereon; and
  - (vi) amounts due and payable to the Asset Monitor (other than the amounts referred to in paragraph (j) below) pursuant to the terms of the Asset Monitor Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
- (c) *third*, in or towards satisfaction *pro rata* according to the respective amounts thereof, of any amounts due and payable to the Interest Rate Swap Providers (including any termination payment due and payable by the LLP under the relevant Interest Rate Swap Agreement but excluding any Excluded Swap Termination Amount) pursuant to the terms of the Interest Rate Swap Agreements;
- (d) *fourth*, to pay *pro rata* and *pari passu* according to the respective amounts thereof, of:
- (i) the amounts due and payable to the Covered Bond Swap Provider (other than in respect of principal) *pro rata* and *pari passu* in respect of each relevant Series of Covered Bonds (including any termination payment due and payable by the LLP under the relevant Covered Bond Swap Agreement but excluding any Excluded Swap Termination Amount) in accordance with the terms of the relevant Covered Bond Swap Agreement; and
  - (ii) to the Bond Trustee or (if so directed by the Bond Trustee) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* Scheduled Interest that is Due for Payment on each Series of Covered Bonds,

provided that if the amount available for distribution under this paragraph (d) (excluding any amounts received from the Covered Bond Swap Provider) would be insufficient to pay the Sterling Equivalent of the Scheduled Interest that is Due for Payment on each Series of Covered Bonds under (ii) above, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis and the amount payable by the LLP to the Covered Bond Swap Provider in respect of each Series of Covered Bonds under (i) above shall be reduced by the amount of the shortfall applicable to the Covered Bonds in respect of which such payment is to be made;

- (e) *fifth*, to pay or provide for *pro rata* and *pari passu* according to the respective amounts thereof, of:

- (i) the amounts (in respect of principal) due and payable to the Covered Bond Swap Provider *pro rata* and *pari passu* in respect of the relevant Series of Covered Bonds (including any termination payment due and payable by the LLP under the relevant Covered Bond Swap Agreement but excluding any Excluded Swap Termination Amount) in accordance with the terms of the relevant Covered Bond Swap Agreement; and
- (ii) to the Bond Trustee or (if so directed by the Bond Trustee) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* Scheduled Principal that is Due for Payment on each Series of Covered Bonds,

provided that if the amount available for distribution under this paragraph (e) (excluding any amounts received from the Covered Bond Swap Provider) would be insufficient to pay the Sterling Equivalent of the Scheduled Principal that is Due for Payment on the relevant Series of Covered Bonds under (e)(ii) above, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis and the amount payable by the LLP to the Covered Bond Swap Provider in respect of each Series of Covered Bonds under (e)(i) above shall be reduced by the amount of the shortfall applicable to the Covered Bonds in respect of which such payment is to be made;

- (f) *sixth*, to deposit the remaining moneys in the GIC Account for application on the next following LLP Payment Date in accordance with the priority of payments described in paragraphs (a) to (e) (inclusive) above, until the Covered Bonds have been fully repaid or provided for (such that the Required Redemption Amount has been accumulated in respect of each outstanding Series of Covered Bonds);
- (g) *seventh*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof of any Excluded Swap Termination Amount due and payable by the LLP to the relevant Swap Provider under the relevant Swap Agreement;
- (h) *eighth*, after the Covered Bonds have been fully repaid or provided for (such that the Required Redemption Amount has been accumulated in respect of each outstanding Series of Covered Bonds), any remaining moneys will be applied in and towards repayment in full of amounts outstanding under the Intercompany Loan Agreement;
- (i) *ninth*, towards payment of any indemnity amount due to the Members pursuant to the LLP Deed;
- (j) *tenth*, towards payment of certain costs, expenses and indemnity amounts due by the LLP to the Asset Monitor pursuant to the Asset Monitor Agreement; and
- (k) *eleventh*, thereafter any remaining moneys will be applied in accordance with the LLP Deed.

**Application of moneys received by the Security Trustee following the occurrence of an LLP Event of Default and enforcement of the Security, realisation of the Security and/or the commencement of winding-up proceedings against the LLP**

Under the terms of the Deed of Charge, all moneys received or recovered by the Security Trustee (or a Receiver appointed on its behalf) following the occurrence of an LLP Event of Default and service of an LLP Acceleration Notice on the Issuer and the LLP will be applied following the enforcement of the Security, realisation of the Security and/or the commencement of winding-up proceedings against the LLP in the following order of priority (the “**Post-Enforcement Priority of Payments**”) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:
- (i) all amounts due and payable or to become due and payable to:
    - (A) the Bond Trustee under the provisions of the Trust Deed together with interest and applicable VAT (or similar taxes) thereon as provided therein; and
    - (B) the Security Trustee and any Receiver appointed by the Security Trustee under the provisions of the Deed of Charge together with interest and applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) any remuneration then due and payable to the Agent Bank and the Agents under or pursuant to the Agency Agreement together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) amounts in respect of:
    - (A) any remuneration then due and payable to the Servicers and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicers under the provisions of the Servicing Agreements, together with applicable VAT (or similar taxes) thereon as provided therein;
    - (B) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager under the provisions of the Cash Management Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
    - (C) amounts due to the Account Bank or, as applicable, the Stand-by Account Bank (including costs) pursuant to the terms of the Bank Account Agreement or, as applicable, the Stand-by Bank Account Agreement, together with applicable VAT (or similar taxes) thereon as provided therein; and
    - (D) amounts (including costs and expenses) due to the Corporate Services Provider pursuant to the terms of the Corporate Services Agreement;
  - (iv) any amounts due and payable to the Interest Rate Swap Providers (including any termination payment (but excluding any Excluded Swap Termination Amounts)) pursuant to the terms of the Interest Rate Swap Agreements; and
  - (v) all amounts due and payable:
    - (A) to the Covered Bond Swap Provider *pro rata* and *pari passu* in respect of each relevant Series of Covered Bonds (including any termination payment due and payable by the LLP under the relevant Covered Bond Swap Agreement (but excluding any Excluded Swap Termination Amount)) in accordance with the terms of the relevant Covered Bond Swap Agreement; and
    - (B) to the Bond Trustee on behalf of the Covered Bondholders *pro rata* and *pari passu* in respect of interest and principal due and payable on each Series of Covered Bonds,

provided that if the amount available for distribution under this paragraph (a) (excluding any amounts received from the Covered Bond Swap Provider) would be insufficient to pay the Sterling Equivalent of the interest and principal due and payable on each Series of Covered Bonds under (v) above, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis and the amount payable by the LLP to the Covered Bond Swap Provider in respect of each Series of Covered Bonds under (v) above shall be reduced by the amount of the shortfall applicable to the Covered Bonds in respect of which such payment is to be made;

- (b) *second*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof, of any Excluded Swap Termination Amounts due and payable by the LLP to the relevant Swap Provider under the relevant Swap Agreement;
- (c) *third*, after the Covered Bonds have been fully repaid, any remaining moneys shall be applied in or towards repayment in full of all amounts outstanding under the Intercompany Loan Agreement;
- (d) *fourth*, towards payment of any indemnity amount due to the Members pursuant to the LLP Deed; and
- (e) *fifth*, thereafter any remaining moneys shall be applied in or towards payment to the Members pursuant to the LLP Deed.

The above Post-Enforcement Priority of Payments is subject to the provisions of Regulations 27, 28 and 29 of the RCB Regulations. In particular, costs properly incurred by a receiver, liquidator, provisional liquidator administrator, administrative receiver or manager of the LLP in relation to:

- (i) persons providing services for the benefit of Covered Bondholders (which pursuant to the RCB Regulations includes the persons listed in paragraph (a) above (excluding the Swap Providers));
- (ii) the Swap Providers in respect of amounts due to them under paragraph (a) above; and
- (iii) any other persons providing a loan to the LLP to enable it to meet the claims of Covered Bondholders or the costs of the people described in paragraphs (i) and (ii) above (e.g. liquidity loans),

shall be expenses which shall be payable out of the proceeds of realisation of the Security (in the case of a receivership) or the assets of the LLP (in the case of an administration, winding-up or provisional liquidation), and shall rank equally among themselves in priority to all other expenses (including the claims of Covered Bondholders). See further, *Risk Factors – Expenses of Insolvency officeholders*.

## THE PORTFOLIO

The Initial Portfolio and each New Portfolio acquired by the LLP (the “**Portfolio**”), consisting of Loans and their Related Security sold by Sellers to the LLP from time to time, in accordance with the terms of the Mortgage Sale Agreement, as more fully described under *Summary of the Principal Documents – Mortgage Sale Agreement*.

For the purposes hereof:

“**Initial Portfolio**” means the portfolio of Loans and their Related Security, particulars of which are set out in the Mortgage Sale Agreement (other than any Loans and their Related Security which have been redeemed in full prior to the First Transfer Date), and all right, title, interest and benefit of the Original Seller in and to:

- (a) all payments of principal and interest (including, for the avoidance of doubt, all Accrued Interest, Arrears of Interest, Capitalised Expenses and Capitalised Arrears) and other sums due or to become due in respect of such Loans and Related Security including, without limitation, the right to demand, sue for, recover and give receipts for all principal moneys, interest and costs and the right to sue on all covenants and any undertakings made or expressed to be made in favour of the Original Seller under the applicable Mortgage Terms;
- (b) subject where applicable to the subsisting rights of redemption of Borrowers, all Deeds of Consent (as defined in the Master Definitions and Construction Agreement), Deeds of Postponement (as defined in the Master Definitions and Construction Agreement), MHA Documentation (as defined in the Master Definitions and Construction Agreement) or any collateral security for the repayment of the relevant Loans;
- (c) the right to exercise all the powers of the Original Seller in relation thereto;
- (d) all the estate and interest in the Properties vested in the Original Seller;
- (e) each Certificate of Title and Valuation Report (in each case where available) and any right of action of the Original Seller against any solicitor, licensed conveyancer, qualified conveyancer, valuer or other person in connection with any report, valuation, opinion, certificate or other statement of fact or opinion given in connection with such Loans and Related Security, or any part thereof or affecting the decision of the Original Seller to make or offer to make any such Loan or part thereof;
- (f) all rights, title and interests of the Original Seller (including, without limitation, the proceeds of all claims) to which the Seller is entitled under the Buildings Policies (as defined in the Master Definitions and Construction Agreement) and the Properties in Possession Cover (as defined in the Master Definitions and Construction Agreement); and
- (g) the MIG Policies (as defined in the Master Definitions and Construction Agreement), so far as they relate to the Loans comprised in that portfolio of Loans and their Related Security, including the right to receive the proceeds of any claim.

“**New Portfolio**” means in each case the portfolio of New Loans and their Related Security (other than any New Loans and their Related Security which have been redeemed in full prior to the Transfer Date or which do not otherwise comply with the terms of the Mortgage Sale Agreement as at the Transfer Date), particulars of which are set out in the relevant New Portfolio Notice or in a document stored upon electronic media (including, but not limited to, a CD-ROM), and all right, title,

interest and benefit of the relevant Seller in and to the rights and assets set out in paragraphs (a) to (g) above (except that “relevant Seller” should be read in place of “Original Seller”).

See also the following risk factors under *Risk Factors – Risk Factors relating to the LLP – Limited description of the Portfolio – Maintenance of Portfolio – Changes to the Lending Criteria of the Sellers* and – *The Loans of New Sellers may be included in the Portfolio*.

## DESCRIPTION OF THE UK REGULATED COVERED BOND REGIME

*This section is only a summary of the UK Covered Bond Regime. Prospective purchasers of Covered Bonds should consider carefully all the information contained in this document, including the information set out below, before making any investment decision.*

The Regulated Covered Bonds Regulations 2008 (SI 2008/346), as amended (the "**RCB Regulations**") and the corresponding implementation provisions, set out in the new RCB Sourcebook, came into force in the UK on 6 March 2008 and were subsequently amended by the Regulated Covered Bonds (Amendment) Regulations (SI 2008/1714) which came into force on 22 July 2008. In summary, the RCB Regulations implement a legislative framework for UK covered bonds. The framework is intended to meet the requirements set out in Article 22(4) of Directive 85/611 EC on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as amended (the "**UCITS Directive**"). In general, covered bonds which are UCITS Directive-compliant benefit from higher prudential investment limits and may be ascribed a preferential risk weighting. Notwithstanding the intention behind the new framework, the FSA will not notify the European Commission of an issuer's inclusion in the register of issuers, regulated covered bonds included in the register of regulated covered bonds and the status of the guarantees offered in respect of such bonds, until the registration process in respect of that issuer and its covered bond programme has been successfully completed. Until such notification is made covered bonds are not UCITS compliant. The RCB Regulations and the RCB Sourcebook include various requirements related to issuers, asset pool owners, pool assets and the contractual arrangements made in respect of such assets. In this regard, issuers and owners have various initial and ongoing obligations under the RCB Regulations and the RCB Sourcebook and are responsible for ensuring they comply with them. In particular, issuers are required to (amongst other things) enter into arrangements with the owner for the maintenance and administration of the asset pool such that certain asset record-keeping obligations and asset capability and quality related requirements are met and notify the FSA of various matters (including any regulated covered bonds it issues, the assets in the asset pool, matters related to its compliance with certain regulations and any proposed material changes). Owners are required to (amongst other things) notify the FSA of various matters (including any proposed transfer of ownership of the asset pool) and, on insolvency of the issuer, make arrangements for the maintenance and administration of the asset pool (similar to the issuer obligations described above).

The FSA will perform certain supervision and enforcement related tasks in respect of the new regime, including admitting issuers and covered bonds to the relevant registers and monitoring compliance with ongoing requirements. To assist it with these tasks, the FSA has certain powers under the RCB Regulations. In particular, in certain circumstances the FSA may direct the winding-up of an owner, remove an issuer from the register of issuers and/or impose a financial penalty of such amount as it considers appropriate in respect of an issuer or owner. Moreover, as the body which regulates the financial services industry in the UK, the FSA may take certain actions in respect of issuers using its general powers under the UK regulatory regime (including restricting an issuer's ability to transfer further assets to the asset pool).

In April 2008, the Issuer applied to the FSA for admission to the register of issuers and for the Programme and any Covered Bonds previously issued under the Programme to be admitted to the register of regulated covered bonds under the RCB Regulations. On 11 November 2008 the Issuer was admitted by the FSA to the register of issuers and the Programme (and all Covered Bonds previously issued under the Programme) was admitted by the FSA to the register of regulated covered bonds under RCB Regulations. The FSA has indicated that notification of such registration and certain other matters was made by the FSA to the European Commission on 13 November 2008. Accordingly, in principle, the Covered Bonds are UCITS Directive-compliant. Under the RCB Regulations, an issuer

may be removed from the register of issuers in certain limited circumstances with the result that the Issuer may not make further issues under the Programme but the FSA is restricted from removing a regulated covered bond from the register of regulated covered bonds before the expiry of the whole period of validity of the relevant bond. See also *Risk Factors – UK regulated covered bond regime* and *– Expenses of insolvency officeholders*.



## **DESCRIPTION OF LIMITED LIABILITY PARTNERSHIPS**

Since 6 April 2001 it has been possible to incorporate a limited liability partnership in England, Wales and Scotland (but not Northern Ireland) under the Limited Liability Partnerships Act 2000 (the “**LLPA 2000**”). Limited liability partnerships are legal entities that provide limited liability to the members of a limited liability partnership combined with the benefits of the flexibility afforded to partnerships and the legal personality afforded to companies.

### **Corporate characteristics**

A limited liability partnership is more like a company than a partnership. A limited liability partnership is a body corporate with its own property and liabilities, separate from its members. Like shareholders in a limited company, the liability of the members of a limited liability partnership is limited to the amount of their capital because it is a separate legal entity and when the members decide to enter into a contract, they bind the limited liability partnership in the same way that directors bind a company. Members may be liable for their own negligence and other torts, like company directors, if they have assumed a personal duty of care and have acted in breach of that duty. Third parties can assume that members, like company directors, are authorised to act on behalf of the limited liability partnership.

The provisions of the Companies Act 2006, the Limited Liability Partnerships Regulations 2001 and the Insolvency Act 1986 have been modified by the Limited Liability Partnerships (Amendment) Regulations 2005 so as to apply most of the insolvency and winding-up procedures for companies equally to a limited liability partnership and its members. As a distinct legal entity, a limited liability partnership can grant fixed and floating security over its assets and a limited liability partnership will survive the insolvency of any of its members. An administrator or liquidator of an insolvent member would be subject to the terms of the members’ agreement relating to the limited liability partnership but a liquidator of an insolvent member may not take part in the administration of the limited liability partnership or its business.

Limited liability partnerships must file annual returns and audited annual accounts at Companies House for each financial year in the same way as companies.

### **Partnership characteristics**

A limited liability partnership retains certain characteristics of a partnership. It has no share capital and there are no capital maintenance requirements. The members are free to agree how to share profits, who is responsible for management and how decisions are made, when and how new members are appointed and the circumstances in which its members retire. The members’ agreement is a private document and there is no obligation to file it at Companies House.

### **Taxation**

Limited liability partnerships are tax transparent except in the case of value added tax (in respect of which a limited liability partnership can register for VAT in its own name) and in certain winding-up proceedings. As such, the members of a limited liability partnership, and not the limited liability partnership itself, are taxed in relation to the business of the limited liability partnership in broadly the same way that the members of a partnership are taxed in relation to the business of that partnership

## BOOK-ENTRY CLEARANCE SYSTEMS

*The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC, Euroclear or Clearstream, Luxembourg (together, the “Clearing Systems”) currently in effect. The information in this section concerning the Clearing Systems has been obtained from sources that the Issuer and the Guarantors believe to be reliable, but none of the Issuer, the Guarantors nor any Dealer takes any responsibility for the accuracy thereof. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. None of the Issuer, the Guarantors nor any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Covered Bonds held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.*

### Book-entry Systems

#### DTC

DTC has advised the Issuer that it is a limited purpose trust company organised under the New York Banking Law, a “banking organisation” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to Section 17A of the Exchange Act. DTC holds and provides asset servicing for securities that its participants (“**Direct Participants**”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerised book-entry transfers and pledges between Direct Participants’ accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“**DTCC**”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC and the National Association of Securities Dealers, Inc. Access to the DTC System is also available to others such as securities brokers and dealers, banks, trust companies and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“**Indirect Participants**”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com).

Purchases of DTC Covered Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the DTC Covered Bonds on DTC’s records. The ownership interest of each actual purchaser of each Covered Bond (“**Beneficial Owner**”) is in turn to be recorded on the Direct and Indirect Participant’s records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the DTC Covered Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in DTC Covered Bonds, except in the event that use of the book-entry system for the DTC Covered Bonds is discontinued.

To facilitate subsequent transfers, all DTC Covered Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other nominee as may be requested by an authorised representative of DTC. The deposit of DTC Covered Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the DTC Covered Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such DTC Covered Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the DTC Covered Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to DTC Covered Bonds unless authorised by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the DTC Covered Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the DTC Covered Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorised representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Issuer or the Principal Paying Agent, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC or its nominee, the Principal Paying Agent or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorised representative of DTC) is the responsibility of the Issuer or Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

Under certain circumstances, DTC will exchange the DTC Covered Bonds for Registered Definitive Covered Bonds, which it will distribute to its Participants in accordance with their proportionate entitlements and which, if representing interests in a Rule 144A Global Covered Bond, will be legended as set forth under *Subscription and Sale and Transfer and Selling Restrictions*.

Since DTC may only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, any Beneficial Owner desiring to pledge DTC Covered Bonds to persons or entities that do not participate in DTC, or otherwise take actions with respect to such DTC Covered Bonds, will be required to withdraw its Registered Covered Bonds from DTC as described below.

## **Euroclear and Clearstream, Luxembourg**

Euroclear and Clearstream, Luxembourg each holds securities for its customers and facilitates the clearance and settlement of securities transactions by electronic book-entry transfer between their respective account holders. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depository and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Euroclear and Clearstream, Luxembourg customers are world-wide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of either system.

## **Book-entry Ownership of and Payments in respect of DTC Covered Bonds**

The Issuer may apply to DTC in order to have any Tranche of Covered Bonds represented by a Registered Global Covered Bond accepted in its book-entry settlement system. Upon the issue of any such Registered Global Covered Bond, DTC or its custodian will credit, on its internal book-entry system, the respective nominal amounts of the individual beneficial interests represented by such Registered Global Covered Bond to the accounts of persons who have accounts with DTC. Such accounts initially will be designated by or on behalf of the relevant Dealer. Ownership of beneficial interests in such a Registered Global Covered Bond will be limited to Direct Participants or Indirect Participants, including, in the case of any Regulation S Global Covered Bond, the respective depositories of Euroclear and Clearstream, Luxembourg. Ownership of beneficial interests in a Registered Global Covered Bond accepted by DTC will be shown on, and the transfer of such ownership will be effected only through, records maintained by DTC or its nominee (with respect to the interests of Direct Participants) and the records of Direct Participants (with respect to interests of Indirect Participants).

Payments in U.S. dollars of principal and interest in respect of a Registered Global Covered Bond accepted by DTC will be made to the order of DTC or its nominee as the registered holder of such Covered Bond. In the case of any payment in a currency other than U.S. dollars, payment will be made to the Exchange Agent on behalf of DTC or its nominee and the Exchange Agent will (in accordance with instructions received by it) remit all or a portion of such payment for credit directly to the beneficial holders of interests in the Registered Global Covered Bond in the currency in which such payment was made and/or cause all or a portion of such payment to be converted into U.S. dollars and credited to the applicable Participants' account.

The Issuer expects DTC to credit accounts of Direct Participants on the applicable payment date in accordance with their respective holdings as shown in the records of DTC unless DTC has reason to believe that it will not receive payment on such payment date. The Issuer also expects that payments by Participants to beneficial owners of Covered Bonds will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers, and will be the responsibility of such Participant and not the responsibility of DTC, the Bond Trustee, the Security Trustee, the Principal Paying Agent, the Bond Registrar or the Issuer. Payment of principal, premium, if any, and interest, if any, on Covered Bonds to DTC is the responsibility of the Issuer.

## Transfers of Covered Bonds Represented by Registered Global Covered Bonds

Transfers of any interests in Covered Bonds represented by a Registered Global Covered Bond within DTC, Euroclear and Clearstream, Luxembourg will be effected in accordance with the customary rules and operating procedures of the relevant clearing system. The laws in some States within the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer Covered Bonds represented by a Registered Global Covered Bond to such persons may depend upon the ability to exchange such Covered Bonds for Covered Bonds in definitive form. Similarly, because DTC can only act on behalf of Direct Participants in the DTC system who in turn act on behalf of Indirect Participants, the ability of a person having an interest in Covered Bonds represented by a Registered Global Covered Bond accepted by DTC to pledge such Covered Bonds to persons or entities that do not participate in the DTC system or otherwise to take action in respect of such Covered Bonds may depend upon the ability to exchange such Covered Bonds for Covered Bonds in definitive form. The ability of any holder of Covered Bonds represented by a Registered Global Covered Bond accepted by DTC to resell, pledge or otherwise transfer such Covered Bonds may be impaired if the proposed transferee of such Covered Bonds is not eligible to hold such Covered Bonds through a direct or indirect participant in the DTC system.

Subject to compliance with the transfer restrictions applicable to the Registered Covered Bonds described under *Subscription and Sale and Transfer and Selling Restrictions*, cross-market transfers between DTC, on the one hand, and directly or indirectly through Clearstream, Luxembourg or Euroclear accountholders, on the other, will be effected by the relevant clearing system in accordance with its rules and through action taken by the Bond Registrar, the Principal Paying Agent and any custodian (“**Custodian**”) with whom the relevant Registered Global Covered Bonds have been deposited.

On or after the Issue Date for any Series, transfers of Covered Bonds of such Series between accountholders in Clearstream, Luxembourg and Euroclear and transfers of Covered Bonds of such Series between participants in DTC will generally have a settlement date three business days after the trade date (T+3). The customary arrangements for delivery versus payment will apply to such transfers.

Cross-market transfers between accountholders in Clearstream, Luxembourg or Euroclear and DTC participants will need to have an agreed settlement date between the parties to such transfer. Because there is no direct link between DTC, on the one hand, and Clearstream, Luxembourg and Euroclear, on the other, transfers of interests in the relevant Registered Global Covered Bonds will be effected through the Bond Registrar, the Principal Paying Agent and the Custodian receiving instructions (and, where appropriate, certification) from the transferor and arranging for delivery of the interests being transferred to the credit of the designated account for the transferee. In the case of cross-market transfers, settlement between Euroclear or Clearstream, Luxembourg accountholders and DTC participants cannot be made on a delivery versus payment basis. The securities will be delivered on a free delivery basis and arrangements for payment must be made separately.

DTC, Clearstream, Luxembourg and Euroclear have each published rules and operating procedures designed to facilitate transfers of beneficial interests in Registered Global Covered Bonds among participants and accountholders of DTC, Clearstream, Luxembourg and Euroclear. However, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued or changed at any time. None of the Bond Trustee, the Security Trustee, the Issuer, the Guarantors, the Agents or any Dealer will be responsible for any performance by DTC, Clearstream, Luxembourg or Euroclear or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations and none of them will have any liability for any aspect of the records relating to or

payments made on account of beneficial interests in the Covered Bonds represented by Registered Global Covered Bonds or for maintaining, supervising or reviewing any records relating to such beneficial interests.

## TAXATION

Purchasers of Covered Bonds who are unsure of their tax treatment as Covered Bondholders (including the effect of the HBOS Group Reorganisation Act 2006 on the Covered Bonds) should consult their own professional tax advisers.

### **United Kingdom Taxation**

*The following is a general description of certain United Kingdom withholding tax considerations relating to the Covered Bonds based on the Issuer's understanding of current law and Her Majesty's Revenue and Customs ("HMRC") published practice in the United Kingdom. It does not purport to be a complete analysis of all tax considerations relating to the Covered Bonds. It only applies to the position of persons who are the absolute beneficial owners of Covered Bonds and may not apply to certain classes of persons such as dealers. This summary is based upon the law as in effect on the date of this Offering Circular and is subject to any change in law that may take effect after such date.*

### ***Payment of Interest by the Issuer on the Covered Bonds***

The Issuer, provided that it continues to be a bank within the meaning of section 991 of the Income Tax Act 2007 ("ITA"), and provided that the interest on the Covered Bonds is paid in the ordinary course of its business within the meaning of section 878 of ITA, will be entitled to make payment of interest without withholding or deduction for or on account of United Kingdom income tax.

Interest on the Covered Bonds may also be paid without withholding or deduction for or on account of United Kingdom tax where (i) the Covered Bonds are and continue to be listed on a "recognised stock exchange", as defined in section 1005 of ITA. The Luxembourg Stock Exchange is a recognised stock exchange and securities will be treated as listed on the Luxembourg Stock Exchange if they are officially listed in Luxembourg in accordance with provisions corresponding to those generally applicable in EEA States and admitted to trading on the Luxembourg Stock Exchange); (ii) the maturity of the Covered Bond is less than 365 days and those Covered Bonds do not form part of a scheme or arrangement of borrowing intended to be capable of remaining outstanding for more than 364 days; or (iii) the interest on the Covered Bond is paid by a company and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Covered Bond is paid reasonably believes) that the interest constitutes an "excepted payment" within the meaning of sections 933 to 937 of ITA, provided that HMRC has not given a direction (in circumstances where it has reasonable grounds to believe the payment of interest is not an "excepted payment") that the interest should be paid under deduction of tax.

In other cases, an amount must generally be withheld from payments of interest on the Covered Bonds on account of United Kingdom income tax at the basic rate (currently 20 per cent.) subject to any direction to the contrary by HMRC under an applicable double taxation treaty that a lower rate of or no withholding tax should be withheld.

### ***Provision of Information***

Covered Bondholders may wish to note that, in certain circumstances, HMRC has the power to obtain information (including the name and address of the beneficial owner of the interest) from any person in the United Kingdom who either credits or pays interest to or receives interest for the benefit of a Covered Bondholder. HMRC also has the power, in certain circumstances, to obtain information from any person in the United Kingdom who pays amounts payable on the redemption of Covered Bonds which are deeply discounted securities for the purposes of the Income Tax (Trading

and Other Income) Act 2005 to or receives such amounts for the benefit of another person. Such information may include the name and address of the beneficial owner of the amount payable on redemption. However, in relation to amounts payable on the redemption of deeply discounted securities, HMRC published practice indicates that HMRC will not exercise its power referred to above to require this information where such amounts are paid on or before 5 April 2010. Any information obtained may, in certain circumstances, be exchanged by HMRC with the tax authorities of the jurisdiction in which the Covered Bondholder is resident for tax purposes.

### ***Payments by the Guarantors***

If a Guarantor makes any payment in respect of interest on the Covered Bonds (or any other amounts due under the Covered Bonds other than the repayment of amounts subscribed for under the Covered Bonds) such payment may (unless the Covered Bonds in question have a maturity of less than 365 days) be subject to United Kingdom withholding tax, whether or not the Covered Bonds are listed on a “recognised stock exchange” within the meaning of section 1005 of ITA.

If payments by a HBOS Group Guarantor are subject to any withholding or deduction for or on account of tax, additional amounts may become payable by such HBOS Group Guarantor subject to Condition 8. The LLP will not be required to pay such additional amounts to the Bond Trustee or any holder of Covered Bonds, Receipts and/or Coupons in respect of such amount of withholding or deduction.

### **European Union Savings Directive**

Under European Union Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange within certain other countries). A number of non-European Union countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland).

On 15 September 2008 the European Commission issued a report to the European Council on the operation of the Directive, which included the Commission’s advice on the need for changes to the Directive. On 13 November 2008 the European Commission published a more detailed proposal for amendments to the Directive, which included a number of suggested changes. The European Parliament approved an amended version of this proposal on 24 April 2009. If any of the proposed changes are made in relation to the Directive, they may amend or broaden the scope of the requirements described above.

If a payment were to be made or collected through a Member State of the European Union which has opted for a withholding system and an amount of, or in respect of tax were to be withheld from that payment, none of the Issuer, the Paying Agent, the Guarantors or any other person would be obliged to pay additional amounts with respect to any Covered Bond as a result of the imposition of such withholding tax. The Issuer is required to maintain a Paying Agent in a Member State of the European Union that does not impose an obligation to withhold or deduct tax pursuant to the Directive.

The attention of Covered Bondholders is drawn to Condition (8) and page 40 in the Risk Factors.



## Luxembourg Taxation

*The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Covered Bonds should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.*

### Withholding Tax

#### (i) Non-resident holders of Covered Bonds

Under Luxembourg general tax laws currently in force and subject to the laws of 21 June 2005 (the “**Laws**”) mentioned below, there is no withholding tax on payments of principal, premium or interest made to non-resident holders of Covered Bonds, nor on accrued but unpaid interest in respect of the Covered Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Covered Bonds held by non-resident holders of Covered Bonds.

Under the Laws implementing the EC Council Directive 2003/48/EC of 3 June 2003 on the taxation of savings income in the form of interest payments and ratifying the treaties entered into by Luxembourg and certain dependent and associated territories of EU Member States (the “**Territories**”), payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner or a residual entity, as defined by the Laws, which is a resident of, or established in, an EU Member State (other than Luxembourg) or one of the Territories will be subject to a withholding tax unless the relevant recipient has adequately instructed the relevant paying agent to provide details of the relevant payments of interest or similar income to the fiscal authorities of his/her/its country of residence or establishment, or, in the case of an individual beneficial owner, has provided a tax certificate issued by the fiscal authorities of his/her country of residence in the required format to the relevant paying agent. Where withholding tax is applied, it is currently levied at a rate of 20 per cent. and will be levied at a rate of 35 per cent. as of 1 July 2011. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Covered Bonds coming within the scope of the Laws would at present be subject to a withholding tax of 20 per cent.

#### (ii) Resident holders of Covered Bonds

Under Luxembourg general tax laws currently in force and subject to the law of 23 December 2005 (the “**Law**”) mentioned below, there is no withholding tax on payments of principal, premium or interest made to Luxembourg resident holders of Covered Bonds, nor on accrued but unpaid interest in respect of Covered Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Covered Bonds held by Luxembourg resident holders of Covered Bonds.

Under the Law, payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the benefit of an individual beneficial owner who is a resident of Luxembourg will be subject to a withholding tax of 10 per cent. Such withholding tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent. Payments of interest under the Covered Bonds falling within the scope of the Law would be subject to a withholding tax of 10 per cent.

## U.S. Federal Income Taxation

*To ensure compliance with U.S. Internal Revenue Service Circular 230, prospective investors are hereby notified that: (a) any discussion of U.S. federal tax issues contained or referred to in this Offering Circular is not intended or written to be used, and cannot be used by prospective investors for the purpose of avoiding penalties that may be imposed on them under the Internal Revenue Code; (b) such discussion is written in connection with the promotion or marketing of the transactions or matters addressed herein; and (c) prospective investors should seek advice based on their particular circumstances from an independent tax adviser.*

The following is a summary of certain material U.S. federal income tax consequences of the acquisition, ownership and disposition of Covered Bonds by a U.S. Holder (as defined below). This summary does not address the material U.S. federal income tax consequences of every type of Covered Bond which may be issued under the Programme, and the applicable Final Terms may contain additional or modified disclosure concerning the material U.S. federal income tax consequences relevant to such type of Covered Bonds as are issued thereunder. This summary deals only with purchasers of Covered Bonds that are U.S. Holders, that will hold the Covered Bonds as capital assets, and that acquire Covered Bonds at initial issuance. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Covered Bonds by particular investors, and does not address state, local, foreign or other tax laws. In particular, this summary does not discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws (such as banks, insurance companies, investors liable for the alternative minimum tax, individual retirement accounts and other tax-deferred accounts, tax-exempt organisations, dealers in securities or currencies, traders in securities that elect to use a mark-to-market method of accounting, persons that own (or are deemed to own) 10 per cent. or more (by voting power) shares in the Issuer or the Guarantors, persons who have ceased to be U.S. citizens or to be taxed as resident aliens, investors that will hold the Covered Bonds as part of straddles, hedging transactions or conversion transactions for U.S. federal income tax purposes, or whose functional currency is not the U.S. dollar). This discussion also does not address any tax consequences applicable to holders of equity interests in a holder of the Covered Bonds. This discussion applies only to holders of Registered Covered Bonds.

As used herein, the term “**U.S. Holder**” means a beneficial owner of Covered Bonds that is for U.S. federal income tax purposes, (i) a citizen or individual resident of the United States, (ii) a corporation, or other entity treated as a corporation, created or organised in or under the laws of the United States or any State thereof, (iii) an estate the income of which is subject to U.S. federal income tax without regard to its source, or (iv) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust, or that is otherwise treated as a United States person. The tax consequences to a partner in a partnership holding Covered Bonds will generally depend upon the status of the partner and the activities of the partnership. A partner in a partnership holding Covered Bonds should consult its tax adviser regarding the tax consequences of an investment in Covered Bonds.

This summary is based on the tax laws of the United States including the Internal Revenue Code of 1986, its legislative history, existing and proposed regulations thereunder (the “**Treasury Regulations**”), published rulings and court decisions, all as currently in effect and all of which are subject to change at any time, possibly with retroactive effect.

**THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX**

## **CONSEQUENCES TO THEM OF OWNING THE COVERED BONDS, THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.**

The Issuer generally intends to treat Covered Bonds issued under the Programme as debt, unless otherwise indicated in the applicable Final Terms. Certain Covered Bonds, however, such as Index Linked Redemption Covered Bonds, may be treated as equity for U.S. federal income tax purposes. The applicable Final Terms may contain modified disclosure concerning the tax treatment of Covered Bonds to which a treatment other than as debt may apply. The following disclosure applies only to Covered Bonds that are treated as debt for U.S. federal income tax purposes.

### **Payment of Interest**

#### *General*

Interest on a Covered Bond, whether payable in U.S. dollars or a currency, composite currency or basket of currencies other than U.S. dollars (“**foreign currency**” interest on a “**Foreign Currency Covered Bond**”), other than interest on a “Discount Covered Bond” that is not “qualified stated interest” (each as defined below under *Original Issue Discount – General*), will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, depending on the holder’s method of accounting for tax purposes. Interest paid by the Issuer on the Covered Bonds and OID, if any, accrued with respect to the Covered Bonds (as described below under *Original Issue Discount*) generally will constitute income from sources outside the United States subject to the rules regarding the foreign tax credit allowable to a U.S. Holder. Prospective purchasers should consult their tax advisers concerning the foreign tax credit implications of any payment of United Kingdom taxes.

### **Original Issue Discount**

#### *General*

The following is a summary of the principal U.S. federal income tax consequences of the ownership of Covered Bonds issued with original issue discount (“**OID**”). The following summary does not discuss Covered Bonds that are characterised as contingent payment debt instruments for U.S. federal income tax purposes.

A Covered Bond, other than a Covered Bond with a term of one year or less (a “**Short-Term Covered Bond**”), will be treated as issued with OID (a “**Discount Covered Bond**”) if the excess of the Covered Bond’s “stated redemption price at maturity” over its issue price is equal to or more than a *de minimis* amount (0.25 per cent. of the Covered Bond’s stated redemption price at maturity multiplied by the number of complete years to its maturity). An obligation that provides for the payment of amounts other than qualified stated interest before maturity (an “**instalment obligation**”) will be treated as a Discount Covered Bond if the excess of the Covered Bond’s stated redemption price at maturity over its issue price is greater than 0.25 per cent. of the Covered Bond’s stated redemption price at maturity multiplied by the weighted average maturity of the Covered Bond. A Covered Bond’s weighted average maturity is the sum of the following amounts determined for each payment on a Covered Bond (other than a payment of qualified stated interest): (i) the number of complete years from the issue date until the payment is made multiplied by (ii) a fraction, the numerator of which is the amount of the payment and the denominator of which is the Covered Bond’s stated redemption price at maturity. Generally, the issue price of a Covered Bond will be the first price at which a substantial amount of Covered Bonds included in the issue of which the Covered Bond is a part is sold to persons other than bond houses, brokers, or similar persons or organisations acting in the capacity of underwriters, placement agents, or wholesalers. The stated redemption price at maturity of a Covered Bond is the total of all payments provided by the Covered Bond that are not

payments of “qualified stated interest.” A qualified stated interest payment is generally any one of a series of stated interest payments on a Covered Bond that are unconditionally payable at least annually at a single fixed rate (with certain exceptions for lower rates paid during some periods), or a variable rate (in the circumstances described below under *Variable Interest Rate Covered Bonds*), applied to the outstanding principal amount of the Covered Bond. Solely for the purposes of determining whether a Covered Bond has OID, the Issuer will be deemed to exercise any call option that has the effect of decreasing the yield on the Covered Bond, and the U.S. Holder will be deemed to exercise any put option that has the effect of increasing the yield on the Covered Bond. If a Covered Bond has *de minimis* OID, a U.S. Holder must include the *de minimis* amount in income as stated principal payments are made on the Covered Bond, unless the holder makes the election described below under – *Election to Treat All Interest as Original Issue Discount*. A U.S. Holder can determine the includible amount with respect to each such payment by multiplying the total amount of the Covered Bond’s *de minimis* OID by a fraction equal to the amount of the principal payment made divided by the stated principal amount of the Covered Bond.

U.S. Holders of Discount Covered Bonds must include OID in income calculated on a constant-yield method before the receipt of cash attributable to the income, and generally will have to include in income increasingly greater amounts of OID over the life of the Discount Covered Bonds. The amount of OID includible in income by a U.S. Holder of a Discount Covered Bond is the sum of the daily portions of OID with respect to the Discount Covered Bond for each day during the taxable year or portion of the taxable year on which the U.S. Holder holds the Discount Covered Bond (“**accrued OID**”). The daily portion is determined by allocating to each day in any “accrual period” a *pro rata* portion of the OID allocable to that accrual period. Accrual periods with respect to a Covered Bond may be of any length selected by the U.S. Holder and may vary in length over the term of the Covered Bonds as long as (i) no accrual period is longer than one year and (ii) each scheduled payment of interest or principal on the Covered Bond occurs on either the final or first day of an accrual period. The amount of OID allocable to an accrual period equals the excess of (a) the product of the Discount Covered Bond’s adjusted issue price at the beginning of the accrual period and the Discount Covered Bond’s yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period) over (b) the sum of the payments of qualified stated interest on the Covered Bond allocable to the accrual period. The “**adjusted issue price**” of a Discount Covered Bond at the beginning of any accrual period is the issue price of the Covered Bond increased by (x) the amount of accrued OID for each prior accrual period and decreased by (y) the amount of any payments previously made on the Covered Bond that were not qualified stated interest payments.

#### *Acquisition Premium*

A U.S. Holder that purchases a Discount Covered Bond for an amount less than or equal to the sum of all amounts payable on the Covered Bond after the purchase date, other than payments of qualified stated interest, but in excess of its adjusted issue price (any such excess being “**acquisition premium**”) and that does not make the election described below under *Election to Treat All Interest as Original Issue Discount*, is permitted to reduce the daily portions of OID by a fraction, the numerator of which is the excess of the U.S. Holder’s adjusted basis in the Discount Covered Bond immediately after its purchase over the Discount Covered Bond’s adjusted issue price, and the denominator of which is the excess of the sum of all amounts payable on the Discount Covered Bond after the purchase date, other than payments of qualified stated interest, over the Discount Covered Bond’s adjusted issue price.

### *Market Discount*

A Covered Bond, other than a Short-Term Bond, generally will be treated as purchased at a market discount (a “**Market Discount Covered Bond**”) if the Covered Bond’s stated redemption price at maturity or, in the case of a Discount Covered Bond, the Covered Bond’s “revised issue price”, exceeds the amount for which the U.S. Holder purchased the Covered Bond by at least 0.25 per cent. of the Covered Bond’s stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the Covered Bond’s maturity (or, in the case of a Covered Bond that is an instalment obligation, the Covered Bond’s weighted average maturity). If this excess is not sufficient to cause the Covered Bond to be a Market Discount Covered Bond, then the excess constitutes “*de minimis market discount*”. For this purpose, the “revised issue price” of a Bond generally equals its issue price, increased by the amount of any OID that has accrued on the Bond and decreased by the amount of any payments previously made on the Bond that were not qualified stated interest payments.

Under the market discount rules, a U.S. Holder will be required to treat any principal payment (or, in the case of a Discount Covered Bond, any payment that does not constitute qualified stated interest) on, or any gain realised on the sale, exchange, retirement or other disposition of, a Market Discount Covered Bond as ordinary income to the extent of the lesser of (i) the amount of such payment or realised gain or (ii) the market discount which has not previously been included in income and is treated as having accrued on such Market Discount Covered Bond at the time of such payment or disposition. Market discount will be considered to accrue rateably during the period from the date of acquisition to the maturity date of the Market Discount Covered Bond, unless the U.S. Holder elects to accrue market discount under a constant yield method.

A U.S. Holder may be required to defer the deduction of all or a portion of the interest paid or accrued on any indebtedness incurred or maintained to purchase or carry a Market Discount Covered Bond until the maturity of such Market Discount Covered Bond or certain earlier dispositions, because a current deduction is only allowed to the extent the interest expense exceeds an allocable portion of market discount. A U.S. Holder may elect to include market discount in income currently as it accrues (under either a rateable or a constant yield method), in which case the rules described above regarding the treatment as ordinary income of gain upon the disposition of the Market Discount Covered Bond and upon the receipt of certain cash payments and regarding the deferral of interest deductions will not apply. Generally, such currently included market discount is treated as ordinary interest income for U.S. federal income tax purposes. Such an election will apply to all debt instruments acquired by the U.S. Holder on or after the first day of the first taxable year to which such election applies and may be revoked only with the consent of the Internal Revenue Service (the “IRS”).

### *Election to Treat All Interest as Original Issue Discount*

A U.S. Holder may elect to include in gross income all interest that accrues on a Covered Bond using the constant-yield method described above under *Original Issue Discount – General*, with certain modifications. For the purposes of this election, interest includes stated interest, OID, *de minimis* OID, market discount, *de minimis* market discount and unstated interest, as adjusted by any amortisable bond premium (described below under *Covered Bonds Purchased at a Premium*) or acquisition premium. If a U.S. Holder makes this election for the Covered Bond, then, when the constant-yield method is applied the issue price of the Covered Bond will equal its cost, the issue date of the Covered Bond will be the date of acquisition, and no payments on the Covered Bond will be treated as payments of qualified stated interest. This election will generally apply only to the Covered Bond with respect to which it is made and may not be revoked without the consent of the IRS. However, if the Covered Bond has amortisable bond premium, the U.S. Holder will be deemed to have made an election to apply amortisable bond premium against interest for all debt instruments

with amortisable bond premium, other than debt instruments the interest on which is excludible from gross income, held as of the beginning of the taxable year to which the election applies or any taxable year thereafter. If the election to apply the constant-yield method to all interest on a Covered Bond is made with respect to a Market Discount Covered Bond, the electing U.S. Holder will be treated as having made the election discussed above under *Market Discount* to include market discount in income currently over the life of all debt instruments with market discount held or thereafter acquired by the U.S. Holder. U.S. Holders should consult their tax advisers concerning the propriety and consequences of this election.

#### *Variable Interest Rate Covered Bonds*

Covered Bonds that provide for interest at variable rates (“**Variable Interest Rate Covered Bonds**”) generally will bear interest at a “qualified floating rate” and thus will be treated as “variable rate debt instruments” under Treasury Regulations governing accrual of OID. A Variable Interest Rate Covered Bond will qualify as a “variable rate debt instrument” if (a) its issue price does not exceed the total noncontingent principal payments due under the Variable Interest Rate Covered Bond by more than a specified *de minimis* amount and (b) it provides for stated interest, paid or compounded at least annually, at (i) one or more qualified floating rates, (ii) a single fixed rate and one or more qualified floating rates, (iii) a single objective rate, or (iv) a single fixed rate and a single objective rate that is a qualified inverse floating rate.

A “qualified floating rate” is any variable rate where variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which the Variable Interest Rate Covered Bond is denominated. A fixed multiple of a qualified floating rate will constitute a qualified floating rate only if the multiple is greater than 0.65 but not more than 1.35. A variable rate equal to the product of a qualified floating rate and a fixed multiple that is greater than 0.65 but not more than 1.35, increased or decreased by a fixed rate, will also constitute a qualified floating rate. In addition, two or more qualified floating rates that can reasonably be expected to have approximately the same values throughout the term of the Variable Interest Rate Covered Bond (e.g., two or more qualified floating rates with values within 25 basis points of each other as determined on the Variable Interest Rate Covered Bond’s issue date) will be treated as a single qualified floating rate. Notwithstanding the foregoing, a variable rate that would otherwise constitute a qualified floating rate but which is subject to one or more restrictions such as a maximum numerical limitation (i.e., a cap) or a minimum numerical limitation (i.e., a floor) may, under certain circumstances, fail to be treated as a qualified floating rate unless the cap or floor is fixed throughout the term of the Covered Bond.

An “objective rate” is a rate that is not itself a qualified floating rate but which is determined using a single fixed formula and which is based on objective financial or economic information (e.g., one or more qualified floating rates or the yield of actively traded personal property). A rate will not qualify as an objective rate if it is based on information that is within the control of the Issuer (or a related party) or that is unique to the circumstances of the Issuer (or a related party), such as dividends, profits or the value of the Issuer’s stock (although a rate does not fail to be an objective rate merely because it is based on the credit quality of the Issuer). Other variable interest rates may be treated as objective rates if so designated by the IRS in the future. Despite the foregoing, a variable rate of interest on a Variable Interest Rate Covered Bond will not constitute an objective rate if it is reasonably expected that the average value of the rate during the first half of the Variable Interest Rate Covered Bond’s term will be either significantly less than or significantly greater than the average value of the rate during the final half of the Variable Interest Rate Covered Bond’s term. A “qualified inverse floating rate” is any objective rate where the rate is equal to a fixed rate minus a qualified floating rate, as long as variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the qualified floating rate. If a Variable Interest Rate Covered Bond provides for stated interest at a fixed rate for an initial period of one year or less followed by a

variable rate that is either a qualified floating rate or an objective rate for a subsequent period and if the variable rate on the Variable Interest Rate Covered Bond's issue date is intended to approximate the fixed rate (e.g., the value of the variable rate on the issue date does not differ from the value of the fixed rate by more than 25 basis points), then the fixed rate and the variable rate together will constitute either a single qualified floating rate or objective rate, as the case may be.

A qualified floating rate or objective rate in effect at any time during the term of the instrument must be set at a "current value" of that rate. A "**current value**" of a rate is the value of the rate on any day that is no earlier than 3 months prior to the first day on which that value is in effect and no later than 1 year following that first day.

If a Variable Interest Rate Covered Bond that provides for stated interest at either a single qualified floating rate or a single objective rate throughout the term thereof qualifies as a "variable rate debt instrument", then any stated interest on the Covered Bond which is unconditionally payable in cash or property (other than debt instruments of the Issuer) at least annually will constitute qualified stated interest and will be taxed accordingly. Thus, a Variable Interest Rate Covered Bond that provides for stated interest at either a single qualified floating rate or a single objective rate throughout the term thereof and that qualifies as a "variable rate debt instrument" will generally not be treated as having been issued with OID unless the Variable Interest Rate Covered Bond is issued at a "true discount" (i.e., at a price below the Covered Bond's stated principal amount) in excess of a specified *de minimis* amount. OID on a Variable Interest Rate Covered Bond arising from true discount is allocated to an accrual period using the constant yield method described above by assuming that the variable rate is a fixed rate equal to (i) in the case of a qualified floating rate or qualified inverse floating rate, the value, as of the issue date, of the qualified floating rate or qualified inverse floating rate, or (ii) in the case of an objective rate (other than a qualified inverse floating rate), a fixed rate that reflects the yield that is reasonably expected for the Variable Interest Rate Covered Bond.

In general, any other Variable Interest Rate Covered Bond that qualifies as a "variable rate debt instrument" will be converted into an equivalent fixed rate debt instrument for purposes of determining the amount and accrual of OID and qualified stated interest on the Variable Interest Rate Covered Bond. Such a Variable Interest Rate Covered Bond must be converted into an equivalent fixed rate debt instrument by substituting any qualified floating rate or qualified inverse floating rate provided for under the terms of the Variable Interest Rate Covered Bond with a fixed rate equal to the value of the qualified floating rate or qualified inverse floating rate, as the case may be, as of the Variable Interest Rate Covered Bond's issue date. Any objective rate (other than a qualified inverse floating rate) provided for under the terms of the Variable Interest Rate Covered Bond is converted into a fixed rate that reflects the yield that is reasonably expected for the Variable Interest Rate Covered Bond. In the case of a Variable Interest Rate Covered Bond that qualifies as a "variable rate debt instrument" and provides for stated interest at a fixed rate in addition to either one or more qualified floating rates or a qualified inverse floating rate, the fixed rate is initially converted into a qualified floating rate (or a qualified inverse floating rate, if the Variable Interest Rate Covered Bond provides for a qualified inverse floating rate). Under these circumstances, the qualified floating rate or qualified inverse floating rate that replaces the fixed rate must be such that the fair market value of the Variable Interest Rate Covered Bond as of the Variable Interest Rate Covered Bond's issue date is approximately the same as the fair market value of an otherwise identical debt instrument that provides for either the qualified floating rate or qualified inverse floating rate rather than the fixed rate. Subsequent to converting the fixed rate into either a qualified floating rate or a qualified inverse floating rate, the Variable Interest Rate Covered Bond is converted into an equivalent fixed rate debt instrument in the manner described above.

Once the Variable Interest Rate Covered Bond is converted into an equivalent fixed rate debt instrument pursuant to the foregoing rules, the amount of OID and qualified stated interest, if any, are

determined for the equivalent fixed rate debt instrument by applying the general OID rules to the equivalent fixed rate debt instrument and a U.S. Holder of the Variable Interest Rate Covered Bond will account for the OID and qualified stated interest as if the U.S. Holder held the equivalent fixed rate debt instrument. In each accrual period, appropriate adjustments will be made to the amount of qualified stated interest or OID assumed to have been accrued or paid with respect to the equivalent fixed rate debt instrument in the event that these amounts differ from the actual amount of interest accrued or paid on the Variable Interest Rate Covered Bond during the accrual period.

If a Variable Interest Rate Covered Bond, such as a Covered Bond the payments on which are determined by reference to an index, does not qualify as a “variable rate debt instrument”, then the Variable Interest Rate Covered Bond will be treated as a contingent payment debt instrument. Prospective purchasers should consult with their own tax advisers concerning the proper U.S. federal income tax treatment of Variable Interest Rate Covered Bonds that are treated as contingent payment debt.

#### *Short-Term Covered Bonds*

In general, an individual or other cash basis U.S. Holder of a Short-Term Covered Bond is not required to accrue OID (calculated as set forth below for the purposes of this paragraph) for U.S. federal income tax purposes unless it elects to do so (but may be required to include any stated interest in income as the interest is received). Accrual basis U.S. Holders and certain other U.S. Holders are required to accrue OID on Short-Term Covered Bonds on a straight-line basis or, if the U.S. Holder so elects, under the constant-yield method (based on daily compounding). In the case of a U.S. Holder not required and not electing to include OID in income currently, any gain realized on the sale or retirement of the Short-Term Covered Bond will be ordinary income to the extent of the OID accrued on a straight-line basis (unless an election is made to accrue the OID under the constant-yield method) through the date of sale or retirement. U.S. Holders who are not required and do not elect to accrue OID on Short-Term Covered Bonds will be required to defer deductions for interest on borrowings allocable to Short-Term Covered Bonds in an amount not exceeding the deferred income until the deferred income is realized.

For purposes of determining the amount of OID subject to these rules, all interest payments on a Short-Term Covered Bond are included in the Short-Term Covered Bond’s stated redemption price at maturity.

A U.S. Holder may elect to determine OID on a Short-Term Covered Bond as if the Short-Term Covered Bond had been originally issued to the U.S. Holder as the U.S. Holder’s purchase price for the Short-Term Covered Bond. This election shall apply to all obligations with a maturity of one year or less acquired by the U.S. Holder on or after the first day of the first taxable year to which the election applies, and may not be revoked without the consent of the IRS.

#### ***Covered Bonds Purchased at a Premium***

A U.S. Holder that purchases a Covered Bond for an amount in excess of its principal amount or, for a Discount Covered Bond, its stated redemption price at maturity, may elect to treat the excess as “amortisable bond premium”, in which case the amount required to be included in the U.S. Holder’s income each year with respect to interest on the Covered Bond will be reduced by the amount of amortisable bond premium allocable (based on the Covered Bond’s yield to maturity) to that year. Any election to amortise bond premium shall apply to all bonds (other than bonds the interest on which is excludible from gross income for U.S. federal income tax purposes) held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and is irrevocable without the consent of the IRS. See also *Original Issue Discount – Election to Treat All Interest as Original Issue Discount*. A U.S. Holder that does



not elect to take bond premium (other than acquisition premium) into account currently will recognise a capital loss when the Covered Bond matures.

### ***Modifications to the Terms and Conditions of the Covered Bonds***

Certain modifications to the terms of the Covered Bonds described in Condition 15, including the assumption by the HBOS Group Guarantor, or a Subsidiary thereof, of the obligations of the Issuer as primary obligor, or the resignation of HBOS as a HBOS Group Guarantor, may constitute taxable events. If any modification to the terms and conditions of the Covered Bonds, including the substitution of a new primary obligor for the Issuer and/or the resignation of the HBOS Group Guarantor, were a taxable event, such modification would be treated for U.S. federal income tax purposes as an exchange of the Covered Bond for a new Covered Bond at the time the modification occurs (a “**Deemed Exchange**”) for an amount equal to the fair market value of the new Covered Bond. As a result, pursuant to a Deemed Exchange, a U.S. Holder of a Covered Bond may be required to recognise gain for U.S. federal income tax purposes despite not having received any actual distributions of income in connection with the Deemed Exchange. (See *Purchase, Sale and Retirement of Covered Bonds* below.)

### ***Purchase, Sale and Retirement of Covered Bonds***

A U.S. Holder’s tax basis in a Covered Bond will generally be its cost, increased by the amount of any OID or market discount included in the U.S. Holder’s income with respect to the Covered Bond and the amount, if any, of income attributable to *de minimis* OID and *de minimis* market discount included in the U.S. Holder’s income with respect to the Covered Bond, and reduced by (i) the amount of any payments that are not qualified stated interest payments, and (ii) the amount of any amortisable bond premium applied to reduce interest on the Covered Bond.

A U.S. Holder will generally recognise gain or loss on the sale or retirement of a Covered Bond equal to the difference between the amount realised on the sale or retirement and the tax basis of the Covered Bond. Except to the extent described above under *Original Issue Discount – Market Discount* or *Original Issue Discount – Short Term Covered Bonds* or attributable to accrued but unpaid interest or changes in exchange rates (as discussed below), gain or loss recognised on the sale or retirement of a Covered Bond will be capital gain or loss and generally will be treated as from U.S. sources for purposes of U.S. foreign tax credit limitation and may be taxable at reduced rates in the case of a U.S. Holder that is an individual, estate or trust, if the Covered Bonds are held for more than one year. The deductibility of capital losses is subject to limitations.

### ***Foreign Currency Covered Bonds***

#### ***Interest***

If an interest payment is denominated in, or determined by reference to, a foreign currency, the amount of income recognised by a cash basis U.S. Holder will be the U.S. dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether the payment is in fact converted into U.S. dollars.

An accrual basis U.S. Holder may determine the amount of income recognised with respect to an interest payment denominated in, or determined by reference to, a foreign currency in accordance with either of two methods. Under the first method, the amount of income accrued will be based on the average exchange rate in effect during the interest accrual period (or, in the case of an accrual period that spans two taxable years of a U.S. Holder, the part of the period within the taxable year).

Under the second method, the U.S. Holder may elect to determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period (or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year). Additionally, if a payment of interest is actually received within five business days of the last day of the accrual period, an electing accrual basis U.S. Holder may instead translate the accrued interest into U.S. dollars at the exchange rate in effect on the day of actual receipt. Any such election will apply to all debt instruments held by the U.S. Holder at the beginning of the first taxable year to which the election applies or thereafter acquired by the U.S. Holder, and will be irrevocable without the consent of the IRS.

Upon receipt of an interest payment (including a payment attributable to accrued but unpaid interest upon the sale or retirement of a Covered Bond) denominated in, or determined by reference to, a foreign currency, the U.S. Holder may recognise U.S. source exchange gain or loss (taxable as ordinary income or loss) equal to the difference between the amount received (translated into U.S. dollars at the spot rate on the date of receipt) and the amount previously accrued, regardless of whether the payment is in fact converted into U.S. dollars.

#### *OID*

OID for each accrual period on a Discount Covered Bond that is denominated in, or determined by reference to, a foreign currency, will be determined in the foreign currency and then translated into U.S. dollars in the same manner as stated interest accrued by an accrual basis U.S. Holder, as described above under *Foreign Currency Covered Bonds – Interest*. Upon receipt of an amount attributable to OID (whether in connection with a payment on the Covered Bond or a sale of the Covered Bond), a U.S. Holder may recognise U.S. source exchange gain or loss (taxable as ordinary income or loss) equal to the difference between the amount received (translated into U.S. dollars at the spot rate on the date of receipt) and the amount previously accrued, regardless of whether the payment is in fact converted into U.S. dollars.

#### *Bond Premium*

Bond premium (including acquisition premium) on a Covered Bond that is denominated in, or determined by reference to, a foreign currency, will be computed in units of the foreign currency, and any such bond premium that is taken into account currently will reduce interest income in units of the foreign currency.

On the date bond premium offsets interest income, a U.S. Holder may recognise U.S. source exchange gain or loss (taxable as ordinary income or loss) measured by the difference between the spot rate in effect on that date, and on the date the Covered Bonds were acquired by the U.S. Holder.

#### *Purchase, Sale and Retirement of Covered Bonds*

As discussed above under *Purchase, Sale and Retirement of Covered Bonds*, a U.S. Holder will generally recognise gain or loss on the sale or retirement of a Covered Bond equal to the difference between the amount realised on the sale or retirement and its tax basis in the Covered Bond. A U.S. Holder's tax basis in a Foreign Currency Covered Bond will be determined by reference to the U.S. dollar cost of the Covered Bond. The U.S. dollar cost of a Covered Bond purchased with foreign currency will generally be the U.S. dollar value of the purchase price on the date of purchase or, in the case of Covered Bonds traded on an established securities market, as defined in the applicable Treasury Regulations, that are purchased by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the purchase.

The amount realised on a sale or retirement for an amount in foreign currency will be the U.S. dollar value of this amount on the date of sale or retirement or, in the case of Covered Bonds traded on an established securities market, as defined in the applicable Treasury Regulations, sold by a cash basis U.S. Holder (or an accrual basis U.S. Holder that so elects), on the settlement date for the sale. Such an election by an accrual basis U.S. Holder must be applied consistently from year to year and cannot be revoked without the consent of the IRS.

A U.S. Holder will recognise U.S. source exchange rate gain or loss (taxable as ordinary income or loss) on the sale or retirement of a Covered Bond equal to the difference, if any between the U.S. dollar values of the U.S. Holder's purchase price for the Covered Bond (or, if less, the principal amount of the Covered Bond) (i) on the date of sale or retirement and (ii) the date on which the U.S. Holder acquired the Covered Bond. Any such exchange rate gain or loss will be realised only to the extent of total gain or loss realised on the sale or retirement.

#### *Disposition of Foreign Currency*

Foreign currency received as interest on a Covered Bond or on the sale or retirement of a Covered Bond will generally have a tax basis equal to its U.S. dollar value at the time the interest is received or at the time of the sale or retirement. Foreign currency that is purchased will generally have a tax basis equal to the U.S. dollar value of the foreign currency on the date of purchase. Any gain or loss recognised on a sale or other disposition of a foreign currency (including its use to purchase Covered Bonds or upon exchange for U.S. dollars) will be U.S. source ordinary income or loss.

#### ***Backup Withholding and Information Reporting***

In general, payments of interest and accrued OID on, and the proceeds of a sale, redemption or other disposition of, the Covered Bonds, payable to a U.S. Holder within the United States or by a U.S. paying agent or certain other U.S.-related intermediaries will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup withholding may apply to these payments and to accruals of OID if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or otherwise to comply with the applicable backup withholding requirements. Certain U.S. Holders (including, among others, corporations) are not subject to information reporting or backup withholding. U.S. Holders should consult their tax advisers as to their qualification for exemption from information reporting and/or backup withholding and the procedure for obtaining an exemption.

#### ***Disclosure Requirements***

Treasury Regulations meant to require the reporting of certain tax shelter transactions (“**Reportable Transactions**”) could be interpreted to cover transactions generally not regarded as tax shelters, including certain foreign currency transactions. Under the Treasury Regulations, certain transactions may be characterised as Reportable Transactions including, in certain circumstances, a sale, exchange, retirement or other taxable disposition of a Foreign Currency Covered Bond and/or a Covered Bond issued with OID. Persons considering the purchase of such Covered Bonds should consult with their own tax advisers to determine the tax return obligations, if any, with respect to an investment in such Covered Bonds, including any requirement to file IRS Form 8886 (Reportable Transaction Disclosure Statement).

## ERISA Considerations

The Rule 144A Global Covered Bonds and Definitive IAI Registered Covered Bonds are eligible for purchase by employee benefit plans and other plans subject to the US Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”), and/or the provisions of section 4975 of the Internal Revenue Code of 1986, as amended (the “**Code**”) and by governmental, church or non-US plans that are subject to state, local, other federal or non-US law that is substantially similar to ERISA or section 4975 of the Code, subject to consideration of the issues described in this section. ERISA imposes certain requirements on “**employee benefit plans**” (as defined in section 3(3) of ERISA) subject to ERISA, including entities such as collective investment funds and separate accounts whose underlying assets include the assets of such plans (collectively, “**ERISA Plans**”) and on those persons who are fiduciaries with respect to ERISA Plans. Investments by ERISA Plans are subject to ERISA’s general fiduciary requirements, including the requirements of investment prudence and diversification and the requirement that an ERISA Plan’s investments be made in accordance with the documents governing the Plan. The prudence of a particular investment must be determined by the responsible fiduciary of an ERISA Plan by taking into account the ERISA Plan’s particular circumstances and all of the facts and circumstances of the investment including, but not limited to, the matters discussed under *Risk factors* and the fact that in the future there may be no market in which such fiduciary will be able to sell or otherwise dispose of the Rule 144A Global Covered Bonds and Definitive IAI Registered Covered Bonds.

Section 406 of ERISA and section 4975 of the Code prohibit certain transactions involving the assets of an ERISA Plan (as well as those plans that are not subject to ERISA but which are subject to section 4975 of the Code, such as individual retirement accounts (together with ERISA Plans, the “**Plans**”)) and certain persons (referred to as “**parties in interest**” or “**disqualified persons**”) having certain relationships to such Plans, unless a statutory or administrative exemption is applicable to the transaction. A party in interest or disqualified person who engages in a prohibited transaction may be subject to excise taxes and other penalties and liabilities under ERISA and the Code.

The Original Seller, the Issuer, the Guarantors, the Servicer, the Security Trustee or any other party to the transactions contemplated by the Transaction Documents may be parties in interest or disqualified persons with respect to many Plans. Prohibited transactions within the meaning of section 406 of ERISA or section 4975 of the Code may arise if any of the Rule 144A Global Covered Bonds and Definitive IAI Registered Covered Bonds are acquired or held by a Plan with respect to which Original Seller, the Issuer, the Guarantors, the Servicer, the Security Trustee or any other party to the transactions contemplated by the Transaction Documents is a party in interest or a disqualified person. Certain exemptions from the prohibited transaction provisions of section 406 of ERISA and section 4975 of the Code may be applicable, however, depending in part on the type of Plan fiduciary making the decision to acquire any such Covered Bonds and the circumstances under which such decision is made. Included among these exemptions are Section 408(b)(17) of ERISA (relating to certain transactions between a plan and non-fiduciary service providers), Prohibited Transaction Class Exemption (“**PTCE**”) 91-38 (relating to investments by bank collective investment funds), PTCE 84-14 (relating to transactions effected by a “qualified professional asset manager”), PTCE 95-60 (relating to transactions involving insurance company general accounts), PTCE 90-1 (relating to investments by insurance company pooled separate accounts) and PTCE 96-23 (relating to transactions determined by in-house asset managers). There can be no assurance that any of these class exemptions or any other exemption will be available with respect to any particular transaction involving any such Covered Bonds.

Each purchaser and subsequent transferee of any Rule 144A Global Covered Bonds or Definitive IAI Registered Covered Bonds will be deemed by such purchase or acquisition of any such Covered Bond to have represented and warranted, on each day from the date on which the purchaser

or transferee acquires such note through and including the date on which the purchaser or transferee disposes of such note, either that (A) it is not a Plan or an entity whose underlying assets include the assets of any Plan or a governmental, church or non-US plan which is subject to any federal, state, local or non-US law that is substantially similar to the provisions of section 406 of ERISA or section 4975 of the Code or (B) its purchase, holding and disposition of such note will not result in a prohibited transaction under section 406 of ERISA or section 4975 of the Code (or, in the case of a governmental plan, any substantially similar federal, state or local law of the United States) for which an exemption is not available.

In addition, section 3(42) of ERISA and a regulation promulgated by the US Department of Labor at 29 C.F.R. section 2510.3-101 (collectively, the “**Plan Asset Regulation**”), describe what constitutes the assets of a Plan with respect to the Plan’s investment in an entity for purposes of certain provisions of ERISA, including the fiduciary responsibility provisions of Title I of ERISA, and section 4975 of the Code. Under the Plan Asset Regulation, if a Plan invests in an “equity interest” of an entity that is neither a “publicly offered security” nor a security issued by an investment company registered under the Investment Company Act, the Plan’s assets include both the equity interest and an undivided interest in each of the entity’s underlying assets, unless one of the exceptions to such treatment described in the Plan Asset Regulation applies. Under the Plan Asset Regulation, a security which is in form debt may be considered an “equity interest” if it has “substantial equity features”. If the issuing entity were deemed under the Plan Asset Regulation to hold plan assets by reason of a Plan’s investment in any of the Rule 144A Global Covered Bonds or Definitive IAI Registered Covered Bonds, such plan assets would include an undivided interest in the assets held by the issuing entity and transactions by the issuing entity would be subject to the fiduciary responsibility provisions of Title I of ERISA and the prohibited transaction provisions of ERISA and section 4975 of the Code. While no assurance can be given, the issuing entity believes that the Rule 144A Global Covered Bonds and Definitive IAI Registered Covered Bonds should not be treated as “equity interests” for the purposes of the Plan Asset Regulation.

Any insurance company proposing to purchase any of the Rule 144A Global Covered Bonds and Definitive IAI Registered Covered Bonds using the assets of its general account should consider the extent to which such investment would be subject to the requirements of ERISA in light of the US Supreme Court’s decision in *John Hancock Mutual Life Insurance Co. v. Harris Trust and Savings Bank* and under any subsequent guidance that may become available relating to that decision. In particular, such an insurance company should consider the retroactive and prospective exemptive relief granted by the US Department of Labor for transactions involving insurance company general accounts in PTCE 95-60, 60 Fed. Reg. 35925 (12 July 1995), the enactment of section 401(c) of ERISA by the Small Business Job Protection Act of 1996 (including, without limitation, the expiration of any relief granted thereunder) and the Insurance Company General Account Regulations, 65 Fed. Reg. No. 3 (5 January 2000) (to be codified at 29 C.F.R. pt. 2550) that became generally applicable on 5 July 2001.

Each Plan fiduciary who is responsible for making the investment decisions whether to purchase or commit to purchase and to hold any of the Rule 144A Global Covered Bonds and Definitive IAI Registered Covered Bonds should determine whether, under the documents and instruments governing the Plan, an investment in such Covered Bonds is appropriate for the Plan, taking into account the overall investment policy of the Plan and the composition of the Plan’s investment portfolio. Any Plan proposing to invest in such Covered Bonds (including any governmental plan) should consult with its counsel to confirm that such investment will not result in a non-exempt prohibited transaction and will satisfy the other requirements of ERISA and the Code (or, in the case of a governmental plan, any substantially similar state, local or other federal law).

The sale of any Rule 144A Global Covered Bonds or Definitive IAI Registered Covered Bonds to a Plan is in no respect a representation by the Original Seller, the Issuer, the Guarantors, the

Servicer, the Security Trustee or any other party to the transactions contemplated by the Transaction Documents that such an investment meets all relevant legal requirements with respect to investments by Plans generally or any particular Plan, or that such an investment is appropriate for Plans generally or any particular Plan.

## SUBSCRIPTION AND SALE AND TRANSFER AND SELLING RESTRICTIONS

The Dealers have, in a programme agreement (as the same may be amended and/or supplemented and/or restated from time to time, the “**Programme Agreement**”) dated the Programme Date agreed with the Issuer and the Guarantors a basis upon which such Dealers or any of them may from time to time agree to purchase Covered Bonds. Any such agreement will extend to those matters stated under *Form of the Covered Bonds* and *Terms and Conditions of the Covered Bonds*. In the Programme Agreement, the Issuer (failing which, the HBOS Group Guarantor) has agreed to reimburse the Dealers for certain of their expenses in connection with the establishment and any future update of the Programme and the issue of Covered Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

The Issuer may pay each relevant Dealer commissions as agreed in connection with the sale of any Covered Bonds. In the Programme Agreement, the Issuer has agreed to reimburse and indemnify the relevant Dealer for certain of its expenses and liabilities in connection with the establishment and any future updates of the Programme and the issue of Covered Bonds under the Programme. The relevant Dealer is entitled to be released and discharged from its obligations in relation to any agreement to purchase Covered Bonds under the Programme Agreement in certain circumstances prior to payment to the Issuer.

In order to facilitate the offering of any Tranche of the Covered Bonds, certain persons participating in the offering of the Tranche may engage in transactions that stabilise, maintain or otherwise affect the market price of the relevant Covered Bonds during and after the offering of the Tranche. Specifically, such persons may over-allot or create a short position in the Covered Bonds for their own account by selling more Covered Bonds than have been sold to them by the Issuer. Such persons may also elect to cover any such short position by purchasing Covered Bonds in the open market. In addition, such persons may stabilise or maintain the price of the Covered Bonds by bidding for or purchasing Covered Bonds in the open market and may impose penalty bids, under which selling concessions allowed to syndicate members or other broker-dealers participating in the offering of the Covered Bonds are reclaimed if Covered Bonds previously distributed in the offering are repurchased in connection with stabilisation transactions or otherwise. The effect of these transactions may be to stabilise or maintain the market price of the Covered Bonds at a level above that which might otherwise prevail in the open market. The imposition of a penalty bid may also affect the price of the Covered Bonds to the extent that it discourages resales thereof. No representation is made as to the magnitude or effect of any such stabilising or other transactions. Such transactions, if commenced, may be discontinued at any time. Under UK laws and regulations stabilising activities may only be carried on by the stabilising manager named in the applicable Final Terms and only for a period ending on the earlier of 30 days following the Issue Date of the relevant Tranche of Covered Bonds and 60 days after the allotment of the relevant Tranche of Covered Bonds.

### **Transfer Restrictions**

*As a result of the following restrictions, purchasers of Covered Bonds in the United States are advised to consult legal counsel prior to making any purchase, offer, sale, resale or other transfer of such Covered Bonds.*

Each purchaser of Registered Covered Bonds (other than a person purchasing an interest in a Registered Global Covered Bond with a view to holding it in the form of an interest in the same Registered Global Covered Bond) or person wishing to transfer an interest from one Registered Global Covered Bond to another will be required to acknowledge, represent and agree as follows (terms used in this paragraph that are defined in Rule 144A or in Regulation S are used herein as defined therein):

- (i) that either: (a) it is a QIB, purchasing (or holding) the Covered Bonds for its own account or for the account of one or more QIBs and it is aware that any sale to it is being made in reliance on Rule 144A, (b) it is an Institutional Accredited Investor which has delivered an IAI Investment Letter or (c) it is outside the United States and is not a U.S. person;
- (ii) that the Covered Bonds are being offered and sold in a transaction not involving a public offering in the United States within the meaning of the Securities Act, that neither the Covered Bonds nor the Covered Bond Guarantee has been or will be registered under the Securities Act or any applicable U.S. State securities laws and that the Covered Bonds may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except as set forth in this section;
- (iii) it agrees that neither the Issuer nor the Guarantors have any obligation to register the Covered Bonds or the Covered Bond Guarantee under the Securities Act;
- (iv) that, unless it holds an interest in a Regulation S Global Covered Bond and either is a person located outside the United States or is not a U.S. person, if in the future it decides to resell, pledge or otherwise transfer the Covered Bonds or any beneficial interests in the Covered Bonds, it will do so, prior to the date which is one year after the later of the last Issue Date for the Series and the last date on which the Issuer or an affiliate of the Issuer was the owner of such Covered Bonds, only (a) to the Issuer or any affiliate thereof, (b) inside the United States to a person whom the seller reasonably believes is a QIB purchasing the Covered Bonds for its own account or for the account of a QIB in a transaction meeting the requirements of Rule 144A, (c) outside the United States in compliance with Rule 903 or Rule 904 under the Securities Act, (d) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available) or (e) pursuant to an effective registration statement under the Securities Act, in each case in accordance with all applicable U.S. State securities laws;
- (v) that it will, and will require each subsequent holder to, notify any purchaser of the Covered Bonds from it of the resale restrictions referred to in paragraph (i) above, if then applicable;
- (vi) that Covered Bonds initially offered in the United States to QIBs will be represented by one or more Rule 144A Global Covered Bonds, that Covered Bonds offered to Institutional Accredited Investors will be in the form of Definitive IAI Registered Covered Bonds and that Covered Bonds offered outside the United States in reliance on Regulation S will be represented by one or more Regulation S Global Covered Bonds;
- (vii) that the Covered Bonds represented by a Rule 144A Global Covered Bond and Definitive Rule 144A Covered Bonds, will bear a legend to the following effect unless otherwise agreed to by the Issuer:

“THIS SECURITY AND ANY GUARANTEE IN RESPECT THEREOF HAVE NOT BEEN REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE **SECURITIES ACT**), OR ANY OTHER APPLICABLE U.S. STATE SECURITIES LAWS AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT AS SET FORTH IN THE FOLLOWING SENTENCE. BY ITS ACQUISITION HEREOF, THE HOLDER (A) REPRESENTS THAT (1) IT IS A “QUALIFIED INSTITUTIONAL BUYER” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) PURCHASING THIS SECURITY FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QUALIFIED INSTITUTIONAL BUYERS OR (2) IT IS AN INSTITUTIONAL “ACCREDITED INVESTOR” (AS DEFINED IN RULE 501(A)(1), (2), (3) OR (7) UNDER THE SECURITIES ACT) (AN INSTITUTIONAL ACCREDITED



INVESTOR); (B) AGREES THAT IT WILL NOT RESELL OR OTHERWISE TRANSFER THIS SECURITY EXCEPT IN ACCORDANCE WITH THE AGENCY AGREEMENT IN RESPECT OF THIS SECURITY (THE AGENCY AGREEMENT) AND, PRIOR TO THE DATE WHICH IS ONE YEAR AFTER THE LATER OF THE LAST ISSUE DATE FOR THE SERIES AND THE LAST DATE ON WHICH THE ISSUER OR AN AFFILIATE OF THE ISSUER WAS THE OWNER OF SUCH SECURITY OTHER THAN (1) TO THE ISSUER OR ANY AFFILIATE THEREOF, (2) INSIDE THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING THE SECURITY FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QUALIFIED INSTITUTIONAL BUYERS IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (3) OUTSIDE THE UNITED STATES IN COMPLIANCE WITH RULE 903 OR RULE 904 UNDER THE SECURITIES ACT, (4) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (5) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND ANY OTHER JURISDICTION; AND (C) IT AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM THIS SECURITY IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

THIS SECURITY AND RELATED DOCUMENTATION (INCLUDING, WITHOUT LIMITATION, THE AGENCY AGREEMENT REFERRED TO HEREIN) MAY BE AMENDED OR SUPPLEMENTED FROM TIME TO TIME, WITHOUT THE CONSENT OF, BUT UPON NOTICE TO, THE HOLDER OF SUCH SECURITY SENT TO ITS REGISTERED ADDRESS, TO MODIFY THE RESTRICTIONS ON AND PROCEDURES FOR REALES AND OTHER TRANSFERS OF THIS SECURITY TO REFLECT ANY CHANGE IN APPLICABLE LAW OR REGULATION (OR THE INTERPRETATION THEREOF) OR IN PRACTICES RELATING TO REALES OR OTHER TRANSFERS OF RESTRICTED SECURITIES GENERALLY. THE HOLDER OF THIS SECURITY SHALL BE DEEMED, BY ITS ACCEPTANCE OR PURCHASE HEREOF, TO HAVE AGREED TO ANY SUCH AMENDMENT OR SUPPLEMENT (EACH OF WHICH SHALL BE CONCLUSIVE AND BINDING ON THE HOLDER HEREOF AND ALL FUTURE HOLDERS OF THIS SECURITY AND ANY SECURITIES ISSUED IN EXCHANGE OR SUBSTITUTION THEREFOR, WHETHER OR NOT ANY NOTATION THEREOF IS MADE HEREON).

PROSPECTIVE PURCHASERS ARE HEREBY NOTIFIED THAT THE SELLER OF THIS SECURITY MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A”;

- (viii) if it is outside the United States and is not a U.S. person, that if it should resell or otherwise transfer the Covered Bonds prior to the expiration of the distribution compliance period (defined as 40 days after the completion of the distribution of the Tranche of Covered Bonds of which such Covered Bonds are a part, as determined and certified by the relevant Dealer, in the case of a non-syndicated issue, or the Lead Manager, in the case of a syndicated issue), it will do so only (a)(i) outside the United States in compliance with Rule 903 or 904 under the Securities Act or (ii) to a QIB in compliance with Rule 144A and (b) in accordance with all applicable U.S. State securities laws; and it acknowledges that the Covered Bonds represented by a Regulation S Global Covered Bond and Definitive Regulation S Covered Bonds will bear a legend to the following effect unless otherwise agreed to by the Issuer:

“THIS SECURITY AND ANY GUARANTEE IN RESPECT THEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE **SECURITIES ACT**), OR ANY APPLICABLE U.S. STATE SECURITIES LAWS AND, ACCORDINGLY, MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS EXCEPT IN ACCORDANCE WITH THE AGENCY AGREEMENT IN RESPECT OF THIS SECURITY AND PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT OR PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT. UNTIL THE EXPIRY OF THE PERIOD OF 40 DAYS AFTER THE COMPLETION OF THE DISTRIBUTION OF ALL THE COVERED BONDS OF THE TRANCHE OF WHICH THIS COVERED BOND FORMS PART, SALES MAY NOT BE MADE IN THE UNITED STATES OR TO U.S. PERSONS UNLESS MADE (I) PURSUANT TO RULE 903 OR 904 OF REGULATIONS UNDER THE SECURITIES ACT OR (II) TO QUALIFIED INSTITUTIONAL BUYERS AS DEFINED IN, AND IN TRANSACTIONS PURSUANT TO, RULE 144A UNDER THE SECURITIES ACT.”; and

- (ix) that the Issuer and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements and agrees that if any of such acknowledgements, representations or agreements made by it are no longer accurate, it shall promptly notify the Issuer; and if it is acquiring any Covered Bonds as a fiduciary or agent for one or more accounts it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

Institutional Accredited Investors who purchase Registered Covered Bonds in definitive form offered and sold in the United States in reliance upon the exemption from registration provided by Regulation D of the Securities Act are required to execute and deliver to the Bond Registrar an IAI Investment Letter. Upon execution and delivery of an IAI Investment Letter by an Institutional Accredited Investor, Covered Bonds will be issued in definitive registered form, see *Form of the Covered Bonds*.

The IAI Investment Letter will state, among other things, the following:

- (i) that the Institutional Accredited Investor has received a copy of the Offering Circular and such other information as it deems necessary in order to make its investment decision;
- (ii) that the Institutional Accredited Investor understands that any subsequent transfer of the Covered Bonds is subject to certain restrictions and conditions set forth in the Offering Circular and the Covered Bonds (including those set out above) and that it agrees to be bound by, and not to resell, pledge or otherwise transfer the Covered Bonds except in compliance with, such restrictions and conditions and the Securities Act;
- (iii) that, in the normal course of its business, the Institutional Accredited Investor invests in or purchases securities similar to the Covered Bonds;
- (iv) that the Institutional Accredited Investor is an institution that is an accredited investor within the meaning of Rule 501(a)(1), (2), (3) or (7) of Regulation D under the Securities Act and has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of its investment in the Covered Bonds, and it and any accounts for which it is acting are each able to bear the economic risk of its or any such accounts' investment for an indefinite period of time;

- (v) that the Institutional Accredited Investor is acquiring the Covered Bonds purchased by it for its own account or for one or more accounts (each of which is an Institutional Accredited Investor) as to each of which it exercises sole investment discretion and not with a view to any distribution of the Covered Bonds, subject, nevertheless, to the understanding that the disposition of its property shall at all times be and remain within its control; and
- (vi) that, in the event that the Institutional Accredited Investor purchases Covered Bonds, it will acquire Covered Bonds having a minimum purchase price of at least U.S.\$500,000 (or the approximate equivalent in another Specified Currency).

No sale of Legended Covered Bonds in the United States to any one purchaser will be for less than U.S.\$100,000 (or the approximate equivalent in another Specified Currency) principal amount or, in the case of sales to Institutional Accredited Investors, U.S.\$500,000 (or the approximate equivalent in another Specified Currency) principal amount and no Legended Covered Bond will be issued in connection with such a sale in a smaller principal amount. If the purchaser is a non-bank fiduciary acting on behalf of others, each person for whom it is acting must purchase at least U.S.\$100,000 (or the approximate equivalent in another Specified Currency) or, in the case of sales to Institutional Accredited Investors, U.S.\$500,000 (or the approximate equivalent in another Specified Currency) principal amount of Registered Covered Bonds.

Dealers may arrange for the resale of Covered Bonds to QIBs pursuant to Rule 144A and each such purchaser of Covered Bonds is hereby notified that the Dealers may be relying on the exemption from the registration requirements of the Securities Act provided by Rule 144A. The minimum aggregate principal amount of Covered Bonds which may be purchased by a QIB pursuant to Rule 144A is U.S.\$100,000 (or the approximate equivalent in another Specified Currency).

### *United States*

The Covered Bonds and the Guarantees have not been and will not be registered under the Securities Act and Covered Bonds may not be offered or sold within the United States or to, or for the account or benefit of, U.S. 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.

The Covered Bonds in bearer form are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. The Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer, sell or deliver a Covered Bond in bearer form within the United States or to United States persons except as permitted by the Programme Agreement. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986, as amended, and regulations thereunder.

In connection with any Covered Bonds which are offered or sold outside the United States in reliance on Regulation S ("**Regulation S Covered Bonds**"), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer, sell or deliver any such Regulation S Covered Bond within the United States or to, or for the account or benefit of, U.S. persons(i) as part of its distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the Issue Date ("**Distribution Compliance Period**"), and except in either case in accordance with Regulation S under the Securities Act. Each Dealer has further agreed, and each further Dealer appointed under the Programme will be required to agree, that it will send to each Dealer to which it sells any Regulation S Covered Bonds during the Distribution Compliance Period a confirmation or other notice setting forth the restrictions

on offers and sales of the Covered Bonds within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Until 40 days after the commencement of the offering of any Series of Covered Bonds, an offer or sale of such Covered Bonds within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Dealers may arrange for the resale of Covered Bonds to QIBs pursuant to Rule 144A and each such purchaser of Covered Bonds is hereby notified that the Dealers may be relying on the exemption from the registration requirements of the Securities Act provided by Rule 144A. The minimum aggregate principal amount of Covered Bonds which may be purchased by a QIB pursuant to Rule 144A is U.S.\$100,000 (or the approximate equivalent in another Specified Currency).

Each issuance of Index Linked Covered Bonds or Dual Currency Covered Bonds shall be subject to such additional U.S. selling restrictions as the Issuer and the relevant Dealer(s) may agree as a term of the issuance and purchase of such Covered Bonds, which additional selling restrictions shall be set out in the applicable Final Terms.

#### ***Public Offer Selling Restriction under the Prospectus Directive***

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make an offer of Covered Bonds which are the subject of the offering contemplated by this offering circular as completed by the final terms in relation thereto to the public in that Relevant Member State, except that it may, with effect from and including the Relevant Implementation Date, make an offer of such Covered Bonds to the public in that Relevant Member State:

- (a) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (b) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (c) at any time to fewer than 100 natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Issuer for any such offer;
- (d) at any time if the denomination per Covered Bond being offered amounts to at least €50,000;  
or
- (e) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Covered Bonds referred to in (a) to (d) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Covered Bonds to the public” in relation to any Covered Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Covered Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Covered Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression “**Prospectus Directive**” means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

### ***United Kingdom***

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

- (i) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Covered Bonds in circumstances in which Section 21(1) of the FSMA does not or, in the case of the Issuer would not, if it was not an authorised person, apply to the Issuer, the HBOS Group Guarantor, or the LLP; and
- (ii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Covered Bonds in, from or otherwise involving the United Kingdom.

### ***Japan***

The Covered Bonds have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Law No. 25 of 1948, as amended, the “**FIEA**”) and each Dealer has represented and agreed and each further Dealer appointed under the Programme will be required to represent and agree that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell any Covered Bonds in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan as defined under Item 5, Paragraph 1, Article 6 of the Foreign Exchange and Foreign Trade Control Law (Law No. 228 of 1949, as amended)), or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of a resident of, any resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEA and any other applicable laws, regulations and ministerial guidelines of Japan.

### ***The Netherlands***

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that any Covered Bonds having a denomination of less than €50,000 or its equivalent in another currency will only be offered in The Netherlands to qualified investors as defined in the Financial Supervision Act (*Wet op het financieel toezicht*) and the decrees issued pursuant thereto.

### ***Republic of Italy***

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that the offering of the Covered Bonds has not been registered pursuant to Italian securities legislation and, accordingly, the Covered Bonds may not be offered, sold or delivered, nor may copies of the Prospectus or of any other document relating to the Covered Bonds be distributed in the Republic of Italy, except:

- (a) to qualified investors (*investitori qualificati*), as defined in Article 100 of Legislative Decree No. 58 of 24 February 1998, as amended (the "**Financial Services Act**") and the relevant implementing regulations of the Italian Securities Exchange Commission ("**CONSOB**") as amended from time to time; or
- (b) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of the Financial Services Act and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14 May 1999, as amended.

Furthermore, each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that any offer, sale or delivery of the Covered Bonds or distribution of copies of this Prospectus or any other document relating to the Covered Bonds in the Republic of Italy under (a) or (b) above must be:

- (i) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act, CONSOB Regulation No. 16190 of 29 October 2007 (as amended from time to time) and Legislative Decree No. 385 of 1 September 1993, as amended (the "**Italian Banking Act**");
- (ii) in compliance with Article 129 of the Italian Banking Act and the implementing guidelines of the Bank of Italy (as amended from time to time) pursuant to which the Bank of Italy may request information on the issue or the offer of securities in the Republic of Italy; and
- (iii) in accordance with any other applicable laws and regulations including those imposed by CONSOB or other Italian authority.

### ***Germany***

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree that it shall only offer or sell Covered Bonds in the Federal Republic of Germany in compliance with the provisions of the German Securities Prospectus Act (*Wertpapier- prospektgesetz*) of 22 June 2005, or any other laws applicable in the Federal Republic of Germany governing the offer and sale of securities. The Dealer has also agreed, and each further Dealer appointed under the Programme will be required to agree that it shall not offer or sell the Covered Bonds in the Federal Republic in Germany in a manner which could result in the Issuer being subject to any licence requirement under the German Banking Act (*Kreditwesengesetz*).

### ***Republic of France***

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

- (a) it has only made and will only make an offer of Covered Bonds to the public in the Republic of France in the period beginning (i) when a prospectus in relation to the Covered Bonds has been approved by the *Autorité des marchés financiers* ("**AMF**"), on the date of such publication or, (ii) when a prospectus has been approved by the competent authority of another Member State of the European Economic Area which has implemented the EU Prospectus Directive No. 2003/71/EC, on the date of notification of such approval to the AMF, and ending at the latest on the date which is 12 months after the date of approval of the Prospectus, all in accordance with Articles L.412-1 and L.621-8 of the French *Code monétaire et financier* and the *Règlement général* of the AMF; or

- (b) it has not offered or sold and will not offer or sell, directly or indirectly, Covered Bonds to the public in France, and has not distributed or caused to be distributed and will not distribute or cause to be distributed to the public in France, the Prospectus, the relevant Final Terms or any other offering material relating to the Covered Bonds, and that such offers, sales and distributions have been and will be made in France only to (i) providers of investment services relating to portfolio management for the account of third parties, and/or (ii) qualified investors (*investisseurs qualifiés*), other than individuals, all as defined in, and in accordance with, Articles L.411-1, L.411-2 and D.411-1 to D.411-3 of the French Code monétaire et financier.

### **General**

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will (to the best of its knowledge and belief) comply with all applicable securities laws, regulations and directives in force in any jurisdiction in which it purchases, offers, sells or delivers Covered Bonds or possesses or distributes this Offering Circular or any Final Terms and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Covered Bonds under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and none of the Issuer, the HBOS Group Guarantor, the LLP, the Bond Trustee, the Security Trustee nor any of the other Dealers shall have any responsibility therefor.

None of the Issuer, the HBOS Group Guarantor, the LLP, the Bond Trustee, the Security Trustee or any of the Dealers represents that Covered Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

With regard to each Tranche, the relevant Dealer(s) will be required to comply with such other restrictions as the Issuer and the relevant Dealer(s) shall agree and as shall be set out in the applicable Final Terms.

### **The Grand Duchy of Luxembourg**

In addition to the cases described in the Public Offer Selling Restriction under the Prospectus Directive in which the Dealers can make an offer of Covered Bonds to the public in an EEA Member State (including the Grand Duchy of Luxembourg (“**Luxembourg**”)), the Dealers can also make an offer of Covered Bonds to the public in Luxembourg:

- (a) at any time, to national and regional governments, central banks, international and supranational institutions (such as the International Monetary Fund, the European Central Bank, the European Investment Bank) and other similar international organisations;
- (b) at any time, to legal entities which are authorised or regulated to operate in the financial markets (including credit institutions, investment firms, other authorised or regulated financial institutions, undertakings for collective investment and their management companies, pension and investment funds and their management companies, insurance undertakings and commodity dealers) as well as entities not so authorised or regulated whose corporate purpose is solely to invest in securities; and
- (c) at any time, to certain natural persons or small and medium-sized enterprises (as defined in the Luxembourg act dated 10 July 2005 on prospectuses for securities implementing the Directive 2003/71/EC (the “**Prospectus Directive**”) into Luxembourg law) recorded in the register of natural persons or small and medium-sized enterprises considered as qualified

investors as held by the *Commission de surveillance du secteur financier* as competent authority in Luxembourg in accordance with the Prospectus Directive.



## GENERAL INFORMATION

### Authorisation

The Programme and the issue of Covered Bonds have been duly authorised by a resolution of a committee of the board of directors of the Issuer dated 14 July 2003, the giving of the Covered Bond Guarantee has been duly authorised by a resolution of a committee of the board of directors of each of the Members of the LLP dated 14 July 2003 and the giving of the HBOS Group Guarantee has been duly authorised by a resolution of a committee of the board of directors of HBOS passed on 14 July 2003.

The update of the Programme has been duly authorised by:

1. a resolution of a committee of the board of directors of the Issuer, dated 4 August 2009;
2. a resolution of a committee of the board of directors of HBOS, dated 4 August 2009; and
3. a resolution of the management board of the LLP, dated 9 March 2010.

### Approval, Listing and Admission to Trading of Covered Bonds

Application has been made to the CSSF to approve this document as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for the Covered Bonds issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and listed on the Official List of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

### Documents Available

So long as Covered Bonds are capable of being issued under the Programme, copies of the following documents will, when published, be available free of charge during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) from the registered office of the Issuer and from the specified office of the Paying Agent for the time being in Luxembourg:

- (i) the Memorandum and Articles of Association of the Issuer and the constitutive documents of the Guarantors;
- (ii) the consolidated audited financial statements of each of the Issuer and the HBOS Group Guarantor in respect of the financial periods ended 31 December 2007 and 2008 and the non-consolidated audited financial statements of the LLP in respect of financial periods ended 31 December 2007 and 2008, in each case together with any audit or review reports prepared in connection therewith. The Issuer and the HBOS Group Guarantor each currently prepares audited consolidated and non-consolidated accounts on an annual basis. The LLP prepares audited non-consolidated accounts on an annual basis;
- (iii) the most recently published audited annual financial statements of the Issuer and the Guarantor and the most recently published unaudited interim financial statements (if any) of the Issuer and the HBOS Group Guarantor, in each case together with any audit or review reports prepared in connection therewith. The Issuer and the HBOS Group Guarantor each currently prepares unaudited consolidated and non-consolidated interim accounts on a semi-annual basis. The LLP is currently not required to produce any interim financial statements;

- (iv) the Issuer's 2009 Results Announcement;
- (v) the HBOS Group Guarantor's 2009 Results Announcement;
- (vi) the forms of the Global Covered Bonds, the Covered Bonds in definitive form, the Receipts, the Coupons and the Talons;
- (vii) a copy of this Offering Circular;
- (viii) any future offering circulars, prospectuses, information memoranda and supplements to this Offering Circular and any other documents incorporated herein including Final Terms (including a Final Terms relating to an unlisted Covered Bond) or therein by reference; and
- (ix) each of the following transaction documents (the “**Transaction Documents**”), namely:
  - Mortgage Sale Agreement
  - each Scottish Declaration of Trust
  - each Servicing Agreement
  - Asset Monitor Agreement
  - Intercompany Loan Agreement
  - LLP Deed
  - Deed of Admission
  - Cash Management Agreement
  - each Interest Rate Swap Agreement
  - each Covered Bond Swap Agreement
  - Guaranteed Investment Contract
  - Stand-by Guaranteed Investment Contract
  - Bank Account Agreement
  - Stand-by Bank Account Agreement
  - Corporate Services Agreement
  - Deed of Charge (and any documents entered into pursuant to the Deed of Charge)
  - Trust Deed
  - Agency Agreement
  - Programme Agreement
  - the Deed Poll

- each Subscription Agreement (as applicable in the case of each issue of Covered Bonds admitted to trading on the Luxembourg Stock Exchange's regulated market subscribed pursuant to a subscription agreement)
- Master Definitions and Construction Agreement
- any other agreement or document designated in writing as a Transaction Document by the Issuer and the Note Trustee and / or the Security Trustee.

In addition, copies of this Offering Circular and each document incorporated herein by reference are available on the Luxembourg Stock Exchange's website at [www.bourse.lu](http://www.bourse.lu).

### **Clearing Systems**

The Bearer Covered Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The appropriate Common Code and ISIN for each Tranche of Bearer Covered Bonds allocated by Euroclear will be specified in the applicable Final Terms. In addition, the Issuer may make an application for any Registered Covered Bonds to be accepted for trading in book-entry form by DTC. The CUSIP and/or CINS numbers for each Tranche of Registered Covered Bonds, together with the relevant ISIN and Common Code, will be specified in the applicable Final Terms. If the Covered Bonds are to clear through an additional or alternative clearing system the appropriate information will be specified in the applicable Final Terms.

The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels; the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855 Luxembourg; and the address of DTC is 55 Water Street, 25th Floor, New York, NY 10041-0099, United States.

### **Conditions for determining price**

The price and amount of Covered Bonds to be issued under the Programme will be determined by the Issuer and the relevant Dealer at the time of issue in accordance with prevailing market conditions.

### **Significant or Material Change**

#### ***BOS Group***

Save as disclosed in: (1) the fourth paragraph of the section entitled "Business Review" on page 1 of the Issuer's 2009 Results Announcement; 2) the table entitled "Consolidated Statement of Changes in Equity for year ended 31 December 2009" on page 10 of the Issuer's 2009 Results Announcement and note 15 on page 21 of the Issuer's 2009 Results Announcement; and 3) note 4 on page 15 of the Issuer's 2009 Results Announcement regarding subvention income, there has been no significant change in the financial or trading position of the BOS Group since 30 June 2009, the date to which the BOS Group's last published interim financial information was prepared, and save as disclosed in: (1) the fourth paragraph of the section entitled "Business Review" on page 1 of the Issuer's 2009 Results Announcement; 2) Risk Factor 2.1.5 ("*The BOS Group's businesses are subject to inherent risks concerning borrower and counterparty credit quality which have affected and are expected to continue to affect the recoverability and value of assets on the HBOS Group's balance sheet*") and; 3) Risk Factor 2.3.2 ("*Lloyds Banking Group is subject to European state aid obligations following the approval of its restructuring plan by the European Commission on 18 November 2009. The implementation of this restructuring plan may have consequences that are materially adverse to the interests of Lloyds Banking Group. Moreover, should a third party successfully challenge the*"),

*European Commission's decision to approve Lloyds Banking Group's restructuring plan, or should Lloyds Banking Group require additional state aid in the future, further restructuring measures could be required and these may be materially adverse to the interests of Lloyds Banking Group and to those of the HBOS Group"), there has been no material adverse change in the prospects of the BOS Group since 31 December 2008.*

### ***HBOS Group***

Save as disclosed in: (1) the seventh paragraph of the section entitled "Business Review" on page 2 of the HBOS Group Guarantor's 2009 Results Announcement; 2) the table entitled "Consolidated Statement of Changes in Equity for year ended 31 December 2009" on page 11 of the HBOS Group Guarantor's 2009 Results Announcement and note 17 on page 25 of the HBOS Group Guarantor's 2009 Results Announcement; and 3) note 4 on page 16 of the HBOS Group Guarantor's 2009 Results Announcement regarding subvention income, there has been no significant change in the financial or trading position of the HBOS Group since 30 June 2009, the date to which the HBOS Group Guarantor's last published interim financial information was prepared, and save as disclosed in: (1) the seventh paragraph of the section entitled "Business Review" on page 2 of the HBOS Group Guarantor's 2009 Results Announcement; 2) Risk Factor 2.1.5 ("*The BOS Group's businesses are subject to inherent risks concerning borrower and counterparty credit quality which have affected and are expected to continue to affect the recoverability and value of assets on the HBOS Group's balance sheet*"); and 3) Risk Factor 2.3.2 ("*Lloyds Banking Group is subject to European state aid obligations following the approval of its restructuring plan by the European Commission on 18 November 2009. The implementation of this restructuring plan may have consequences that are materially adverse to the interests of Lloyds Banking Group. Moreover, should a third party successfully challenge the European Commission's decision to approve Lloyds Banking Group's restructuring plan, or should Lloyds Banking Group require additional state aid in the future, further restructuring measures could be required and these may be materially adverse to the interests of Lloyds Banking Group and to those of the HBOS Group*"), there has been no material adverse change in the prospects of the HBOS Group since 31 December 2008.

### ***LLP***

There has been no significant change in the financial or trading position of the LLP since 31 December 2008, the date of its last audited consolidated and non-consolidated annual financial statements, and there has been no material adverse change in the prospects of the LLP since 31 December 2008, the date of its last audited consolidated and non-consolidated annual financial statements.

### **Litigation**

#### ***BOS Group***

Save as disclosed in the section entitled "Legal Actions" on page 110 of this document, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) during the 12 months preceding the date of this document, which may have or have had in the past, significant effects on the financial position or profitability of the BOS Group.

#### ***HBOS Group***

Save as disclosed in the section entitled “Legal Actions” on page 110 of this document, there are no governmental, legal or arbitration proceedings (including any such proceedings pending or threatened of which HBOS is aware) during the 12 months preceding the date of this document, which may have or have had in the past, significant effects on the financial position or profitability of the HBOS Group.

### ***LLP***

The LLP is not and has not been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the LLP is aware) since 15 May 2003, the date of its incorporation, which may have or have had in the recent past a significant effect on the LLP's financial position or profitability.

### **Auditor**

Following the resignation of KPMG Audit plc, the auditor of the Issuer, the HBOS Group Guarantor and the LLP is PricewaterhouseCoopers LLP. PricewaterhouseCoopers LLP are chartered accountants with the Institute of Chartered Accountants in England and Wales and regulated in the United Kingdom by the Audit Inspection Unit for the Public Oversight Board and Financial Reporting Council. KPMG Audit plc, previously auditors of the Issuer, the HBOS Group Guarantor and the LLP, have audited, without qualification, in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board in the United Kingdom, the Issuer's financial statements for each of the two financial years ended on 31 December 2007 and 2008, the HBOS Group Guarantor's financial statements for each of the two financial years ended on 31 December 2007 and 2008 the LLP's financial statements for each of the two financial years ended on 31 December 2007 and 2008.

### **Reports**

The Trust Deed provides that the Bond Trustee may rely on reports or other information from professional advisers or other experts in accordance with the provisions of the Trust Deed, whether or not any such report or other information, or engagement letter or other document entered into by the Bond Trustee and the relevant person in connection therewith, contains any monetary or other limit on the liability of the relevant person.

So long as the Covered Bonds are admitted to trading on the Luxembourg Stock Exchange's regulated market and to listing on the Luxembourg Stock Exchange, the Issuer or a Guarantor shall notify the CSSF and the Luxembourg Stock Exchange of any replacement or substitution of the Issuer or a Guarantor by filing with the CSSF and the Luxembourg Stock Exchange a new base prospectus. In addition, the Issuer or such Guarantor will publish a notice in respect of such replacement or substitution in accordance with Condition 14 of the Conditions.

**Post-issuance information**

The Issuer does not intend to provide post-issuance information except if required by any applicable laws and regulations.

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