



## Bank of Scotland Capital Funding L.P.

£250,000,000

8.117% Non-cumulative Perpetual Preferred Securities, Class A  
and

£150,000,000

7.754% Non-cumulative Perpetual Preferred Securities, Class B  
each having the benefit of a subordinated guarantee of

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

(established by an Act of the Parliament of Scotland in 1695)

**Issue price: £1,000 per Class A Preferred Security  
(equal to 100% of its liquidation preference)**

**Issue price: £1,000 per Class B Preferred Security  
(equal to 100% of its liquidation preference)**

The £250,000,000 8.117% Non-cumulative Perpetual Preferred Securities, Class A (the “Class A Preferred Securities”) and the £150,000,000 7.754% Non-cumulative Perpetual Preferred Securities, Class B (the “Class B Preferred Securities” and, together with the Class A Preferred Securities, the “Preferred Securities”) each with a liquidation preference of £1,000 (the “Liquidation Preference”), comprising limited partnership interests in Bank of Scotland Capital Funding L.P. (the “Issuer”), are proposed to be in issue on March 14, 2000 (the “Issue Date”). The Preferred Securities will entitle holders to receive non-cumulative preferential cash distributions (“Distributions”) in arrear on May 31 and November 30 in each year, subject to certain conditions described herein. From (and including) the Issue Date to (but excluding) May 31, 2010 in the case of the Class A Preferred Securities, or May 31, 2021 in the case of the Class B Preferred Securities, Distributions will be at a fixed rate per annum of 8.117% of the Liquidation Preference in the case of the Class A Preferred Securities, or 7.754% of the Liquidation Preference in the case of the Class B Preferred Securities. From (and including) May 31, 2010 in the case of the Class A Preferred Securities, or May 31, 2021 in the case of the Class B Preferred Securities, Distributions will be at a rate calculated as the sum of the Reference Rate and a Margin (each as defined herein). See “*Description of the Preferred Securities — Distributions*”.

Investors should be aware that the Issuer is a Jersey limited partnership and is not a legal entity separate from its partners. All obligations of the Issuer to make payment in respect of the Preferred Securities are guaranteed on a subordinated basis pursuant to a guarantee dated March 14, 2000 (the “Guarantee”) given by the Governor and Company of the Bank of Scotland (“Bank of Scotland” or the “Bank”). See “*Description of the Guarantee*”.

The Preferred Securities are perpetual securities and not subject to any mandatory redemption provisions. The Preferred Securities may be redeemed, at the option of Bank of Scotland Capital Funding (Jersey) Limited, as general partner of the Issuer (the “General Partner”), on May 31, 2010 or on each fifth anniversary thereafter, in the case of the Class A Preferred Securities, or on May 31, 2021 or on each fifth anniversary thereafter in the case of the Class B Preferred Securities, in whole, but not in part, at an amount equal to the Optional Redemption Price, subject to satisfaction of the Redemption Conditions (each as defined herein). The Preferred Securities are also redeemable, subject to satisfaction of certain conditions, in whole but not in part, at any time following the occurrence of a Tax Event or a Regulatory Event (each as defined herein). Under existing requirements, neither the Issuer nor the Bank nor any of its subsidiaries may redeem or purchase any Preferred Securities unless the Financial Services Authority, or any successor organisation thereto, (the “FSA”) in the United Kingdom has given its prior written consent. See “*Description of the Preferred Securities — Redemption and Purchase*”.

In the event of the dissolution or winding-up of the Issuer, holders of Preferred Securities will be entitled, subject to satisfaction of certain conditions, to receive a Liquidating Distribution (as defined herein). See “*Description of the Preferred Securities — Liquidating Distributions*”. Upon the occurrence of a Substitution Event (as defined herein), the Preferred Securities will, subject as provided herein, be substituted by the Substitute Stock (as defined herein). See “*Description of the Preferred Securities — Substitution by Substitute Stock*”.

The Preferred Securities are expected to be assigned on issue a rating of BBB+ by Standard and Poor’s Rating Services, a division of The McGraw Hill Companies, Inc. (“Standard and Poor’s”) and “a1” by Moody’s Investors Service, Inc (“Moody’s”). A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating agency.

Application has been made to list the Class A Preferred Securities and the Class B Preferred Securities on the Luxembourg Stock Exchange.

**See “*Investment Considerations*” for a discussion of certain factors that should be considered by prospective investors.**

The Preferred Securities have not been registered under the Securities Act (as defined herein) or any U.S. State securities laws and, subject to certain exceptions, may not be offered or sold within the United States except to qualified institutional buyers in accordance with Rule 144A under the Securities Act (“Rule 144A”). For a description of restrictions on resales or transfers, see “*Notice to Investors*”.

The Preferred Securities sold in the United States pursuant to Rule 144A will be represented by a single global certificate for each class in registered form (the “Restricted Global Certificates”). The Preferred Securities sold outside the United States pursuant to Regulation S under the Securities Act (“Regulation S”) will be represented by a single global certificate for each class in registered form (the “Regulation S Global Certificates” and, together with the Restricted Global Certificates, the “Global Certificates”). The Global Certificates will be registered in the name of a nominee of, and will be deposited with a common depository for, Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear System (“Euroclear”) and Clearstream Banking, société anonyme (“Clearstream, Luxembourg”) on or around the Issue Date.

**CREDIT SUISSE FIRST BOSTON**

**MORGAN STANLEY DEAN WITTER**

**LEHMAN BROTHERS**

*Each of the General Partner (in relation to itself, the Issuer and the Preferred Securities only) and the Bank confirms, after having made all reasonable enquiries, that this Offering Circular contains all information with regard to the Issuer, the Group (as defined herein) and the Preferred Securities which is material in the context of the issue of the Preferred Securities, that the information contained in this Offering Circular is true and accurate in all material respects and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which makes this Offering Circular as a whole or any such information or the expression of any such opinions or intentions misleading. Each of the General Partner and the Bank accepts responsibility accordingly.*

*No person has been authorised to give any information or to make any representation not contained in this document and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the General Partner, the Bank or the Managers (as defined herein). Neither the delivery of this document nor any subscription, sale or purchase made in connection herewith shall, in any circumstances, create any implication that there has been no change in the affairs of the Issuer, the General Partner, the Bank or the Group since the date hereof.*

*Prospective investors should inform themselves as to the legal requirements and tax consequences within the countries of their residence and domicile for the acquisition, holding or disposal by them of Preferred Securities and any foreign exchange restrictions that might be relevant to them. This Offering Circular does not constitute an offer of or an invitation by or on behalf of the Issuer or any of its partners, the Bank or the Managers to subscribe for or purchase any of the Preferred Securities.*

*Investors should satisfy themselves that they understand all the risks associated with making investments in the Preferred Securities. If a prospective investor is in any doubt whatsoever as to the risks involved in investing in the Preferred Securities, he should consult his professional advisers. This Offering Circular does not constitute investment advice or a recommendation to buy, subscribe for or underwrite any Preferred Securities by the Issuer, the General Partner, the Bank or the Managers.*

**EACH PURCHASER OF THE PREFERRED SECURITIES MUST COMPLY WITH ALL APPLICABLE LAWS AND REGULATIONS IN FORCE IN ANY JURISDICTION IN WHICH IT PURCHASES, OFFERS OR SELLS THE PREFERRED SECURITIES OR POSSESSES OR DISTRIBUTES THIS OFFERING CIRCULAR AND MUST OBTAIN ANY CONSENT, APPROVAL OR PERMISSION REQUIRED BY IT FOR THE PURCHASE, OFFER OR SALE BY IT OF THE PREFERRED SECURITIES UNDER THE LAWS AND REGULATIONS IN FORCE IN ANY JURISDICTION TO WHICH IT IS SUBJECT OR IN WHICH IT MAKES SUCH PURCHASES, OFFERS OR SALES, AND NONE OF THE BANK OR THE MANAGERS SHALL HAVE ANY RESPONSIBILITY THEREFOR.**

*Investors in the Preferred Securities will be deemed to have represented that they do not own, directly or indirectly, 10% or more of the ordinary stock of the Bank. If at any time an investor in the Preferred Securities owns, directly or indirectly, 10% or more of the ordinary stock of the Bank, the Issuer will have the right to suspend payment of Distributions in respect of such investor's Preferred Securities. Investors in the Preferred Securities are required to provide written notice to the General Partner on behalf of the Issuer if at any time any such holder of Preferred Securities owns, directly or indirectly, 10% or more of the ordinary stock of the Bank.*

*The distribution of this document and the offering of the Preferred Securities in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by the Issuer, the Bank and the Managers to inform themselves about, and to observe, any such restrictions. In particular, there are restrictions on the distribution of this Offering Circular, and the offer and sale of the Preferred Securities, in the United States and the United Kingdom. See "Notice to Investors" and "Subscription and Sale."*

*No action has been taken to permit a public offering of the Preferred Securities in any jurisdiction where action would be required for such purpose. Accordingly, the Preferred Securities may not be offered or sold, directly or indirectly and this Offering Circular may not be distributed in any jurisdiction, except in accordance with the legal requirements applicable in that jurisdiction. In particular, the Preferred Securities have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the "Securities Act").*

*Subject to certain exceptions, the Preferred Securities may not be offered, sold or delivered within the United States or to U.S. persons. A further description of certain restrictions on the offering and sale of the Preferred Securities and on the distribution of this document is given under "Subscription and Sale".*

*The Jersey Financial Services Commission (the "Commission") has given and has not withdrawn its consent under Article 4 of the Control of Borrowing (Jersey) Order 1958 to the creation by the Issuer of the Preferred Securities. The Commission is protected by the Borrowing (Control) (Jersey) Law 1947, as amended, against liability arising from the discharge of its functions under that Law.*

INVESTORS SUBJECT TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED ("ERISA"), OR SECTION 4975 OF THE INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE "CODE"), SHOULD CONSULT WITH THEIR ADVISORS AS TO THE APPROPRIATENESS OF THEIR INVESTMENT IN THE PREFERRED SECURITIES UNDER ERISA AND/OR SECTION 4975 OF THE CODE.

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

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ("RSA 421-B") 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 RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE OF NEW HAMPSHIRE 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.

#### **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 the Bank 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.

#### **PRESENTATION OF FINANCIAL INFORMATION**

The Financial Statements are prepared in accordance with generally accepted accounting principles in the United Kingdom ("U.K. GAAP"). U.K. GAAP relevant to the Group differs from generally accepted accounting principles in the United States ("U.S. GAAP") in certain material aspects. For a discussion of material differences between U.K. GAAP and U.S. GAAP relevant to the Financial Statements, see "*Summary of Material Differences Between U.K. GAAP and U.S. GAAP*".

In this Offering Circular, references to "£", "sterling" and "pounds sterling" are to the lawful currency of the United Kingdom; references to "U.S.\$", "\$" and "U.S. dollars" 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 January 1, 1999; references to "A\$" are to the lawful currency of the United States.

are to the lawful currency of Australia; references to “NZ\$” are to the lawful currency of New Zealand; references to “DFL” are to the lawful currency of The Netherlands 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*”.

Unless otherwise indicated, any reference in this Offering Circular to the “Financial Statements” is to the audited Consolidated Financial Statements (including the notes thereto) of the Group included in this Offering Circular. Any reference to the “Interim Consolidated Financial Statements” is to the unaudited interim Consolidated Financial Statements of the Group (including the notes thereto) included in Annex A to this Offering Circular.

For the purposes of the presentation of financial information, the term “Group” refers to Bank of Scotland together with its consolidated subsidiaries (including, among others, Capital Bank plc (“Capital Bank”), Bank of Western Australia Limited (“BankWest”), The British Linen Bank Limited (“British Linen Bank”), Bank of Wales plc (“Bank of Wales”) and Countrywide Banking Corporation Limited (“Countrywide”)); the term “Bank” refers to the Group *excluding* the following Bank of Scotland subsidiaries (and their respective consolidated subsidiaries): Capital Bank, BankWest, British Linen Bank, Bank of Wales and Countrywide. Financial information presented for each of these excluded entities includes information with respect to such entity’s consolidated subsidiaries.

The Group prepares its Consolidated Financial Statements on the basis of a financial year (a “fiscal year”) beginning on March 1 and ending on the last day of February of the following year. For the periods up to February 28, 1994, the accounts of the Bank’s subsidiaries, Capital Bank (formerly NWS BANK plc) and Countrywide were prepared on the basis of a fiscal year beginning on January 1 and ending on December 31 and the accounts of British Linen Bank Group Limited (with effect from March 2, 1998, The British Linen Bank Limited, which became the new holding company of the British Linen Bank group of companies) were prepared on the basis of a fiscal year beginning on February 1 and ending on January 31 of the following year. These subsidiaries (including Countrywide until its disposal in September 1998) now report coterminously with the Bank. As a result, financial information extracted from the Group’s consolidated financial statements for the year ended February 28, 1995 contained accounts for 12, 13 and 14 month periods as the relevant subsidiaries aligned their accounting years with that of the Bank. References to a year in this Offering Circular are, unless otherwise indicated, references to the Group’s fiscal year ended on the last day of February of such year. In this Offering Circular, financial and statistical information is, unless otherwise indicated, stated on the basis of such fiscal year. Financial information with respect to BankWest, in which the Bank currently has a 55.39% interest, is presented in accordance with U.K. GAAP on a fully consolidated basis. The Bank’s ownership interest in BankWest has increased from 51% in 1995, reflecting the Bank’s policy of applying dividends received from BankWest to increase its ownership interest.

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.

#### **ENFORCEMENT OF LIABILITIES; SERVICE OF PROCESS**

The Bank is a U.K. clearing bank established by an Act of the Parliament of Scotland in 1695 with its headquarters in Edinburgh. All of the directors and executive officers of the Bank are non-residents of the United States. All or a substantial portion of the assets of such non-resident persons and of the Bank are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United

States upon such persons or the Bank or to enforce against them in U.S. courts judgments obtained in such courts predicated upon civil liability provisions of the federal securities laws of the United States. The Bank has been advised by its solicitors, Tods Murray W.S., that there is doubt as to the enforceability in the United Kingdom in original actions or in actions for the enforcement of judgments of U.S. courts, of civil liabilities predicated upon the federal securities laws of the United States.

**IN CONNECTION WITH THE OFFERING, MORGAN STANLEY & CO. INTERNATIONAL LIMITED MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILISE OR MAINTAIN THE MARKET PRICE OF THE PREFERRED SECURITIES AT LEVELS WHICH MIGHT NOT OTHERWISE PREVAIL. SUCH STABILISING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. ANY SUCH STABILISING SHALL BE IN COMPLIANCE WITH APPLICABLE LAWS, REGULATIONS AND RULES.**

#### **EXCHANGE RATE AND CURRENCY INFORMATION**

The following table shows the period end, average, high and low noon buying rates, based on the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the "Noon Buying Rate"), for the pound sterling, expressed in U.S.\$ per £1.00, for the periods indicated.

<u>U.S.\$ per £1.00 for the year ended February 28/29,</u>	<u>Period End</u>	<u>Average<sup>(1)</sup></u>	<u>High</u>	<u>Low</u>
1995 .....	1.55	1.58	1.64	1.53
1996 .....	1.71	1.57	1.72	1.49
1997 .....	1.64	1.64	1.70	1.58
1998 .....	1.66	1.66	1.72	1.61
1999 .....	1.60	1.66	1.72	1.60
2000 .....	1.58	1.61	1.68	1.55

(1) The average of the Noon Buying Rates on the last business day of each month during the relevant period.

Fluctuations in exchange rates that have occurred in the past are not necessarily indicative of fluctuations in the rate that may occur at any time in the future. No representations are made herein that the pound sterling amounts referred to herein could have been or could be converted into U.S. dollars at any particular rate.



## NOTICE TO INVESTORS

*Because of the following restrictions, purchasers are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of Preferred Securities.*

Each purchaser of Preferred Securities offered hereby will be deemed to have represented and agreed as set out below. Terms used in this section have meanings as defined in Rule 144A or in Regulation S.

- (1) (a) It is a qualified institutional buyer (a “QIB”) within the meaning of Rule 144A and it is acquiring such Preferred Securities for its own account or for the account of another QIB, and it is aware, and each beneficial owner of such Preferred Securities has been advised, that the sale of such Preferred Securities to it is being made in reliance on Rule 144A or (b) it is acquiring the Preferred Securities in an offshore transaction within the meaning of Regulation S and it is not a U.S. person (and is not acquiring the Preferred Securities for the account or benefit of a U.S. person) within the meaning of Regulation S.
- (2) It understands that the Preferred Securities have not been, and will not be, registered under the Securities Act and may not be offered, resold, pledged or otherwise transferred except (i) to a purchaser that the holder reasonably believes is a QIB within the meaning of Rule 144A purchasing for its own account or for the account of another QIB, in a transaction meeting the requirements of Rule 144A; (ii) in an offshore transaction in accordance with Rule 903 or 904 of Regulation S; or (iii) pursuant to an exemption under the Securities Act provided by Rule 144 thereunder (if available) and, in each case, in accordance with the applicable securities laws of any State of the United States. **No representation can be made as to the availability of the exemption provided by Rule 144 for resales of Preferred Securities.**
- (3) It understands that the Preferred Securities will bear a legend to the following effect, unless the Bank determines otherwise in compliance with applicable law:

“THE PREFERRED SECURITIES EVIDENCED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”) AND MAY NOT AS A MATTER OF U.S. LAW BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A)(1) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ANOTHER QUALIFIED INSTITUTIONAL BUYER, IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A; (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT OR (3) OTHERWISE PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT AND (B) IN ACCORDANCE WITH THE APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND OTHER JURISDICTIONS”.
- (4) (a) The purchaser is not an “employee benefit plan” as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), a plan described in Section 4975(e)(1) of the Internal Revenue Code of 1986, as amended (the “Code”), or an entity whose underlying assets include plan assets by reason of a plan’s investment in the entity, or a governmental plan which is subject to any federal, state or local law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code or (b) the purchaser’s acquisition and ownership of Preferred Securities will not result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code (or, in the case of a governmental plan, a violation of any substantially similar federal, state or local law).

- (5) It acknowledges that the Bank, the Managers and their respective affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Preferred Securities for the account of one or more QIBs, 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.

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## SUMMARY OF THE OFFERING

*The following summary is qualified in its entirety by the more detailed information appearing elsewhere in this Offering Circular. Prospective investors should consider carefully the factors set forth under "Investment Considerations".*

### **Bank of Scotland**

Bank of Scotland and its subsidiaries are a diversified financial services group engaged in banking, insurance broking and financial services and finance-related activities throughout the United Kingdom and internationally. The Bank, which was established by an Act of the Parliament of Scotland in 1695, is headquartered in Edinburgh. It is a U.K. clearing bank and an "authorised institution" under the Banking Act 1987. In addition to clearing services, the Group provides a range of banking services to corporate and personal customers in the United Kingdom and abroad, including commercial loans, property finance, letters of credit, overdraft facilities, credit card services, foreign exchange, treasury services, lease financing and factoring services.

As at August 31, 1999, the Group operated from locations throughout the world, including 320 branch outlets in Scotland and 23 branch outlets in London and other regional commercial centres in England, as well as from overseas branches in New York City, Hong Kong, Paris, Amsterdam and Frankfurt and representative offices in Chicago, Houston, Jacksonville, Los Angeles, Boston, Seattle, Minneapolis and Singapore. As at August 31, 1999, the Group employed approximately 20,000 people on a full-time equivalent basis.

The Group's total assets were £66.5 billion as at August 31, 1999, an increase of 11% over £59.8 billion as at February 28, 1999. As at August 31, 1999, the Group's proprietors' funds were £3,208 million, compared to £2,748 million as at August 31, 1998. For the six month period ended August 31, 1999, the Group's operating profit (before provisions for bad and doubtful debts) was £601 million, an increase of 14% over the corresponding period in 1998. The Group's return after taxes on average proprietors' equity was 21% (annualised) in the six month period ended August 31, 1999, compared to 22.5% (annualised) in the corresponding period in 1998. The Group's return before taxes on average total assets (excluding gains on sales arising from discontinued operations) was 1.5% (annualised) in the six month period ended August 31, 1999, the same as in the corresponding period in 1998. The Group's cost to income ratio (operating expenses to total income) was 48.2% in the six month period ended August 31, 1999, compared to 49.9% in the corresponding period in 1998. Moody's currently rates the Group's long term senior debt securities Aa3 and Standard & Poor's currently rates the Group's long term senior debt securities A+.

The Group's business has historically been organised and as a result reported along the lines of its principal operating subsidiaries. In the United Kingdom, the Group operates through the Bank (which includes for operational and reporting purposes Bank of Scotland Treasury Services Plc ("Treasury Services")) and operates through its principal wholly-owned U.K. subsidiaries: Capital Bank, British Linen Bank and Bank of Wales. In Australia, the Bank operates through BankWest, in which it has a 55.39% interest.

In January 1999, the Bank announced the creation of a new organisational structure for managing the businesses of the Bank and its direct and indirect U.K. subsidiaries. Since then, the various profit centres that were previously within divisions of the Bank have been realigned into and report through new structures, Personal Banking, Business Banking and Corporate Banking and Structured Banking, which are supported by the Services Division and the Group Office. During the course of 1999, the operations of the Bank's direct and indirect U.K. subsidiaries, including Capital Bank, British Linen Bank and Bank of Wales, have largely been realigned to report for management purposes through this new structure. Financial information was reported by corporate entity until the end of the fiscal year ended February 29, 2000. The operations of BankWest are not affected by the new structure.

The Bank's Ordinary Stock and its Non-Cumulative Irredeemable Preference Stocks are listed on the London Stock Exchange. The Head Office of the Bank is located at The Mound, Edinburgh EH1 1YZ, Scotland (telephone (0131) 442-7777).

On February 14, 2000, an offer by the Bank for all outstanding ordinary shares of National Westminster Bank Plc (“NatWest Shares”) lapsed. On that same date a competing offer for NatWest Shares by The Royal Bank of Scotland Group plc became unconditional as to acceptances. The result of the NatWest bid is not expected to affect the Bank’s established strategy, which includes the provision of competitive and innovative banking products in its core retail and corporate markets through low cost delivery systems.

### Summary of the Financing

Bank of Scotland Capital Funding L.P. is the issuer of the Preferred Securities, which are guaranteed on a subordinated basis by the Bank.

The Preferred Securities sold in the United States pursuant to Rule 144A will be represented by a Restricted Global Certificate for each class. The Preferred Securities sold outside the United States pursuant to Regulation S will be represented by a Regulation S Global Certificate for each class. The Global Certificates will be registered in the name of a nominee of, and will be deposited with a common depositary for, Euroclear and Clearstream, Luxembourg on or around the Issue Date. The global certificates will be exchangeable in certain limited circumstances described therein in whole, but not in part, for Preferred Securities in definitive form.

Payments in respect of the Preferred Securities will be made without deduction for or on account of withholding requirements with respect to income taxes, subject to certain limited exceptions. For a more detailed discussion of U.S. and U.K. tax considerations, see “*Taxation*”.

### Summary of Terms of the Preferred Securities and the Guarantee

*This summary does not purport to be complete and is qualified in its entirety by reference to the detailed information appearing in “Description of the Preferred Securities” and “Description of the Guarantee”.*

<b>Issuer</b> .....	Bank of Scotland Capital Funding L.P., a subsidiary undertaking of the Bank established for an unlimited duration as a limited partnership in Jersey and registered under the Limited Partnerships (Jersey) Law, 1994. See “ <i>Bank of Scotland Capital Funding L.P.</i> ”.
<b>General Partner</b> .....	Bank of Scotland Capital Funding (Jersey) Limited, a wholly owned subsidiary of, and fully controlled by, the Bank, incorporated in Jersey with limited liability and resident in Jersey for U.K. tax purposes, is the sole general partner in the Issuer and, as such, solely manages the Issuer.
<b>Guarantor</b> .....	The Governor and Company of the Bank of Scotland, established by an Act of the Parliament of Scotland in 1695.
<b>Issue</b> .....	£250,000,000 8.117% Non-cumulative Perpetual Preferred Securities, Class A and £150,000,000 7.754% Non-cumulative Perpetual Preferred Securities, Class B, each with a liquidation preference of £1,000, comprising limited partnership interests in the Issuer.  The total Liquidation Preference will be included as Tier 1 capital in the Bank’s solo-consolidated accounts prepared in accordance with the capital adequacy requirements of the FSA.
<b>Use of Proceeds</b> .....	The proceeds of the issue of the Preferred Securities will be used by the Issuer, after paying any expenses of the issue, to subscribe for subordinated cumulative perpetual notes in bearer form (the “Subordinated Notes”) issued by the Bank. See “ <i>Use of Proceeds</i> ”.

**Subordinated Notes** ..... The Subordinated Notes will be issued in two Series under Bank of Scotland's programme for the issuance of debt instruments. Each Series will contain terms and conditions which correspond in all material respects to the provisions of the corresponding class of Preferred Securities in respect of which it is issued save that interest payable in respect of the Subordinated Notes will be paid on a cumulative basis. In particular, each Series of the Subordinated Notes will have an aggregate principal amount which equals the aggregate Liquidation Preference of the corresponding class of Preferred Securities, will bear interest at a rate which is the same as the Distribution Rate (as defined herein) in respect of the corresponding class of Preferred Securities and will contain rights as to redemption which are substantially the same as those of the corresponding class of Preferred Securities.

Interests in the Subordinated Notes will not be delivered or otherwise made available in bearer form or in any other form to holders of the Preferred Securities, and the rights of such holders shall be represented solely by Preferred Securities in registered form.

**Ranking of the Preferred**

**Securities** ..... Claims under the Preferred Securities in respect of any Liquidating Distribution will rank (i) senior to the rights of the General Partner (as defined herein), (ii) *pari passu* with the equivalent claims under all outstanding Parity Obligations (as defined herein) of the Issuer and (iii) junior to the rights of all other creditors of the Issuer and holders of obligations of the Issuer which are not Parity Obligations nor subordinated to the Preferred Securities.

**Guarantee** ..... Bank of Scotland will irrevocably guarantee on a subordinated basis to the Holders (as defined herein) payments of (i) all Distributions as due on the Preferred Securities, (ii) any Liquidating Distribution to which they are entitled, (iii) the Optional Redemption Price, the Tax Redemption Price and the Regulatory Redemption Price (each as defined herein) and (iv) any Additional Amounts (as defined herein) (together, the "Guaranteed Payments").

The Guarantee is intended to provide Holders, on a dissolution or winding up of the Issuer or on a default by the Issuer in discharging its obligations in respect of the Preferred Securities, with rights against Bank of Scotland in respect of Guaranteed Payments which are as nearly as possible equivalent to those which they would have had if the Preferred Securities had been directly issued preference stock of the Bank (whether or not the Bank could in fact have issued such securities). Accordingly, the Guarantee will not enable Holders to cause redemption of the Preferred Securities or enforce creditor rights against the Bank.

Unless with the prior consent of the Holders, the Bank has agreed that it will neither (1) issue any preference stock which would rank (as regards dividends and/or distributions on a return of assets) senior to the Guarantee (other than any bonus stock that may require to be issued pursuant to the terms of the Existing Preference Stock) nor (2) give any guarantee or enter into any support agreement in respect of any preference shares or other preferred securities (not constituting debt obligations) having in all material respects the same ranking as preference shares, issued by any subsidiary or subsidiary undertaking of the Bank, which guarantee or

support agreement would rank (as regards dividends and/or distributions on a return of assets) senior to the Guarantee unless, in either case, the Guarantee is amended so as to rank *pari passu* in all material respects with such stock, guarantee or other support, as the case may be. See “*Description of the Guarantee*”.

**Ranking of the Guarantee . . . . .** Claims under the Guarantee will rank (i) senior to the rights of the holders of ordinary stock of the Bank and of any other securities or obligations of the Bank which are subordinated to the Guarantee (ii) *pari passu* with the equivalent claims under all outstanding and future Parity Obligations of the Bank and (iii) junior to the claims of depositors, the holders of the Existing Preference Stock and all other creditors (including holders of subordinated debt) of the Bank.

**Maturity and Redemption . . . . .** The Preferred Securities are perpetual securities and not subject to any mandatory redemption provisions and may only be redeemed, at the option of the General Partner only, in the circumstances described below.

**Optional Redemption . . . . .** The Class A Preferred Securities are redeemable, in whole but not in part, at the option of the General Partner, subject to satisfaction of the Redemption Conditions, on May 31, 2010 or on each fifth anniversary thereafter at the Optional Redemption Price (which, for these purposes, means an amount equal to the Liquidation Preference of £1,000).

The Class B Preferred Securities are redeemable, in whole but not in part, at the option of the General Partner, subject to satisfaction of the Redemption Conditions, on May 31, 2021 or on each fifth anniversary thereafter at the Optional Redemption Price.

Subject to the foregoing, the Class A Preferred Securities may be redeemed without redeeming the Class B Preferred Securities, and *vice versa*.

As used herein, “Redemption Conditions” means (i) that the consent of the FSA to the redemption, if then required, has been obtained and (ii) that the Bank either has (a) Adjusted Distributable Reserves (as defined herein) or (b) proceeds available from an issue of Replacement Capital (as defined herein) that has been made for the purpose of funding the redemption, in either of cases (ii)(a) or (b) in an amount at least equal to the aggregate Optional Redemption Price, Tax Redemption Price (as defined herein) or Regulatory Redemption Price (as defined herein), as the case may be.

See “*Description of the Preferred Securities — Redemption and Purchase*”.

**Tax Redemption . . . . .** The Preferred Securities are redeemable, in whole but not in part, at the option of the General Partner, subject to satisfaction of the Redemption Conditions, if at any time a Tax Event has occurred and is continuing, by payment of the Tax Redemption Price together with any accrued but unpaid Distribution in respect of the Distribution Period (as defined herein) in which the redemption date falls.

For these purposes:

“Tax Event” means that, as a result of a change in any law or regulation of the United Kingdom or Jersey, or in any treaty to which the United Kingdom or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in the United Kingdom or Jersey (i) the Issuer or the General Partner would be subject to

more than a *de minimis* amount of tax (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) profits arising to it as a result of payments received by it from the Issuer or (b) activities (if any) carried on by it other than those permitted or contemplated in the Partnership Agreement) in Jersey or the United Kingdom, (ii) payments to Holders would be subject to deduction or to withholding tax or would give rise to any obligation to account for any tax in Jersey or the United Kingdom, (iii) payments by the Bank in respect of the Subordinated Notes would be subject to deduction or to withholding tax in the United Kingdom or (iv) the Bank would not obtain relief for the purposes of United Kingdom corporation tax for any payment of interest in respect of the Subordinated Notes; and

“Tax Redemption Price” means, in the case of a Tax Event described in clauses (ii) or (iii) above, an amount equal to the Liquidation Preference and, in the case of a Tax Event described in clauses (i) or (iv) above, the higher of an amount equal to the Liquidation Preference and the Make Whole Amount (as defined herein).

Before a tax redemption may take place, the General Partner shall be required to obtain an opinion of counsel to the Bank experienced in such matters to the effect that a Tax Event has occurred and specifying which of clauses (i) to (iv) above is applicable.

See “*Description of the Preferred Securities — Redemption and Purchase*”.

**Regulatory Redemption . . . . .**

The Preferred Securities are redeemable, in whole but not in part, at the option of the General Partner, subject to satisfaction of the Redemption Conditions, if at any time a Regulatory Event has occurred and is continuing, by payment of the Regulatory Redemption Price together with any accrued but unpaid Distribution in respect of the Distribution Period in which the redemption date falls.

For these purposes:

“Regulatory Event” means a change in any applicable law or regulation, or in the official interpretation or application thereof, which results in more than an insubstantial risk that for the purposes of the FSA’s capital adequacy requirements applicable to banks in the United Kingdom at that time an amount equal to the total Liquidation Preference of the Preferred Securities will not be included in the Tier 1 capital of the Bank on a solo-consolidated basis; and

“Regulatory Redemption Price” means the higher of an amount equal to the Liquidation Preference and the Make Whole Amount.

Before a regulatory redemption may take place, the General Partner shall be required to obtain an opinion of counsel to the Bank experienced in such matters to the effect that a Regulatory Event has occurred.

See “*Description of the Preferred Securities — Redemption and Purchase*”.

**Distributions . . . . .**

Subject to the Limited Partnerships (Jersey) Law, 1994, Holders will be entitled to receive, subject to certain conditions described below, non-cumulative preferential cash distributions payable in arrear on May 31 and November 30 in each year (each a “Distribution Date”).

If payable, such Distributions will be paid (i) from and including the Issue Date to but excluding May 31, 2010 in the case of the Class A Preferred Securities, or May 31, 2021 in the case of the Class B Preferred Securities, at a fixed rate per annum of 8.117% of the Liquidation Preference in the case of the Class A Preferred Securities, or 7.754% of the Liquidation Preference in the case of the Class B Preferred Securities; and (ii) from and including May 31, 2010 in the case of the Class A Preferred Securities, or May 31, 2021 in the case of the Class B Preferred Securities, at a distribution rate determined as the sum of the Reference Rate (calculated as described herein) for the relevant Distribution Period and the relevant Margin (as defined herein).

If payable, Distributions will be payable in sterling.

**Limitations on Payment** . . . . .

The Partnership Agreement provides that, whether or not the Issuer has funds available for the purpose, a Distribution will not be payable on the Preferred Securities in respect of any Distribution Period to the extent that (i) on the relevant Distribution Date the Bank is prevented by applicable U.K. banking regulations or other requirements from making payment in full (a) of dividends or other distributions on its Parity Obligations or (b) under the Guarantee; or (ii) the amount of such Distribution (if paid in full), together with the sum of any dividends and other distributions on the Bank's Parity Obligations due and payable on that Distribution Date would exceed the Adjusted Distributable Reserves (for this purpose, reduced by the aggregate amount of the dividend to be paid on the Existing Preference Stock on such Distribution Date) of the Bank. To the extent that a Distribution is not paid by reason of the limitations described above, no Guaranteed Payment will be paid, or may be claimed. In the event that any amounts paid in respect of the Subordinated Notes exceed the amount (if any) then due and payable by way of Distribution under the Preferred Securities, the amount of such excess will be paid to the holder of the Preferential Right (as defined herein) and Holders will have no rights in respect thereof.

The Bank has undertaken that, if any Distribution is not payable in full by the Issuer by reason of the above limitations, the Bank will not (a) declare or pay any dividends or other distributions in respect of its ordinary stock or (if permitted) effect any repurchase of its ordinary stock or any other securities of the Bank ranking junior to the Guarantee (or contribute any moneys to a sinking fund for the redemption of any such stock or securities) until after the second consecutive following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distributions to be paid in respect of the next two Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders) or (b) (if permitted) repurchase or redeem any Parity Obligations which are securities until after the second consecutive following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distributions to be paid in respect of the next two Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).

None of the Bank, any of its subsidiaries or the Issuer shall make or procure or permit to be made any payments in respect of the Preferred Securities or under the Guarantee except for payments to which the



Holders are expressly entitled under the terms of the Preferred Securities or the Guarantee. See “*Description of the Preferred Securities — Distributions*” and “*Description of the Guarantee — Undertakings*”.

**Substitution** . . . . . If either (i) the Bank’s solo-consolidated total capital ratio and/or its consolidated total capital ratio, in each case calculated in accordance with applicable U.K. bank capital adequacy regulations, has fallen below the then applicable minimum ratio required by such regulations (currently 8%) or (ii) the Bank’s board of directors in its sole discretion has notified the FSA and the Issuer that it has determined, in view of the Bank’s deteriorating financial condition, that (i) above is expected to occur in the near term (each, a “Substitution Event”) and provided that proceedings have not been commenced for the sequestration or winding up of the Bank, the Preferred Securities will, as soon as reasonably practicable thereafter, be substituted by the Substitute Stock.

**Substitute Stock** . . . . . The Substitute Stock will be fully-paid non-cumulative sterling perpetual preference stock issued directly by the Bank having in all material respects equivalent terms (including those terms relating to non-cumulative distributions, status and rights on a sequestration or winding up of the Bank) to those of the Preferred Securities and the Guarantee taken together. The Substitute Stock will be redeemable or effectively redeemable and therefore will contain provisions similar to those described under “*Optional Redemption*”, “*Tax Redemption*”, “*Regulatory Redemption*” and “*Distributions*” above.

**Rights upon Liquidation** . . . . . In the event of the dissolution of the Issuer, each holder of a Preferred Security will be entitled to receive out of the assets of the Issuer available for distribution the Liquidating Distribution. The Liquidating Distribution will be made (i) before any distribution of assets is made to the General Partner or the holder of the Preferential Right and (ii) *pari passu* with the equivalent claims under all outstanding Parity Obligations of the Issuer but (iii) after the claims of all other creditors of the Issuer and holders of obligations of the Issuer which are not Parity Obligations nor subordinated to the Preferred Securities.

Notwithstanding the availability of sufficient assets of the Issuer to pay the Liquidating Distribution, if, at the time the Liquidating Distribution is to be paid, proceedings have been commenced for the sequestration or winding up of the Bank then the Liquidating Distribution paid to the Holders shall not exceed the amount per security that would have been paid as a liquidation distribution from the assets of the Bank had the Preferred Securities been directly issued preference stock of the Bank with equivalent rights of participation in the capital of the Bank (whether or not the Bank could in fact have issued such securities) and ranked (i) junior to depositors, the holders of the Existing Preference Stock and all other creditors (including the holders of subordinated debt) of the Bank, (ii) *pari passu* with all Parity Obligations of the Bank and (iii) senior to the holders of the Bank’s ordinary stock and any other securities or obligations of the Bank which are subordinated to the Guarantee.

After any Liquidating Distribution, the holder of the Preferential Right will be entitled to any remaining assets of the Issuer available for distribution. After payment of the amount of the Liquidating Distribution to which they

are entitled, the Holders will have no right or claim to any of the remaining assets of the Issuer or the Bank.

The Partnership Agreement provides that, in the event that proceedings are commenced for the sequestration or winding up of the Bank, proceedings will also be commenced for the dissolution of the Issuer and the Liquidating Distribution to which Holders shall be entitled will be calculated as described above. However, the Partnership Agreement generally prohibits the General Partner from taking any action that would or might cause the dissolution of the Issuer in any other circumstances. See “*Description of the Preferred Securities — Liquidating Distributions*”.

**Withholding Tax and  
Gross Up** .....

Except in certain limited cases and subject to the limitations on payments in excess of Adjusted Distributable Reserves and if permitted by the FSA, the Issuer, and the Bank pursuant to the Guarantee, will pay such additional amounts as may be necessary in order that the net amounts received by each holder in respect of Distributions or other payments under the Preferred Securities or the Guarantee, as the case may be, after withholding for any taxes imposed by Jersey or the United Kingdom, as the case may be, on payments made by or on behalf of the Issuer or the Bank (in the case of payments under the Guarantee) will equal the amount which would have been received in the absence of any such withholding taxes.

**Voting Rights** .....

Except as stated in the following paragraph, Holders will not be entitled to receive notice of, or attend or vote at, any meeting of partners of the Issuer or participate in the management of the Issuer.

If Distributions have not been paid in full (and/or the Bank has not made payments due under the Guarantee in respect of such Distributions) for any two consecutive Distribution Periods, the Holders will be entitled by written notice to the Issuer given by the holders of a majority in Liquidation Preference or by resolution passed at an appropriately constituted meeting to appoint a special representative to enforce their statutory rights, including provision of information on the affairs of the Issuer. Such special representative must vacate its office if, after its appointment, Distributions are made by the Issuer or by the Bank under the Guarantee for two consecutive Distribution Periods or an amount equivalent to the Distributions to be paid in respect of two consecutive Distribution Periods has been set aside in a separately designated trust account for payment to the Holders.

**Variation of Rights** .....

Any variation of the rights of the Holders will only take effect if approved in writing by at least a simple majority of the Holders or approved by a simple majority of Holders present or represented at a meeting at which the quorum is at least one-third by Liquidation Preference of such Holders. See “*Description of the Preferred Securities — Voting Rights*”.

**Form of the Securities** .....

The Preferred Securities will be issued in registered form. The Preferred Securities sold in the United States pursuant to Rule 144A will, on issue, be represented by a Restricted Global Certificate for each class. The Preferred Securities sold outside the United States pursuant to Regulation S will, on issue, be represented by a Regulation S Global Certificate for each class. The Global Certificates will be registered in the name of a nominee of, and deposited with a common depository for, Euroclear and Clearstream, Luxembourg. For so long as the Preferred Securities are

deposited and registered as described above, book-entry interests in the Preferred Securities will be shown on, and transfers thereof will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg. Preferred Securities will be issued in definitive certificated form only in limited circumstances. See “*Description of the Preferred Securities — Transfers and Form*”.

**Governing Law** ..... The Guarantee will be governed by, and construed in accordance with, English law. The Partnership Agreement and the Preferred Securities will be governed by, and construed in accordance with, Jersey law.

**Listing** ..... Application has been made to list each class of the Preferred Securities on the Luxembourg Stock Exchange.

**Ratings** ..... The Preferred Securities are expected to be assigned on issue a rating of BBB+ by Standard and Poor’s and “a1” by Moody’s.

## **USE OF PROCEEDS**

The net proceeds of the offering of the Preferred Securities, which are expected to amount to approximately £396 million, will be used by the Issuer to subscribe for the Subordinated Notes and will be used by the Bank to augment the Bank's Tier 1 capital base. The Managers will receive fees and commissions as set out under "*Subscription and Sale*".

## INVESTMENT CONSIDERATIONS

*Prospective investors should consider carefully the following information in conjunction with the other information contained in this Offering Circular before purchasing any Preferred Securities.*

### **Risks associated with the Bank's Financial Condition — An investment in the Preferred Securities has the same economic risks as an investment in non-cumulative perpetual preference stock issued by the Bank**

An investment in the Preferred Securities has substantially the same economic risks as an investment in non-cumulative perpetual preference stock issued directly by the Bank (were the Bank able to directly issue such securities) having the same liquidation preference and rate of distribution as the Preferred Securities. In addition, in certain circumstances the Preferred Securities may be substituted by directly issued preference stock of the Bank. It is expected that the Issuer's sole source of funds to pay Distributions will be payments that it receives from the Bank under the Subordinated Notes issued by the Bank and subscribed by the Issuer using the proceeds of the issue of the Preferred Securities. Holders will not have creditor rights against the Bank in respect of the Subordinated Notes. The Preferred Securities are guaranteed on a subordinated basis by the Bank pursuant to the terms of the Guarantee. Accordingly, if the Bank's financial condition were to deteriorate, the Issuer and the Holders might suffer direct and materially adverse consequences, including non-payment of Distributions or of payments under the Guarantee.

### **Distributions not Cumulative — In certain circumstances Distributions may not be paid on the Preferred Securities**

Distributions on the Preferred Securities are not cumulative. As set out in "*Description of the Preferred Securities — Distributions*", Distributions will be paid on each Distribution Date out of interest received by the Issuer under the Subordinated Notes and from other resources legally available, if any. Distributions may not be paid in full by the Issuer, or at all, if the Bank does not have sufficient distributable profits (calculated in the manner described herein) or if the Bank is limited in making payments on other obligations, including the Guarantee. If Distributions for any Distribution Period are not paid by reason of the above limitations, Holders will not be entitled to receive such Distributions (or any Guaranteed Payment in respect of such Distributions) whether or not funds are or subsequently become available.

### **Perpetual Nature of the Preferred Securities — Holders have no right to require redemption of their Preferred Securities**

The Preferred Securities have no fixed final redemption date and Holders have no rights to call for the redemption of the Preferred Securities. Although the Issuer may redeem the Preferred Securities in certain circumstances (including at its option after 10 years in the case of the Class A Preferred Securities, or 21 years in the case of the Class B Preferred Securities, or following the occurrence of a Tax Event or a Regulatory Event), there are limitations on its ability to do so, including satisfaction of the Redemption Conditions (as described herein) relating to FSA consent and the availability of sufficient funds to effect redemption.

### **Mandatory Substitution — No certainty that Substitute Stock will be authorised or listed; Potential tax issues**

In certain circumstances the Preferred Securities may be substituted by directly issued preference stock of the Bank.

Although the Bank has undertaken in the Guarantee to take all reasonable steps to create and authorise, and procure a listing for, the Substitute Stock, there can be no assurance that, in the event that a Substitution Event occurs, proprietors of the Bank will approve, or that a recognised stock exchange will agree to list, the Substitute Stock. In addition, the tax treatment for holders of Substitute Stock may be different from that for holders of Preferred Securities.

## **BANK OF SCOTLAND CAPITAL FUNDING L.P.**

### **Introduction**

Bank of Scotland Capital Funding L.P. was registered in Jersey on March 10, 2000 under the Limited Partnerships (Jersey) Law, 1994 for an unlimited duration, with Bank of Scotland Capital Funding (Jersey) Limited as the general partner (the “General Partner”), Paribas Luxembourg, as Common Depositary as the initial limited partner and Uberior Investments plc, a wholly owned subsidiary of the Bank, as a limited partner holding only the Preferential Rights. Bank of Scotland Capital Funding (Jersey) Limited, Paribas Luxembourg, as Common Depositary, the Bank and Uberior Investments plc have entered into a partnership agreement dated March 10, 2000 (the “Partnership Agreement”) for the purpose of establishing the Issuer. The Issuer is not a legal entity separate from its partners. The Partnership Agreement does not create a trust relationship between any of the partners. The Bank is not a partner in the Issuer.

### **Management of the Issuer**

The General Partner, a wholly owned subsidiary of, and fully controlled by, the Bank, is the sole general partner in the Issuer and, as such, solely manages the Issuer.

Provided that limited partners do not become involved with the management of the Issuer other than in the circumstances provided for in the Partnership Agreement (see “*Description of the Preferred Securities — Voting Rights*”), the liability of the limited partners for the debts or obligations of the Issuer will be limited to the amount which they have contributed or agreed to contribute to the partnership.

### **Sole Activity**

The Issuer was established for the sole purpose of raising finance for the Group. It has carried out no operations since its registration other than in relation to the creation of the Preferred Securities. The capital contributions to be made by the limited partners will be used by the Issuer to subscribe for the Subordinated Notes.

### **Management**

The Issuer will be operated by the General Partner. The registered office of the Issuer and of the General Partner is 22 Grenville Street, St Helier, Jersey JE4 8PX. No holder of a Preferred Security may participate in the management of the Issuer. The Bank has undertaken in the Guarantee to ensure that the General Partner will at all times be a directly or indirectly wholly owned subsidiary of the Bank.

The General Partner has agreed to contribute capital from time to time to the extent required for the Issuer to meet any operating expenses which it may have. The General Partner has also agreed that it will at all times maintain sole ownership of its general partner interest in the Issuer. The Partnership Agreement provides that all of the Issuer’s business and affairs will be conducted by the General Partner and the General Partner will have unlimited liability for the debts and obligations of the Issuer to the extent that these cannot be satisfied out of partnership assets.

If the Issuer is dissolved or wound up, the Partnership Agreement provides that the General Partner will only be entitled to any assets of the Issuer remaining after (i) all debts and other liabilities of the Issuer have been satisfied in full and (ii) the full Liquidation Preference to which the Holders are entitled has been paid to or irrevocably set aside for the Holders.

### **Capital Contributions**

Save for the initial capital contribution and such other capital contributions as may be made by the General Partner from time to time to meet certain operating expenses of the partnership, the initial capital contribution by Uberior Investments plc and the capital contribution of £400,000,000 to be made by the limited partners in relation to the Preferred Securities, there is intended to be no other capital contribution to the Issuer.



**Indebtedness**

Since the date of its registration, the Issuer has not had any loan capital outstanding, has not incurred any borrowings, has had no contingent liabilities, has not granted any guarantees and does not intend to have outstanding any such loan capital, incur any such borrowings, have any such contingent liabilities or grant any such guarantees. The General Partner has undertaken not to incur any indebtedness in the name of the Issuer other than costs and expenses incidental to creating the Preferred Securities and the Issuer, performing its obligations in respect of the Partnership Agreement, maintaining the listing of the Preferred Securities, the Register, the Registrar and Paying and Transfer Agents in respect of the Preferred Securities, its holding of the Subordinated Notes or any securities substituted therefor and the maintenance of a custodian thereof, the exercise of the Issuer's rights in respect of the Subordinated Notes or any securities substituted therefor and the administration of the Issuer.

## CAPITALISATION OF BANK OF SCOTLAND

The following table sets out unaudited consolidated information regarding the capitalisation of the Group, which has been extracted from the Group's Annual Report and Accounts 1999 updated to the date set forth below, where applicable, by the Group's Interim Report and Accounts 1999 and as adjusted to reflect the issue of the Preferred Securities. Except as disclosed below, there has been no material change in the consolidated capitalisation of the Group since August 31, 1999.

	<b>As at August 31, 1999</b>	
	<b>Bank of Scotland<sup>(1)</sup></b>	<b>As adjusted after giving effect to the issue of the Preferred Securities</b>
	( <b>£ millions</b> )	
<i>Proprietors' Funds</i>		
Preference stocks (of £1 each, fully paid) . . . . .	400	400
Ordinary stock (units of 25p each, fully paid) . . . . .	311	311
Reserves . . . . .	2,497	2,497
Minority interests . . . . .	150	546
<i>Subordinated liabilities</i>		
Undated . . . . .	1,090	1,090
Dated . . . . .	1,184	1,184
Total capitalisation . . . . .	5,632	5,928

(1) For a description of the subordinated undated and dated loan capital of the Bank and its subsidiaries, see "Capitalisation and Indebtedness".

## DIVIDEND POLICY

Under the Regulations for the Management and Administration of the Bank, as amended (the “Regulations”), interim and final dividends on Ordinary Stock may only be paid out of profits arising from the business or operations of the Bank or arising from the property or reserve funds of the Bank. See “*Description of Capital Stock*” for further summary of the terms of the Regulations.

Provided that the first instalment of dividend due on the Existing Preference Stock (as defined under “Description of the Preferred Securities”) payable in respect of a financial year has been or is to be paid in full, and provided the board of Bank of Scotland (the “Board”) is satisfied that the financial position of the Bank justifies the payment of an interim dividend on the Ordinary Stock, the Board may make payment of an interim dividend. Provided that the instalments of dividend on the Existing Preference Stock payable in respect of a financial year have been or are to be paid in full, the Bank may in general meeting declare a dividend to be paid to the proprietors of Ordinary Stock in respect of that financial year. No larger dividend may be declared than that recommended by the Board. Such dividend is payable at such times and subject to such conditions as the general meeting may determine. All dividends shall belong and be paid (subject to the Bank’s lien and the provisions of the Regulations) to those proprietors on the stock ledger at such date as the Board or the Bank in general meeting may specify for the purpose notwithstanding any subsequent transfer or transmission of stock.

Before recommending or paying any dividend, the Board may make such provision as it deems desirable for depreciation of the property and assets of the Bank. Before recommending or paying any dividend on Ordinary Stock, the Board may set aside out of the profits of the Bank such sum as it deems proper as a reserve fund for the purpose of strengthening the financial position of the Bank or to meet contingencies; or for special dividends or bonuses or equalising dividends; or for redeeming debentures, debenture stock, mortgage debentures or other securities; or for repairing, replacing, improving and maintaining any of the property of the Bank or in respect of the depreciation of the property of the Bank; or for providing for losses; or for repaying any loan or loans obtained by the Bank; or for discharging any other liabilities; or as an insurance fund or a fund for the benefit of the persons who are or have been in the employment of the Bank or the families or dependants of such persons; or for such purposes as the Board in its absolute discretion believes to be in the interests of the Bank.

Details of the dividend rights attaching to the Existing Preference Stock are set out under “*Description of Capital Stock*”.

## SELECTED CONSOLIDATED FINANCIAL INFORMATION

The financial information set forth on the following pages as at the end of and for each of the five years ended February 28, 1999 has been extracted from the audited Consolidated Financial Statements and notes thereto of the Group for those years. The consolidated Financial Statements for the years ended February 28, 1998 and 1999 have been audited by Ernst & Young, independent auditors (the “Audited Consolidated Financial Statements”). The financial information set forth on the following pages as at the end of and for each of the six month periods ended August 31, 1998 and 1999 has been extracted from the unaudited interim Consolidated Financial Statements and notes thereto for the corresponding periods (the “Interim Consolidated Financial Statements”, and together with the Audited Consolidated Financial Statements, the “Consolidated Financial Statements”). The financial information contained in this Offering Circular should be read in conjunction with, and is qualified by reference to, the Consolidated Financial Statements included in Annex A to this Offering Circular.

With effect for the first time from the year ended February 28, 1995, the Bank’s principal subsidiaries began to report coterminously with a fiscal year-end of February 28/29. As a result, the Consolidated Financial Statements for the year ended February 28, 1995 contain accounts for 12, 13 and 14 month periods as the relevant subsidiaries aligned their accounting years with that of the Bank. For the purposes of the presentation of financial information, the term the “Group” refers to Bank of Scotland together with its consolidated subsidiaries; the term the “Bank” refers to the Group *excluding* the following Bank of Scotland subsidiaries (and their respective consolidated subsidiaries), Capital Bank, BankWest, British Linen Bank, Bank of Wales and Countrywide. Financial information presented for each of these excluded entities includes information with respect to such entity’s consolidated subsidiaries. Financial information with respect to BankWest, in which the Bank currently has a 55.39% interest, is presented in accordance with U.K. GAAP on a fully consolidated basis. The Bank’s ownership interest in BankWest has increased from 51% in 1995, reflecting the Bank’s policy of applying dividends received from BankWest to increase its ownership interest. See “*Presentation of Financial Information.*”

The Group’s Consolidated Financial Statements are prepared in accordance with U.K. GAAP, which differ in certain significant respects from U.S. GAAP. See “*Summary of Material Differences between U.K. GAAP and U.S. GAAP*” for an explanation of the relevant principal differences between U.K. GAAP and U.S. GAAP.

## SUMMARY CONSOLIDATED PROFIT AND LOSS ACCOUNT

	Year ended February 28/29,						Six months ended August 31,	
	1995	1996	1997	1998	1999	1999 <sup>(1)</sup>	1998	1999
	(in millions, except per stock unit amounts)							
Net interest income	£ 899.8	£ 997.7	£ 1,218.0	£ 1,328.4	£ 1,529.4	\$ 2,445.8	£ 746.4	£ 829
Non-interest income	394.4	430.9	544.2	568.7	623.1	996.5	307.5	332
Total income	1,294.2	1,428.6	1,762.2	1,897.1	2,152.5	3,442.3	1,053.9	1,161
Operating expenses	(644.2)	(768.8)	(925.2)	(980.4)	(1,055.9)	(1,688.6)	(526.1)	(560)
Property revaluation deficit			(11.5)					
Total operating profit before bad debt provisions	650.0	659.8	825.5	916.7	1,096.6	1,753.7	527.8	601
Provisions for bad and doubtful debts	(221.5)	(177.1)	(175.3)	(218.8)	(267.9)	(428.4)	(115.6)	(151)
Gains on sale arising from discontinued operations	—	46.6	—	26.4	162.4	259.7	—	—
Share of profits of associated undertakings and joint ventures	21.2	15.7	13.9	17.7	20.8	33.2	7.9	21
Profit before taxation	£ 449.7	£ 545.0	£ 664.1	£ 742.0	£ 1,011.9	\$ 1,618.2	£ 420.1	£ 471
Taxation	(167.4)	(210.0)	(236.2)	(210.5)	(431.3)	(689.7)	(139.5)	(154)
Attributable to minority interests	(2.6)	(3.3)	(23.3)	(20.8)	(23.8)	(38.1)	(10.0)	(16)
Profit attributable to proprietors	£ 279.7	£ 331.7	£ 404.6	£ 510.7	£ 556.8	\$ 890.4	£ 270.6	£ 301
Dividends								
Preference	(19.0)	(27.7)	(28.2)	(39.7)	(37.5)	(60.0)	(18.7)	(19)
Ordinary	(68.1)	(81.0)	(98.3)	(120.2)	(143.7)	(229.8)	(49.5)	(57)
Retained profit	£ 192.6	£ 223.0	£ 278.1	£ 350.8	£ 375.6	\$ 600.6	£ 202.4	£ 225
Pence per ordinary stock unit								
Earnings	22.3p	25.8p	31.6p	38.9p	42.1p	67.3c	20.5p	22.7p
Dividends	5.82p	6.85p	8.22p	9.86p	11.6p	18.6c	4.0p	4.6p

(1) Converted into U.S. dollars from pounds sterling at £1.00 = \$1.5992, the end of period rate as at February 28, 1999.

## CONSOLIDATED BALANCE SHEET EXTRACTS

	As at February 28/29,						As at August 31,	
	1995	1996	1997	1998	1999	1999 <sup>(1)</sup>	1998	1999
	(in millions, except per stock unit amounts)							
Issued capital								
Ordinary stock	£ 292.8	£ 295.8	£ 299.2	£ 306.8	£ 310.0	\$ 495.7	£ 308.3	£ 311
Preference stocks	200.0	300.0	300.0	400.0	400.0	639.7	400.0	400
Reserves	1,010.9	1,155.0	1,443.6	1,820.8	2,261.2	3,616.1	2,039.5	2,497
Proprietors' funds	1,503.7	1,750.8	2,042.8	2,527.6	2,971.2	4,751.5	2,747.8	3,208
Minority interests	8.0	125.2	130.9	122.4	132.6	212.1	110.6	150
Subordinated undated loan capital	547.5	763.3	929.2	1,071.4	1,087.9	1,739.8	1,064.8	1,090
Subordinated dated loan capital	671.7	893.8	814.9	716.1	681.9	1,090.5	699.6	1,184
Capital resources	£ 2,730.9	£ 3,533.1	£ 3,917.8	£ 4,437.5	£ 4,873.6	\$ 7,793.9	£ 4,622.8	£ 5,632
Deposits by banks, customer accounts and debt securities in issue	£29,637.0	£38,399.9	£40,872.0	£47,514.2	£51,422.2	\$82,234.4	£49,414.0	£ 57,270
Loans and advances to customers and banks <sup>(2)</sup>	£27,732.8	£36,152.8	£40,229.9	£47,624.9	£51,395.3	\$82,191.4	£48,932.3	£ 56,186
Cumulative provisions for bad and doubtful debts	£ 694.2	£ 680.2	£ 660.8	£ 677.1	£ 707.5	\$ 1,131.4	£ 660.1	£ 739
Total assets	£34,103.8	£44,099.1	£47,274.5	£54,697.2	£59,796.1	\$95,625.9	£57,069.6	£ 66,519
Net assets per ordinary stock unit	111.3p	122.6p	145.6p	173.4p	207.4p	331.7c	190.4p	225.9p

(1) Converted into U.S. dollars from pounds sterling at £1.00 = \$1.5992, the end of period rate as at February 28, 1999.

(2) Net of cumulative provisions for bad and doubtful debts and interest in suspense.

## OTHER FINANCIAL DATA

(unaudited)

	As at and for the year ended February 28/29,					As at and for the six months ended August 31,	
	1995	1996	1997	1998	1999	1998	1999
	(in percent, except earnings ratios)						
Return on average proprietors' equity before taxation <sup>(1)</sup> .....	35.0	36.4	36.1	33.9 <sup>(2)</sup>	32.4	33.4	31.4
Return after taxes on average proprietors' equity <sup>(4)</sup> ..	n/a	22.1	23.6	24.3	22.1	22.5 <sup>(3)</sup>	21.0 <sup>(3)</sup>
Return on average total assets before taxation <sup>(5)</sup> ....	1.39	1.27	1.45	1.48 <sup>(2)</sup>	1.48	1.5 <sup>(3)</sup>	1.5 <sup>(3)</sup>
Net interest income as a percentage of average total assets <sup>(6)</sup> .....	2.77	2.55	2.67	2.68 <sup>(2)</sup>	2.67	2.67	2.63
Cost to total income ratio (operating expenses as a percentage of net total income) <sup>(7)</sup> .....	49.8	53.8	52.5	50.7 <sup>(2)</sup>	49.1	49.9	48.2
Basle convergence ratios <sup>(8)</sup>							
Tier I capital .....	6.1	6.1	6.4	6.8	6.8	6.8	6.6
Total capital .....	11.4	11.8	11.8	11.7	11.1	11.3	11.3
Cumulative provisions as a percentage of average advances <sup>(9)</sup>							
Specific .....	2.17	1.54	1.12	0.92	0.83	0.76	0.76
General .....	0.76	0.83	0.78	0.77	0.76	0.75	0.74
Total .....	2.93	2.37	1.90	1.69	1.59	1.51	1.50
Earnings to fixed charges (excluding deposits) <sup>(10)</sup> ...	5.11x	4.47x	4.95x	4.76x	5.41x	5.18x	5.67x
Earnings to fixed charges (including deposits) <sup>(10)</sup> ....	1.32x	1.26x	1.30x	1.28x	1.32x	1.35x	1.36x

(1) Profit before taxation (excluding gains on sales arising from discontinued operations) after deducting the gross cost of preference dividends, expressed as a percentage of the average of opening and closing Proprietors' funds attributable to ordinary stock and minority interests.

(2) Before write-down of finance leases of £37.1 million.

(3) Annualised.

(4) Profit after taxation and gains on sale arising from discontinued operations and after deducting the gross cost of preference dividends, expressed as a percentage of the average of opening and closing proprietors' funds attributable to ordinary stock and minority interests.

(5) Profit before taxation (excluding gains on sales arising from discontinued operations), expressed as a percentage of the average of opening and closing total assets.

(6) Net interest income expressed as a percentage of the average of opening and closing total assets.

(7) Operating expenses expressed as a percentage of net total income excluding gains on sales arising from discontinued operations.

(8) Tier I and Total Capital expressed as a percentage of risk weighted assets, including off-balance sheet items calculated in accordance with the Basle Guidelines.

(9) Cumulative provisions expressed as a percentage of the average of opening and closing advances to customers (net of provisions).

(10) Earnings comprise of profit before taxation (excluding gains on sales arising from discontinued operations) plus fixed charges. Fixed charges comprise interest on loan capital plus the gross cost of preference dividends, together with interest on deposits where stated.



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is based on the Consolidated Financial Statements included elsewhere in this Offering Circular. The Consolidated Financial Statements are prepared in accordance with U.K. GAAP, which differ in certain significant respects from U.S. GAAP. For an explanation of the relevant principal differences, see "Summary of Material Differences between U.K. GAAP and U.S. GAAP".

The Group prepares its Consolidated Financial Statements on the basis of a fiscal year beginning on March 1 and ending on the last day of February of the following year (a "fiscal year"). In the discussion below, for example, income earned in the fiscal year ended February 28, 1999 is referred to as earned "in 1999", income earned in the fiscal year ended February 28, 1998 is referred to as earned "in 1998", income earned in the fiscal year ended February 28, 1997 is referred to as earned "in 1997", income earned in the six month period ended August 31, 1999 is referred to as earned "in the six month period in 1999" and income earned in the six month period ended August 31, 1998 is referred to as earned "in the six month period in 1998". For the purposes of the presentation of financial information, the term the "Group" refers to Bank of Scotland together with its consolidated subsidiaries; the term the "Bank" refers to the Group *excluding* the following Bank of Scotland subsidiaries (and their respective consolidated subsidiaries), Capital Bank, BankWest, British Linen Bank, Bank of Wales and Countrywide. Financial information presented for each of these excluded entities includes information with respect to such entity's consolidated subsidiaries. Financial information with respect to BankWest, in which the Bank currently has a 55.39% interest, is presented in accordance with U.K. GAAP on a fully consolidated basis. The Bank's ownership interest in BankWest has increased from 51% in 1995, reflecting the Bank's policy of applying dividends received from BankWest to increase its ownership interest.

### Overview

#### *The Bank of Scotland Group*

The following table summarises key indicators of the Group's performance for the periods indicated:

	Year ended February 28/29,					Six months ended August 31,	
	1995	1996	1997	1998	1999	1998	1999
	(£ millions, except percentages)						
Operating profit (before provisions for bad and doubtful debts) . . . . .	650.0	659.8	825.5	953.8 <sup>(1)</sup>	1,096.6	527.8	601
Profit before taxation . . . . .	449.7	545.0	664.1	742.0	1,011.9	420.1	471
Total assets . . . . .	34,103.8	44,099.1	47,274.5	54,697.2	59,796.1	57,069.6	66,519
Return before taxes on average total assets <sup>(2)</sup> . . .	1.39%	1.27%	1.45%	1.48% <sup>(1)</sup>	1.48%	1.5% <sup>(4)</sup>	1.5% <sup>(4)</sup>
Return after taxes on average proprietors' equity <sup>(3)</sup> . . . . .	n/a	22.1%	23.6%	24.3%	22.1%	22.5% <sup>(4)</sup>	21.0% <sup>(4)</sup>
Cost to income ratio (operating expenses to total income) . . . . .	49.8%	53.8%	52.5%	50.7% <sup>(1)</sup>	49.1%	49.9%	48.2%
Total capital resources . . . . .	2,730.9	3,533.1	3,917.8	4,437.5	4,873.6	4,622.8	5,632
Tier I capital ratio . . . . .	6.1%	6.1%	6.4%	6.8%	6.8%	6.8%	6.6%
Total capital ratio . . . . .	11.4%	11.8%	11.8%	11.7%	11.1%	11.3%	11.3%

(1) Before write-down of finance leases of £37.1 million.

(2) Profit before taxation (excluding gains on sale arising from discontinued operations), expressed as a percentage of the average of opening and closing total assets.

(3) Profit after taxation and gains on sale arising from discontinued operations and after deducting the gross cost of preference dividends, expressed as a percentage of the average of opening and closing Proprietors' funds attributable to ordinary stock and minority interests.

(4) Annualised.

The Group's operating profit (before provisions for bad and doubtful debts) increased by 15% to a record £1,096.6 million in 1999 from £953.8 million (before write-down of leases) in 1998 and by a total of 33% over two years from £825.5 million in 1997. For the six month period in 1999, the Group's operating profit (before provisions for bad and doubtful debts) was £601 million, an increase of 14% over the corresponding period in

1998. The Group's profit before taxation increased by 36% to a record £1,011.9 million in 1999 from £742.0 million (after a write-down of leases of £37.1 million) in 1998 and by a total of 52% over two years from £664.1 million in 1997. For the six month period in 1999, the Group's profit before taxation was £471 million, an increase of 12% over the corresponding period in 1998.

The Group's total assets were £66.5 billion as at August 31, 1999, an increase of 11% over £59.8 billion as at February 28, 1999, and a total increase of 22% over £54.7 billion as at February 28, 1998.

The Group's return before taxes on average total assets (excluding gains on sales arising from discontinued operations) was 1.5% (annualised) in the six month period in 1999, the same as in the corresponding period in 1998, 1.48% in the year to 1999 and 1.48% in the year to 1998.

The Group's return after taxes on average proprietors' equity was 21% (annualised) in the six month period in 1999, compared to 22.5% (annualised) in the corresponding period in 1998, 22.1% in 1999 and 24.3% in 1998, and helped to sustain the high levels of internal generation of capital achieved in recent years.

The Group's cost to income ratio (operating expenses to total income) was 48.2% in the six month period in 1999, compared to 49.9% in the corresponding period in 1998, 49.1% in 1999 and 50.7% in 1998. The Group's cost to income ratio continues to benefit from the expansion of low cost direct banking and the efficiency gains inherent in the centralisation of processing for the branch network.

The Group's total capital resources were £5.6 billion as at August 31, 1999, an increase of 14% over £4.9 billion as at February 28, 1999, and a total increase of 27% over £4.4 billion as at February 28, 1998. The Group's Tier I and Total Capital ratios were 6.6% and 11.3%, respectively, as at August 31, 1999, 6.8% and 11.1%, respectively, as at February 28, 1999, and 6.8% and 11.7%, respectively, as at February 28, 1998.

### ***Changes in the banking industry***

The Bank has approximately 320 branches and 23 corporate offices in Scotland and England. The banking market in the United Kingdom is characterised by continuing structural change which has increased competition in recent years from a variety of sources, including merged banks, demutualised life insurers and building societies and diversified consumer services companies. In addition, the U.K. financial services industry has continued to attract new entrants, often well-established non-financial companies with large customer bases or insurance companies. Technology has lowered many traditional barriers to such new entrants. For example, several supermarkets have started banks, generally as joint ventures with existing banks and life companies, that provide certain banking products and services using new technology and their established brand names to reach existing customer bases.

### ***European economic and monetary union***

The introduction of the single European currency, the Euro, in 11 European Union member states (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain) on January 1, 1999 has not significantly impacted the Group. However, the Group has been able to reduce currency exchange costs as a direct result of replacing conversion into 11 currencies with conversion into Euro only.

Although the United Kingdom has not adopted the Euro, U.K. businesses with operations or trading links in the Euro area are affected. In addition, those that buy from or sell to U.K. subsidiaries of continental European corporations that have decided to trade in Euros are also being affected. The Group supports its business customers by offering a range of Euro services including current accounts, payment and cash management services, loans and deposits and treasury services. An internal steering committee of the Group is monitoring developments respecting the Euro and its potential impact on operating systems and products of the Group as well as the potential impact of adoption of the Euro by the United Kingdom.

### ***Interest rate developments***

The U.K. Monetary Policy Committee began to cut interest rates in the fourth quarter of 1998, following the lead of the U.S. Federal Reserve. Base interest rates in the United Kingdom reached a low of 5% in June 1999

and have subsequently increased to 6.00% following increases of 0.25% in each of September 1999, November 1999 and January and February 2000.

### *Sale of discontinued operations*

Comparison of the results in 1999 with those in 1998 is affected by gains on sales of discontinued operations. The three disposals in 1999 giving rise to such gains were the sale by the Bank of Countrywide, the Group's New Zealand banking business, the sale of the Bank's Registrar Services business and the sale to its management of a majority stake in Haydock Finance, a lease financing business. Comparison of the results in 1998 with those in 1997 is also affected by gains on sales of discontinued operations. These gains arose primarily from the sale by the Bank of its Corporate Trustee Services, which was completed in February 1998. There were no gains (or losses) on the sale of discontinued operations in the six month periods in 1998 and 1999. See "Extraordinary Income and Expenses".

### **Results of operations**

The contribution of individual companies towards Group profit on ordinary activities before taxation is summarised below:

#### **Profit before taxation by corporate entity**

	Year ended February 28,			Six months ended August 31,	
	1997	1998	1999	1998	1999
	(£ millions)				
Bank of Scotland (including Treasury Services) . . . . .	398.9	513.0	730.9	278.0	313
Capital Bank . . . . .	135.3	113.6	166.1	83.7	103
BankWest . . . . .	71.6	62.2	71.2	30.8	43
British Linen Bank . . . . .	14.5	15.1	23.3	12.6	7
Bank of Wales . . . . .	6.6	8.2	10.1	4.7	5
Countrywide . . . . .	37.2	29.9	10.3 <sup>(1)</sup>	10.3	—
Profit before taxation . . . . .	<u>664.1</u>	<u>742.0</u>	<u>1,011.9</u>	<u>420.1</u>	<u>471</u>

(1) For the period to disposal on September 11, 1998.

*Six month periods ended August 31, 1999 and 1998.* The Group's profit before taxation increased by 12% to £471 million in the six month period in 1999 from £420.1 million in the corresponding period in 1998.

The Bank's profit before taxation increased 13% to £313 million in the six month period in 1999 from £278.0 million in the corresponding period in 1998 due primarily to growth of 23% (annualised) in customer loans and advances from February 28, 1999 to August 31, 1999, led by growth in consumer mortgages and lending to a range of corporate customers. This growth was somewhat offset by an increase of 12% in expenses.

Capital Bank's profit before taxation increased 23% to £103 million in the six month period in 1999 from £83.7 million in the corresponding period in 1998, due primarily to growth of 21% (annualised) in customer loans and advances from February 28, 1999 to August 31, 1999, led by growth in consumer mortgages, an increase in market share of unsecured personal lending and one-off dispositions, which were partially offset by increased provisioning.

BankWest's profit before taxation increased 40% to £43 million (including the £2 million gain on sale of Trustees of Western Australia in the six month period in 1999, from £30.8 million in the corresponding period in 1998, due primarily to 14% growth (annualised in local currency terms) in customer loans and advances from February 28, 1999 to August 31, 1999 and strong growth in lending fees and financial market activities, which was partially offset by 14% growth in expenses, reflecting overall growth in business.

The British Linen Bank's profit before taxation decreased to £7 million in the six month period in 1999 from £12.6 million in the corresponding period in 1998, due primarily to the transfer of certain assets of British Linen Bank to other members of the Group as well as the fact that the bank's particularly strong performance in providing advisory services related to the U.K. government sponsored Private Finance Initiatives ("PFIs") in the 1998 period was not repeated in the 1999 period.

Bank of Wales' profit before taxation remained nearly constant at £5 million in the six month period in 1999, compared to £4.7 million in the six month period in 1998, reflecting in part the sale of its wholly-owned subsidiary Bank of Wales (Jersey) to the Bank in March 1999. Adjusting for the sale of the former subsidiary, the underlying growth in customer advances was 9% in the six month period in 1999.

*Years ended February 28, 1999 and 1998.* The Group's profit before taxation increased by 30% to a record £1,011.9 million in 1999 from £779.1 million (before taking a write-down of leases of £37.1 million) in 1998.

The Bank's profit before taxation increased 42% to £730.9 million in 1999 from £513.0 million in 1998. Adjusting for gains on sale of discontinued operations in 1999 and 1998, the underlying growth was 16%, due primarily to an increase in customer loans and advances, led by consumer mortgages and lending to corporates and overdrafts.

Capital Bank's profit before taxation increased 12% to £166.1 million in 1999 from £147.7 million (before taking a write-down of leases of £34.1 million arising from reductions in the rate of corporation tax) in 1998, due primarily to growth of 21% in customer loans and advances and increased fees on new lending and credit insurance commissions, which were partially offset by an increase in provisions of 36% and expenses of 14%.

BankWest's profit before taxation increased 14% to £71.2 million in 1999, from £62.2 million (after taking account of restructuring costs of £5 million) in 1998, primarily due to an increase of 16% in customer loans and advances (in local currency terms), led by an expansion into new geographic areas, an increase in lending fees, dealing activities and disposals and a decrease of 11% in provisioning, which were partially offset by a 17% growth in expenses.

The British Linen Bank's profit before taxation increased 29% to £23.3 million in 1999 from £18.1 million (before taking a write-down of leases of £3 million) in 1998, reflecting primarily the fact that 1999 included a full year of income from the subsidiary EFT Group, which was acquired in August 1997, whereas 1998 included only six months of such income.

Bank of Wales' profit before taxation increased 23% to £10.1 million in 1999 from £8.2 million in 1998, primarily due to an increase of 8% in customer loans and advances, as well as cost savings and decreased provisioning.

Countrywide's profit before taxation was £10.3 million in 1999 compared to £29.9 million in 1998, reflecting primarily the fact that the results in 1999 included profits from only six months of operations (to September 11, 1998, the date on which the subsidiary was sold to third parties), whereas the results in 1998 included profits from a full 12 months of operations.

*Years ended February 28, 1998 and 1997.* The Group's profit before taxation increased by 17% to £779.1 million (before taking a write-down on leases of £37.1 million) in 1998 from £664.1 million in 1997.

The Bank's profit before taxation increased 29% to £513.0 million in 1998 from £398.9 million in 1997. This increase reflected the growth of 14% in customer loans and advances and an increase of 13% in non-interest income, which were partially offset by a 4% increase in expenses and 15% increase in provisioning.

Capital Bank's profit before taxation increased 9% to £147.7 million (before taking write-downs on leases of £34.1 million arising from reductions in the rate of corporation tax) in 1998, from £135.3 million in 1997. This increase was due primarily to growth of 31% in customer loans and advances, led by motor vehicle lending, and fees on new lending and credit insurance commissions, which were partially offset by a 24% growth in expenses, reflecting expansion of business into new geographic areas, and a 45% increase in provisioning, reflecting a change in the composition of the loan portfolio to include a larger consumer lending component.

BankWest's profit before taxation decreased 13% to £62.2 million in 1998 (after taking account of restructuring costs of £5 million) from £71.6 million in 1997. This decrease reflected the depreciation of the Australian dollar against the pound sterling. Before taking account of restructuring costs, profit before taxation increased 9% in local currency terms, reflecting the 27% growth in customer loans and advances (in local currency terms), which was somewhat offset by narrowing interest margins, and increases in dealing profits and fee income.

The British Linen Bank's profit before taxation increased 25% to £18.1 million (before taking a write-down on leases of £3 million) in 1998 from £14.5 million in 1997, reflecting primarily the six month contribution of £3.8 million from EFT Group, which was acquired in August 1997, that was included in profit before taxation in 1998.

Bank of Wales' profit before taxation increased 24% to £8.2 million in 1998 from £6.6 million in 1997, mainly reflecting improvements in cost control.

Countrywide's profit before taxation decreased 20% to £29.9 million in 1998 from £37.2 million in 1997.

## Net interest income

The following table shows net interest income and net interest margin of the Group for the periods stated.

	Net interest income				
	Year ended February 28,			Six months ended August 31,	
	1997	1998	1999	1998	1999
	(€ millions)				
<b>NET INTEREST INCOME</b>					
<b>Bank of Scotland</b>					
Interest and investment income receivable	1,784.3	2,132.5	2,279.0	932.1	1,232
Interest payable . . . . .	(1,151.0)	(1,407.4)	(1,437.9)	(527.3)	(765)
	<u>633.3</u>	<u>725.1</u>	<u>841.1</u>	<u>404.8</u>	<u>467</u>
<b>Capital Bank</b>					
Interest and investment income receivable	728.0	926.0	1,145.0	553.2	599
Interest payable . . . . .	(409.9)	(536.0)	(689.5)	(331.9)	(338)
Write-down of finance leases . . . . .	—	(34.1)	—	—	—
	<u>318.1</u>	<u>355.9</u>	<u>455.5</u>	<u>221.3</u>	<u>261</u>
<b>BankWest</b>					
Interest and investment income receivable	448.0	373.8	388.6	168.1	212
Interest payable . . . . .	(295.8)	(240.3)	(255.1)	(111.3)	(139)
	<u>152.2</u>	<u>133.5</u>	<u>133.5</u>	<u>56.8</u>	<u>73</u>
<b>British Linen Bank</b>					
Interest and investment income receivable	85.5	108.0	135.8	68.5	51
Interest payable . . . . .	(60.7)	(73.4)	(83.2)	(43.3)	(30)
Write-down of finance leases . . . . .	—	(3.0)	—	—	—
	<u>24.8</u>	<u>31.6</u>	<u>52.6</u>	<u>25.2</u>	<u>21</u>
<b>Bank of Wales</b>					
Interest and investment income receivable	56.3	54.9	58.4	29.8	21
Interest payable . . . . .	(35.1)	(39.4)	(41.7)	(21.5)	(14)
	<u>21.2</u>	<u>15.5</u>	<u>16.7</u>	<u>8.3</u>	<u>7</u>
<b>Countrywide</b>					
Interest and investment income receivable	303.4	262.1	124.8	124.8	—
Interest payable . . . . .	(235.0)	(195.3)	(94.8)	(94.8)	—
	<u>68.4</u>	<u>66.8</u>	<u>30.0</u>	<u>30.0</u>	<u>—</u>
<b>Group Total</b>					
Interest and investment income receivable	3,405.5	3,857.3	4,131.6	1,876.5	2,115
Interest payable . . . . .	(2,187.5)	(2,491.8)	(2,602.2)	(1,130.1)	(1,286)
Write-down of finance leases . . . . .	—	(37.1)	—	—	—
	<u>1,218.0</u>	<u>1,328.4</u>	<u>1,529.4</u>	<u>746.4</u>	<u>829</u>
<b>NET INTEREST MARGIN<sup>(1)(2)</sup></b>					
Bank of Scotland . . . . .	n/a	2.05%	2.05%	2.08%	1.89%
Capital Bank . . . . .	n/a	4.47%	4.11%	4.14%	4.16%
BankWest . . . . .	n/a	2.54%	2.46%	2.16%	2.28%
British Linen Bank . . . . .	n/a	2.98%	4.10%	3.84%	3.83%
Bank of Wales . . . . .	n/a	2.42%	2.46%	2.54%	2.54%
Countrywide . . . . .	n/a	2.22%	2.24%	2.25%	n/a
Group total . . . . .	n/a	2.83%	2.88%	2.85%	2.85%

(1) Net interest income as a percentage of average interest earning assets.

(2) Prior to 1998, net interest margin was computed as net interest income divided by average total assets. Figures for the fiscal year 1997 are not comparable to figures from later periods and accordingly have not been presented.



*Six month periods ended August 31, 1999 and 1998.* The Group's net interest income increased 11% to £829 million in the six month period in 1999 from £746.4 million in the six month period in 1998. The increase arose mainly from further growth in Group lending. The Group's net interest margin remained unchanged at 2.85%.

The Bank's net interest income increased 15% to £467 million in the six month period in 1999 from £404.8 million in the six month period in 1998. This increase was primarily due to growth from February 28, 1999 to August 31, 1999 of 23% (annualised) in customer loans and advances, led by growth in consumer mortgages and lending to a range of corporate customers. The Bank's overall net interest margin was 1.89% in the six month period in 1999, compared with 2.08% in the six month period in 1998.

Capital Bank's net interest income increased 18% to £261 million in the six month period in 1999 from £221.3 million in the six month period in 1998. This increase was due primarily to growth from February 28, 1999 to August 31, 1999 of 21% (annualised) in customer loans and advances, led by growth in consumer mortgages and increase in market share in unsecured personal lending. Capital Bank's overall net interest margin remained broadly unchanged at 4.16% (from 4.14% in 1998).

BankWest's net interest income increased 29% to £73 million in the six month period in 1999. This increase, due primarily to growth (in local currency terms on an annualised basis) of 14% in customer loans and advances from February 28, 1999 to August 31, 1999, led by strong growth in corporate and consumer mortgage lending. BankWest's overall net interest margin, which increased to 2.28% in the six month period in 1999 compared to 2.16% in the six month period in 1998 in sterling terms, actually declined in local currency terms from 2.36% to 2.30%, respectively.

*Years ended February 28, 1999 and 1998.* The Group's net interest income increased 12% to £1,529.4 million in 1999 from £1,365.5 million (before taking account of a write-down on leases of £37.1 million) in 1998. The Group's net interest margin increased to 2.88% in 1999 from 2.83% in 1998.

The Bank's net interest income increased 16% to £841.1 million in 1999 from £725.1 million in 1998. Most of the increase came from the 16% growth in customer loans and advances, led by consumer mortgages, Libor lending to corporates and overdrafts. The Bank's overall net interest margin, based on average interest earning assets, remained unchanged at 2.05% in 1999. The net interest margin benefited from the higher average base rate on equity capital and non-interest bearing current accounts, improving margins on wholesale funding and the widening of mortgage margins, especially in the second half of the period in the falling interest rate environment. However, competitive pressures resulted in these favourable factors being offset by a narrowing of both business and personal deposit margins.

Capital Bank's net interest income increased 17% to £455.5 million in 1999 from £390.0 million (before taking account of a write-down on leases of £34.1 million) in 1998. This increase was due primarily to growth of 21% in customer loans and advances, led by personal lending (mortgages, motor vehicle finance and unsecured lending). New business lending margins continued to be under pressure in very competitive market conditions and, as a result, Capital Bank's overall net interest margin fell to 4.11% in 1999 from 4.47% in 1998.

BankWest's net interest income in 1999 remained constant at £133.5 million as compared to 1998, reflecting growth in lending, which was partially offset by narrowing interest margins. BankWest's overall net interest margin declined to 2.46% in 1999 from 2.54% in 1998. In local currency terms, net interest income rose by 7% to A\$343.9 million.

*Years ended February 28, 1998 and 1997.* The Group's net interest income increased 12% to £1,365.5 million (before taking account of a write-down on leases of £37.1 million) in 1998 from £1,218.0 million, in 1997. The Group's net interest margin was 2.83% in 1998.

The Bank's net interest income increased 14% to £725.1 million in 1998 from £633.3 million in 1997. This increase was due primarily to growth of 14% in customer loans and advances, led by mortgages and corporate lending. The Bank's overall net interest margin was 2.05% in 1998.

Capital Bank's net interest income increased 23% to £390.0 million (before taking account of a write-down on leases of £34.1 million) in 1998 from £318.1 million in 1997. After taking account of the write-down on

leases, net interest income increased 12%. This increase was due primarily to growth of 31% in customer loans and advances, led by motor vehicle lending. Capital Bank's net interest margin was 4.47% in 1998.

BankWest's net interest income decreased 12% (in pound sterling terms) to £133.5 million in 1998 from £152.2 in 1997, reflecting the depreciation of the Australian dollar against the pound sterling. BankWest's net interest income increased 1.3% in local currency terms, reflecting the 27% growth in customer loans and advances, led by business and mortgage loans. Net interest margin was 2.54% in 1998.

### *Non-interest income*

The Group's non-interest income consists of net fees and commissions, dealing profits, profit on sales of investments and other operating income. The Bank classifies its fee and commission income as income related to branch-based services, banking direct, international, central support services, foreign exchange and other (which includes the profit on sale of equity-related investment securities negotiated alongside senior debt facilities in the corporate banking business). Non-interest income for Capital Bank consists principally of fees on new lending and credit insurance commissions (net of commissions payable to new business introducers). Non-interest income for BankWest principally consists of lending and foreign exchange fees and commissions.

The following table shows non-interest income of the Group for the periods stated.

### **Non-interest income**

	<b>Year ended February 28,</b>			<b>Six months ended August 31,</b>	
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>1998</b>	<b>1999</b>
	( <b>£ millions</b> )				
Net fees and commissions . . . . .	481.0	506.0	549.0	274.3	304
Fees and commissions receivable . . . . .	560.4	640.0	707.1	357.4	391
Fees and commissions payable . . . . .	(79.4)	(134.0)	(158.1)	(83.1)	(87)
Dealing profits . . . . .	19.6	25.1	36.3	16.4	13
Profit on sale of investments . . . . .	40.8	30.0	32.5	15.2	19
Other operating income . . . . .	2.8	7.6	5.3	1.6	(4)
<b>Total non-interest income . . . . .</b>	<b>544.2</b>	<b>568.7</b>	<b>623.1</b>	<b>307.5</b>	<b>332</b>

*Six month periods ended August 31, 1999 and 1998.* The Group's non-interest income increased 8% to £332 million in the six month period in 1999 from £307.5 million in the six month period in 1998. The Bank's non-interest income increased 7% to £246 million in the six month period in 1999 from £230 million in the six month period in 1998. The Bank's major sources of fee income during the six month period in 1999 were branch-based services (54%), banking direct (23%), international (11%), central support services (3%), foreign exchange (4%) and other sources (5%), which included £12 million of profit on sale of investment securities. Capital Bank's non-interest income increased 46% to £52.3 million in the six month period in 1999 from £35.7 million in the six month period in 1998. BankWest's non-interest income increased 50% to £33 million in the six month period in 1999 from £22 million in the six month period in 1998.

Group net fees and commissions increased 11%, led primarily by commitment fees. Net fees and commissions increased 8% at the Bank, led by commitment fees, and 62% at Capital Bank, led by new lending fees and credit insurance. Group dealing profits declined 21%, with the Bank also registering a 21% decline. Profit on sale of investments increased 25%, with the Bank registering 20% growth and Capital Bank 88% growth due to one-off disposals. The Group registered a loss of £4 million in other operating income in the six month period in 1999 compared to income of £1.6 million in the six month period in 1998, due to start-up costs associated with the formation of the Bank of Scotland Investors Club and write-downs on fixed asset investments. These costs offset growth primarily at BankWest resulting from the disposal of Trustees of Western Australia.

*Years ended February 28, 1999 and 1998.* The Group's non-interest income increased 10% to £623.1 million in 1999 from £568.7 million in 1998. The Bank's non-interest income increased 7% to

£467.3 million in 1999 from £436.3 million in 1998. The Bank's major sources of fee income in 1999 were branch-based services (51%), banking direct (20%), international (10%), central support services (5%), foreign exchange (6%) and other sources (8%), which included £24.6 million from profit on sale of investment securities. Capital Bank's non-interest income increased 30% to £79.8 million in 1999 from £61.5 million in 1998. BankWest's non-interest income increased 13% to £63.6 million in 1999 from £56.3 million in 1998.

Group net fees and commissions increased 8%, with the Bank, led by commitment and account activity fees, registering 7% growth and Capital Bank, led by new lending and credit insurance fees, registering 20% growth. Group dealing profits increased 45%. Group profit on sale of investments increased 8%.

*Years ended February 28, 1998 and 1997.* The Group's non-interest income increased 5% to £568.7 million in 1998 from £544.2 million in 1997. The Bank's non-interest income increased 8% to £436.3 million in 1998 from £405.2 million in 1997. The Bank's major sources of fee income in 1998 were branch-based services (50%), banking direct (19%), international (8%), foreign exchange (5%) and other sources (18%), which included £27.2 million from profit on sale of investment securities. Capital Bank's non-interest income increased 2% to £61.5 million in 1998 from £60.5 million in 1997. BankWest's non-interest income increased 19% to £56.3 million in 1998 from £47.5 million in 1997.

Group net fees and commissions increased 5%, with the Bank, led by commitment, credit card activity fees and third party processing fees, registering 7% growth. Group dealing profits increased 28%. Profit on sale of investments declined 26%.

### *Operating expenses*

The Group's operating expenses consist of staff costs, expenditures on premises and equipment, depreciation and amortisation, professional service (including auditors remuneration, legal and professional and consultancy services fees), allocation to staff profit sharing scheme and others (including advertising and marketing, computer software and services, telephone, postage and stationery, irrecoverable VAT and other miscellaneous expenditures). In each of the periods discussed, Group profit before taxation was sufficient to generate the maximum allocation under the rules of the Staff Profit Sharing Schemes. These schemes are formula-driven and are based upon the return before taxation on Proprietors' Funds. The following table shows operating expenses of the Group for the periods stated.

### Operating expenses

	Year ended February 28,			Six months ended August 31,	
	1997	1998	1999	1998	1999
	(£ millions)				
Staff costs . . . . .	425.5	463.9	485.7	244.0	249
Expenditure on premises and equipment . . . . .	86.7	87.1	86.6	43.7	49
Depreciation and amortisation . . . . .	66.7	69.8	71.4	35.1	38
Professional services . . . . .	36.0	50.0	54.2	23.4	33
Allocation to staff profit sharing scheme . . . . .	34.3	37.1	42.0	20.8	23
Other . . . . .	<u>276.0</u>	<u>272.5</u>	<u>316.0</u>	<u>159.1</u>	<u>168</u>
Total . . . . .	<u>925.2</u>	<u>980.4</u>	<u>1,055.9</u>	<u>526.1</u>	<u>560</u>

*Six month periods ended August 31, 1999 and 1998.* The Group's operating expenses increased by 6% to £560 million in the six month period in 1999 from £526.1 million in the six month period in 1998. The Bank's operating expenses increased 12% to £335 million in the six month period in 1999 from £298 million in the six month period in 1998, primarily due to an increase in costs for professional services, expenditure for computer software and services and an increase in staff costs. Capital Bank's operating expenses increased by 10% to £150 million in the six month period in 1999 from £136 million in the six month period in 1998, with growth in income outpacing growth in expenses. BankWest's operating expenses increased 33% to £67.1 million

in the six month period in 1999 from £50.4 million in the six month period in 1998, reflecting growth in the Bank's staff costs and professional fees and the impact of exchange rate movements. During this period operating expenses increased 14% in local currency terms.

Group staff costs increased 2% to £249 million in the six month period in 1999 from £244.0 million in the six month period in 1998 due in part to an increase in staff salaries and headcount. In the six months to August 1998, Group staff costs included those of Countrywide. Group expenditure on premises and equipment increased 12% to £49 million in the six month period in 1999 from £43.7 million in the six month period in 1998 due in part to the new premises for Capital Bank which opened in the 1999 fiscal year. Group depreciation and amortisation increased 8% to £38 million in the six month period in 1999 from £35.1 million in the six month period in 1998 due primarily to increases in depreciation relating to investments in information technology. Group professional services expenses increased 41% to £33 million in the six month period in 1999 from £23.4 million in the six month period in 1998, due primarily to the increase in legal and professional fees, including consultancy. Group allocation to the staff profit sharing scheme increased 11% to £23 million in the six month period in 1999 from £20.8 million in the six month period in 1998, reflecting increased salaries. Other Group operating costs increased 6% to £169 million in the six month period in 1999 from £159.1 million in the six month period in 1998, reflecting an increase in computer software and services in addition to increases in irrecoverable VAT and other expenses, offset by a decrease in advertising and marketing costs.

*Years ended February 28, 1999 and 1998.* The Group's operating expenses increased by 8% to £1,055.9 million in 1999 from £980.4 million in 1998. The Bank's operating expenses increased 10% to £605.6 million in 1999 from £549.5 million in 1998. The Bank increased its staff numbers and its information technology systems development expenditure to support the expansion of business, further process automation and to meet the costs of the Year 2000 project and the replacement of obsolete systems. Capital Bank's operating expenses increased by 14% to £280.0 million in 1999 from £245.6 million in 1998. BankWest's operating expenses increased by 21% to £117.3 million in 1999 from £96.8 million in 1998.

Group staff costs increased 5% to £485.7 million in 1999 from £463.9 million in 1998 due primarily to increased salaries and an increase of 5% in full time equivalent employees at the Bank over the period. Group expenditure on premises and equipment decreased 1% to £86.6 million in 1999 from £87.1 million in 1998. Group depreciation and amortisation increased 2% to £71.4 million in 1999 from £69.8 million in 1998. Group professional services expenses increased 8% to £54.2 million in 1999 from £50.0 million in 1998. Group allocation to the staff profit sharing scheme increased 13% to £42.0 million in 1999 from £37.1 million in 1998, reflecting increased staff count and higher salaries. Other Group operating costs increased 16% to £316.0 million in 1999 from £272.5 million in 1998, reflecting primarily increases in computer software and services and advertising and marketing.

*Years ended February 28, 1998 and 1997.* The Group's operating expenses increased 6% to £980.4 million in 1998 from £925.2 million in 1997. The Bank's operating expenses increased 4% to £523.9 million in 1998 from £501.9 million in 1997 as staff numbers increased. Capital Bank's operating expenses increased by 24% to £247.0 million in 1998 from £198.7 million in 1997.

Group staff costs increased 9% to £463.9 million in 1998 from £425.5 million in 1997 due primarily to growth in full time equivalent employees at the Bank over the period. Group expenditure on premises and equipment remained roughly constant. Group depreciation and amortisation increased 5% to £69.8 million in 1998 from £66.7 million in 1997. Group professional services expenses increased 39% to £50.0 million in 1998 from £36.0 million in 1997, reflecting primarily increased legal and professional fees and consultancy fees. Group allocation to the staff profit sharing scheme increased 8% to £37.1 million in 1998 from £34.3 million in 1997, primarily reflecting increased headcount. Other Group operating costs decreased 1%.

## Income taxes

The following table shows income taxes of the Group for the periods stated.

	Year ended February 28,		
	1997	1998	1999
	(£ millions)		
U.K. corporation tax <sup>(1)</sup> . . . . .	181.1	181.8	261.4
Deferred taxation . . . . .	20.5	(3.3)	144.5
Relief for overseas taxation . . . . .	(14.0)	(9.9)	(28.4)
	187.6	168.6	377.5
Overseas taxation . . . . .	43.9	36.2	47.0
Share of joint ventures' taxation . . . . .	—	6.7	6.9
Share of associated undertakings taxation . . . . .	4.7	(1.0)	(0.1)
	<u>236.2</u>	<u>210.5</u>	<u>431.3</u>

(1) Based on applicable statutory tax rates of 31% in 1999, 31.17% in 1998 and 33% in 1997.

*Years ended February 28, 1999 and 1998.* Group income taxes increased by 105% to £431.3 million in 1999 from £210.5 million in 1998. The taxation charge in 1999 represented 43% of profit before taxation, compared with 28% in 1998. The percentage rate of tax in 1999 was above the standard rate of corporation tax primarily as the result of an additional, non-recurring charge of £80 million arising from a change in the level of provisioning in respect of deferred tax. Because of the erosion of tax benefits associated with leasing and future fiscal uncertainties, the Group began in 1999 to take provisions on a more conservative basis of 100% (previously 75%) of the deferred tax liability on the Group's portfolio of U.K. leases.

*Years ended February 28, 1998 and 1997.* Income taxes decreased by 11% to £210.5 million in 1998 from £236.2 million in 1997. Income taxes represented 28% of Group profit before taxation in 1998, compared to 36% in 1997. The percentage rate of tax was below the nominal rate of corporation tax mainly as a result of recognising in the tax charge a reduction in the deferred tax liability of £29.7 million in respect of the Group's portfolio of leases arising from reductions in the rate of U.K. corporation tax.

## Extraordinary income and expenses

The Group's extraordinary income and expenses have consisted solely of the gains and losses on the disposal of businesses in the periods discussed. The term "extraordinary income and expenses" encompasses the same items that would be considered "exceptional expenses" in accordance with U.K. GAAP. The following table shows extraordinary income and expenses of the Group for the periods indicated.

	Year ended February 28,			Six months ended August 31,	
	1997	1998	1999	1998	1999
	(£ millions)			(£ millions)	
Gain/(loss) on sale of discontinued operations . . . . .	—	26.4	162.4	—	—

*Six month periods ended August 31, 1999 and 1998.* The Group had no extraordinary income or expenses in the six month period in 1999 or 1998.

*Years ended February 28, 1999 and 1998.* Extraordinary income of the Group increased to £162.4 million in 1999 from £26.4 million in 1998. Extraordinary income in the 1999 fiscal year included a gain of £162.1 million from the disposal of Countrywide.



*Years ended February 28, 1998 and 1997.* Extraordinary income of the Group was £26.4 million in 1998 compared with zero in 1997. Extraordinary income in the 1998 fiscal year included gains from disposals of £21.3 million from the disposal of Corporate Trustees and £5.1 million from the disposal of a number of other small investments.

### ***Provisions for bad and doubtful debts***

The provisions for bad and doubtful debts consist of specific loan loss provisions for individual risks on loans and advances and a general risk provision that is intended to cover losses on advances which are latently doubtful but not yet identified as such. Specific risk provisions are increased where exposures may be considered at risk as a result of adverse influences in a particular market sector. The general provision consists of annual tranches which are each calculated as a specific proportion of the growth in the Group's lending to third parties in specified product categories. The general provision may also be adjusted at the discretion of the Group to reflect special circumstances such as changes in the economy or geographic or sector risks.

While ultimate responsibility for approving the provisioning policy rests with the Group's Board of Directors, based on recommendations from the Group Management Board, day to day responsibility and monitoring is delegated to the Divisional Boards and the Divisional Chief Executive, and down to Management and Account Officers within the individual lending areas.

The following table shows the charge to the Group's consolidated profit and loss account.

### **Provisions for bad and doubtful debts**

	Year ended February 28,			Six months ended August 31,	
	1997	1998	1999	1998	1999
	(£ millions)				
<i>Credit risk provisions less releases charged to profit and loss account<sup>(1)</sup></i>					
Specific risk . . . . .	163.7	199.9	251.8	100.7	142
General risk . . . . .	33.0	39.8	39.9	26.4	26
Recoveries . . . . .	(21.4)	(20.9)	(23.8)	(11.5)	(17)
Total provisions . . . . .	<u>175.3</u>	<u>218.8</u>	<u>267.9</u>	<u>115.6</u>	<u>151</u>
<i>Credit risk provisions charged to profit and loss account<sup>(1)(2)</sup></i>					
Bank of Scotland (including Treasury Services) . . . . .	101.2	116.4	135.3	56.8	71
Capital Bank . . . . .	58.2	84.2	112.9	46.7	73
British Linen Bank . . . . .	5.3	4.2	7.5	4.0	2
Bank of Wales . . . . .	3.3	2.4	2.0	1.4	2
BankWest . . . . .	4.7	7.6	6.4	2.9	3
Countrywide . . . . .	2.6	4.0	3.8	3.8	—
Total provisions . . . . .	<u>175.3</u>	<u>218.8</u>	<u>267.9</u>	<u>115.6</u>	<u>151</u>

(1) Provisions calculated on basis of end-of-period exchange rate.

(2) Net of reversals of provisions and recoveries from loans written-off in prior years.

*Six month periods ended August 31, 1999 and 1998.* The Group's combined provisions charge (after taking account of recoveries) increased 31% to £151 million in the six month period in 1999 from £115.6 million in the six month period in 1998. The charge for specific provisions (before taking account of recoveries) increased 41% to £142 million in the six month period in 1999 from £100.7 million in the six month period in 1998. Expressed as a percentage of average customer advances, the specific provision charge (after accounting for recoveries) increased to 0.25% in the six month period in 1999 from 0.20% in the six month period in 1998. The Group's

general provisions charge was £26 million in the six month period in 1999, essentially the same as in the six month period in 1998.

The Bank's net combined provision charge increased 25% to £71 million for the six month period in 1999 from £56.8 million for the six month period in 1998, reflecting sustained growth in the Bank's customer loan portfolio, which grew 23% (annualised) in the six month period in 1999 as compared to 7% (annualised) in the six month period in 1998. The Bank's net combined provisions charge (after accounting for recoveries), expressed as a percentage of average customer advances, was 0.23% at August 31, 1999, compared to 0.22% at August 31, 1998. Capital Bank's net combined provisions charge (after accounting for recoveries) increased 56% to £73 million for the six month period in 1999 from £46.7 million for the six month period in 1998, reflecting the changing mix of Capital Bank's loan portfolio from business to higher-risk (and higher margin) personal credit.

*Years ended February 28, 1999 and 1998.* The Group's combined provisions charge (after taking account of recoveries) increased 22% to £267.9 million in 1999 from £218.8 million in 1998. The charge for specific provisions increased 26% to £251.8 million in 1999 from £199.9 million in 1998. Expressed as a percentage of average customer advances, the specific provisions charge (after accounting for recoveries) increased to 0.51% in 1999 from 0.45% in 1998. The Group's general provisions charge was £39.9 million in 1999, virtually identical to the charge in 1998, reflecting similar levels of growth in the customer loan portfolio in 1999 and 1998.

The Bank's net combined provisions charge (after taking account of recoveries) increased 16% to £135.3 million in 1999 from £116.4 million in 1998, reflecting growth in the customer loan portfolio. The Bank's net combined provisions charge (after taking account of recoveries), expressed as a percentage of average customer advances, was 0.51% at February 28, 1999, compared to 0.50% at February 28, 1998. Capital Bank's net combined provisions charge (after taking account of recoveries) increased 34% to £112.9 million in 1999 from £84.2 million in 1998, reflecting growth in loan volume and the change in the mix in the bank's loan portfolio from business to higher-risk (and higher margin) personal credit.

*Years ended February 28, 1998 and 1997.* The Group's net combined provisions charge (after taking account of recoveries) increased 25% to £218.8 million in 1998 from £175.3 million in 1997. The charge for specific provisions (before taking account of recoveries) increased 22% to £199.9 million in 1998 from £163.7 million in 1997. Expressed as a percentage of average customer advances, the specific provision charge (after taking account of recoveries) increased to 0.45% in 1998 from 0.41% in 1997. The Group's general provision charge increased 21% to £39.8 million in 1998 from £33.0 million in 1997, reflecting growth in risk lending.

The Bank's net combined provisions charge (after taking account of recoveries) increased 15% to £116.4 million in 1998 from £101.2 million in 1997, reflecting growth in the customer loan portfolio. The Bank's net combined provisions charge, expressed as a percentage of average customer advances, was 0.50% at February 28, 1998 compared to 0.49% at February 28, 1997. Capital Bank's net combined provisions charge increased 45% to £84.2 million in 1998 from £58.2 million in 1997, reflecting growth in loan volume and the change in the mix of the bank's loan portfolio.



### *Loan loss ratios*

The following table sets forth the Group's specific bad debt charge as a percentage of average loans and advances to customers net of provisions for the periods stated.

#### **Loan loss ratios<sup>(1)</sup>**

	<u>Year ended February 28,</u>			<u>Six months ended,</u>	
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>August 31,<sup>(2)</sup></u>	<u>1999</u>
			(in percent)		
Bank of Scotland (including Treasury Services) . . . . .	0.41	0.44	0.40	0.17	0.17
Capital Bank . . . . .	0.72	0.78	1.00	0.37	0.56
BankWest . . . . .	0.05	0.05	0.08	(0.01)	0.04
British Linen Bank . . . . .	0.63	0.49	0.82	0.41	0.20
Bank of Wales . . . . .	0.66	0.57	0.37	0.32	0.35
Countrywide . . . . .	0.06	0.13	n/a	0.14	n/a
Total loans . . . . .	0.41	0.45	0.51	0.20	0.25

(1) Specific bad debt charge as a percentage of average loans and advances to customers net of provisions.

(2) Loan loss ratios for interim periods have not been annualised for comparative purposes.

Capital Bank's historically relatively higher loan loss ratios reflect the higher risk/higher margin nature of its loan portfolio. BankWest's loan loss ratios reflect the fact that BankWest was purchased from the Government of Western Australia and also has a significant volume of residential mortgages within its portfolio.

### **Description of assets and liabilities**

#### *Assets*

*As at August 31, 1999 and February 28, 1999.* As at August 31, 1999, the Group's total assets reached £66,519 million, an increase of £6,723 million or 11% from £59,796.1 million as at February 28, 1999. This increase was primarily related to an increase of £5,124 million or 11% in net customer loans and advances.

*As at February 28, 1999 and 1998.* As at February 28, 1999, the Group's total assets were £59,796.1 million, an increase of £5,098.9 million or 9% from £54,697.2 million as at February 28, 1998. This increase was chiefly related to an increase of £3,705.6 million or 9% in net customer loans and advances and an increase of £1,401 million or 43% in the Group's securities portfolio.

*As at February 28, 1998 and 1997.* As at February 28, 1998, the Group's total assets were £54,697.2 million, an increase of £7,422.7 million or 16% from £47,274.5 million as at February 28, 1997. This increase was mainly attributable to an increase of £5,744.8 million or 15% in net customer loans and advances, which was somewhat offset by a decline of £716.0 million or 18% in the Group's debt securities portfolio.

#### *Loan portfolio*

The Group's loans and advances portfolio consists of loans and advances to customers and banks. Gross loans and advances to customers are classified as advances to customers (including banking advances, instalment credit and other financial agreements and assets leased to customers), advances to joint ventures and advances to associated undertakings. Cumulative provisions for bad and doubtful debts and interest in suspense are deducted from gross loans and advances to determine net loans and advances to customers.

## Loans and advances to customers and banks

	As at February 28,			As at
	1997	1998	1999	August 31,
	(£ millions)			1999
<i>Loans and advances to customers</i>				
Advances to customers				
Banking advances . . . . .	30,573.2	33,752.4	35,652.7	40,042
Instalment credit and other financial agreements . . . . .	3,482.6	5,512.7	6,951.8	7,374
Assets leased to customers . . . . .	3,022.1	3,351.0	3,602.5	3,831
Advances to joint ventures . . . . .	796.8	883.7	971.2	1,063
Advances to associated undertakings . . . . .	—	136.0	204.7	216
Gross advances to customers . . . . .	<u>37,874.7</u>	<u>43,635.8</u>	<u>47,382.9</u>	<u>52,526</u>
Cumulative provisions for bad and doubtful debts . . . . .	(660.8)	(677.1)	(707.5)	(739)
Interest in suspense . . . . .	(83.6)	(83.6)	(94.7)	(82)
Net advances to customers . . . . .	<u>37,130.3</u>	<u>42,875.1</u>	<u>46,580.7</u>	<u>51,705</u>
<i>Loans and advances to banks</i>				
Sterling advances . . . . .	2,050.5	2,827.6	2,913.4	2,499
Other currencies . . . . .	1,033.8	1,899.3	1,884.7	1,969
Assets leased to banks . . . . .	15.3	22.9	16.5	13
Loans and advances to banks . . . . .	<u>3,099.6</u>	<u>4,749.8</u>	<u>4,814.6</u>	<u>4,481</u>
Total loans and advances to customers and banks . . . . .	<u>40,229.9</u>	<u>47,624.9</u>	<u>51,395.3</u>	<u>56,186</u>

*As at August 31, 1999 and February 28, 1999.* The Group's loans and advances to customers and banks (after taking into account provisions for bad and doubtful debts and interest in suspense) totalled £56,186 million at August 31, 1999, an increase of £4,791 million or 9% from £51,395.3 million as at February 28, 1999. The increase primarily reflected the 11% increase in loans and advances to customers. Loans and advances to banks decreased £334 million or 7% during the period.

*As at February 28, 1999 and 1998.* The Group's loans and advances to customers and banks (after taking into account provisions for bad and doubtful debts and interest in suspense) totalled £51,395.3 million at February 28, 1999, an increase of £3,770.4 million or 8% from £47,624.9 million as at February 28, 1998. The increase was primarily due to the 9% increase in loans and advances to customers, which was led by an increase of £1,900.3 million or 6% in banking advances to customers and £1,439.1 million or 26% in instalment credit and other financial agreements (before taking into account provisions for bad and doubtful debts and interest in suspense). Loans and advances to banks increased £64.8 million or 1% during the period.

*As at February 28, 1998 and 1997.* The Group's loans and advances to customers and banks (after taking into account provisions for bad and doubtful debts and interest in suspense) totalled £47,624.9 million at February 28, 1998, an increase of £7,395.0 million or 18% from £40,229.9 million as at February 28, 1997. The increase was primarily due to the 15% increase in loans and advances to customers, which was led by an increase of £3,179.2 million or 10% in banking advances to customers and £2,030.1 million or 58% in instalment credit and other financial agreements. Loans and advances to banks increased £1,650.2 million or 53% during the period.

### *Loans and advances to customers*

The following table analyses the Group's classification of loans and advances to customers in accordance with FSA reporting requirements:

## Loans and advances to customers by classification

	As at February 28,			As at
	1997 <sup>(1)</sup>	1998	1999	August 31, 1999
	(£ millions)			
Agriculture, forestry and fishing . . . . .	683.7	764.6	802.1	938
Energy . . . . .	430.1	627.1	871.7	1,011
Manufacturing industry . . . . .	3,033.3	3,398.5	3,895.1	4,163
Construction and property . . . . .	3,479.6	4,038.6	4,434.8	6,014
Hotels, restaurants and wholesale and retail trade . . . . .	2,271.9	2,817.2	3,665.2	4,149
Transport, storage and communication . . . . .	1,455.6	1,844.6	1,736.9	1,665
Financial . . . . .	1,676.0	1,925.5	2,409.9	3,354
Other services . . . . .	5,191.5	5,043.6	5,776.0	6,213
Individuals:				
Home mortgages . . . . .	12,963.5	14,541.3	13,900.0	15,072
Other personal lending . . . . .	4,936.0	6,439.2	7,172.5	7,281
Overseas residents . . . . .	<u>1,753.5</u>	<u>2,195.6</u>	<u>2,718.7</u>	<u>2,666</u>
Gross advances . . . . .	<u>37,874.7</u>	<u>43,635.8</u>	<u>47,382.9</u>	<u>52,526</u>

(1) Effective for the year ended February 28, 1998, the Bank of England Statistical Review amended the categories into which loans and advances to customers should be classified. Loans and advances for the year ended February 28, 1997 have been restated to reflect these changes.

### *Lending concentrations*

One of the principal factors influencing the quality of the Group's earnings is the diversification of its loan portfolio by geographical area within the United Kingdom, by industry classification and by individual customer. The spread of the Group's assets is intended to reduce concentration of risk. The Bank has a widespread lending base in Scotland and England through approximately 320 retail and 23 corporate branch outlets at August 31, 1999.

The following table analyses the Group's loans and advances to customers by maturity as at the dates indicated.

### Analysis of loans and advances to customers by maturity

	As at February 28,		As at
	1998	1999	August 31, 1999
	(£ millions)		
Repayable on demand . . . . .	8,034.4	9,883.6	10,230
Other loans and advances repayable:			
in 3 months or less . . . . .	5,404.6	6,090.5	9,783
between 3 months and 1 year . . . . .	4,151.5	4,349.3	5,233
between 1 year and 5 years . . . . .	9,331.6	10,127.5	10,356
after 5 years . . . . .	<u>16,713.7</u>	<u>16,932.0</u>	<u>16,924</u>
Gross loans and advances to customers . . . . .	<u>43,635.8</u>	<u>47,382.9</u>	<u>52,526</u>

### *Loans and advances to banks*

The Group places funds with other banks for a number of reasons, including liquidity management, facilitation of international money transfers and documentary credit business with correspondent banks. Limits on

the aggregate amount of placings that may be made with individual institutions are established in accordance with Group credit policy.

The following table analyses the Group's loans and advances to banks by maturity as at the dates indicated.

#### Analysis of loans and advances to banks by maturity

	As at February 28,		As at
	1998	1999	August 31,
	(£ millions)		1999
Repayable on demand . . . . .	1,530.3	372.9	1,114
Other loans and advances repayable:			
in 3 months or less . . . . .	3,028.1	4,108.0	2,454
between 3 months and 1 year . . . . .	143.8	255.8	755
between 1 year and 5 years . . . . .	31.5	64.7	122
after 5 years . . . . .	16.1	13.2	36
Gross loans and advances to banks . . . . .	<u>4,749.8</u>	<u>4,814.6</u>	<u>4,481</u>

#### Country Exposure

The authority to set lending limits for countries has been delegated by the Board to the International Board, which is composed of executive and non-executive directors, and senior representatives from Group Foreign & Strategic Operations and Corporate Banking. The International Board meets every two months. In assessing the limits for individual countries, various factors are taken into consideration, but principal among these are the rating agencies' view of the country concerned, the economic situation and the political climate.

The Group classifies the countries where its customers are located as either "Group A" countries or "Group B" countries.

Pre-set country limits are approved by the International Board for all Group A countries. These limits are either unlimited in the case of those countries which are considered undoubted, such as the United States, or specific in the case of countries where the exposure is limited to a specific level which is determined by the Group's perception of the degree of country risk involved.

Country limits are not pre-set for Group B countries, but approvals of individual transactions are required from the Treasurer or Group Chief Executive irrespective of amount. Limits for each Group B country therefore reflect the committed exposures to that country. Individual country risk is examined on each occasion when an increase in the country exposure is proposed.

The following table sets forth the Group's country exposure as at September 30, 1999:

<u>As at September 30, 1999</u>	<b>Country exposure</b>	<u>Risk Exposure</u> (£ millions)
<i>Geographic area</i> <sup>(1)</sup>		
Australia . . . . .		5,755
Western Europe (other than U.K.) . . . . .		2,434
U.S./Canada . . . . .		2,233
Asia (including Hong Kong and Singapore) <sup>(2)</sup> . . . . .		378
Eastern Europe . . . . .		64
Other . . . . .		316

(1) Based on the location of the customer.

(2) Total country exposure to Indonesia, Malaysia, Philippines, South Korea and Thailand amounts to £56 million.

## Securities Portfolio

The Group's securities portfolio consists of investment securities and trading securities (classified as "other securities" for U.K. bank regulatory purposes). Investment securities consist of both listed (including British government and other) and unlisted securities (including in joint ventures, certificates of deposit issued by banks and building societies and others). Trading securities consist of both listed and unlisted securities, which are predominantly held in Treasury Services and BankWest. Unlisted securities are securities that are not listed on the London Stock Exchange or another "recognised investment exchange" as defined in the U.K. Financial Services Act 1986. The Group carries all investment securities at book value. Listed trading securities are valued on a marked-to-market basis. Unlisted trading securities are valued by the Board. The following table shows the value of the Group's investment and trading securities portfolios as at the dates indicated:

### Securities portfolio

	As at February 28,			As at
	1997	1998	1999	August 31, 1999
	(£ millions)			
<i>Investment securities</i>				
Listed	424.0	308.0	245.7	1,752
British Government	279.7	155.0	100.3	594
Others <sup>(1)</sup>	144.3	153.0	145.4	1,158
Unlisted <sup>(2)</sup>	2,584.7	2,164.7	3,844.3	3,711
Joint ventures	2.2	2.2	2.2	2
Certificates of deposit issued by banks and building societies	2,265.1	1,929.6	3,363.6	3,238
Others <sup>(1)</sup>	317.4	232.9	478.5	471
Total investment securities	3,008.7	2,472.7	4,090.0	5,463
<i>Trading securities</i>				
Listed	267.8	61.4	239.8	170
Unlisted <sup>(2)</sup>	674.2	700.6	305.5	398
Total trading securities	942.0	762.0	545.3	568
Total securities	3,950.7	3,234.7	4,635.3	6,031

(1) Securities classified as "other securities" in accordance with FSA requirements.

(2) Securities which are not listed on the London Stock Exchange or another "recognised investment exchange" (as defined in the U.K. Financial Services Act 1986).

*As at August 31, 1999 and February 28, 1999.* The book value of the Group's securities portfolio as at August 31, 1999 was £6,031 million, an increase of £1,396 million or 30% as compared to February 28, 1999. The book value of the Group's investment securities increased £1,373 million or 34% during the period. Unlisted certificates of deposit issued by banks and building societies decreased £126 million or 4%. The book value of the Group's listed investment securities as at August 31, 1999 was £1,752 million, an increase of £1,506 million from February 28, 1999 due to increased investment activity at Treasury Services. The Group's trading securities were valued at £568 million as at August 31, 1999, an increase of £23 million or 4% from 28 February 1999.

*As at February 28, 1999 and 1998.* The book value of the Group's securities portfolio as at February 28, 1999 was £4,635.3 million, an increase of £1,400.6 or 43% as compared to February 28, 1998. The book value of the Group's investment securities increased £1,617.3 or 65% during the period, lead by an increase of £1,679.6 or 78% in unlisted investment securities, which had a book value of £3,844.3 million as at February 28, 1999. Unlisted certificates of deposit issued by banks and building societies increased £1,434 million or 74%. The book value of the Group's listed investment securities as at February 28, 1999 was £245.7 million, a decrease of

£62.3 million or 20% from a year earlier. The Group's trading securities had a book value of £545.3 million as at February 28, 1999, a decrease of £216.7 million or 28% from a year earlier.

*As at February 28, 1998 and 1997.* The book value of the Group's securities portfolio as at February 28, 1998 was £3,234.7 million, a decrease of £716.0 million or 18% as compared to February 28, 1997. The book value of the Group's investment securities decreased £536.0 million or 18% during the period, lead by a decrease of £420 million or 16% in unlisted investment securities, which had a book value of £2,164.7 million as at February 28, 1998. Unlisted certificates of deposit issued by banks and building societies decreased £335.5 million or 15%. The book value of the Group's listed investment securities as at February 28, 1998 was £308.0 million, a decrease of £116.0 million or 27% from a year earlier. The Group's trading securities had a book value of £762.0 million as at February 28, 1998, a decrease of £180.0 million or 19% from a year earlier, due primarily to a decline in listed securities held by BankWest.

#### ***Provisions for bad and doubtful debts***

The Group regularly reviews the quality of its advances and other extensions of credit. Specific provisions are made against loans and other extensions of credit when, as a matter of banking judgement, it is considered that recovery is doubtful, which depends in each case on the individual circumstances of the loan or extension of credit, including, among other things, the adequacy of any collateral security. In addition, a general provision to cover advances which are latently bad or doubtful but not yet identified as such, is also maintained for use in appropriate circumstances. The general provision is augmented regularly by a formula that takes into account the magnitude and character of the portfolio of advances. Provisions made during a year (less amounts released and recoveries of amounts written off in previous years) are charged to revenue. Loans and other extensions of credit classified as bad are charged off in whole or in part when, as a matter of banking judgement, the extent of the loss incurred has been confirmed.

The following table sets forth the cumulative balances of the Group's provisions for bad and doubtful debts by type of provision and by corporate entity as at the dates indicated:

#### **Cumulative provisions for bad and doubtful debts**

	<u>As at February 28,</u>			<u>As at August 31,</u>	
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1998</u>	<u>1999</u>
	(£ millions)				
<i>Cumulative balances by type of provision:</i>					
General provision . . . . .	270.9	307.7	337.8	327.3	364.5
Specific provisions . . . . .	389.9	369.4	369.7	332.8	374.7
Total . . . . .	<u>660.8</u>	<u>677.1</u>	<u>707.5</u>	<u>660.1</u>	<u>739.2</u>
<i>Cumulative balances by corporate entity:</i>					
Bank of Scotland (including Treasury Services) . . . . .	447.8	437.9	424.6	407.9	451.9
Capital Bank . . . . .	153.3	172.7	223.2	184.2	225.4
BankWest . . . . .	28.9	31.4	35.7	29.2	39.2
British Linen Bank . . . . .	12.9	16.4	14.4	17.9	12.4
Bank of Wales . . . . .	5.8	7.5	9.6	9.0	10.3
Countrywide . . . . .	12.1	11.2	—	11.9	—
Total . . . . .	<u>660.8</u>	<u>677.1</u>	<u>707.5</u>	<u>660.1</u>	<u>739.2</u>

The following table sets forth the Group's risk provisioning rates (total provisions as a percentage of total loans and advances to customers), broken down by corporate entity, as at the dates indicated:

#### Risk provisioning rates<sup>(1)</sup>

	As at February 28,			As at August 31,	
	1997	1998	1999	1998	1999
	(in percent)			(in percent)	
Bank of Scotland (including Treasury Services) . . . . .	2.02	1.74	1.46	1.54	1.40
Capital Bank . . . . .	2.03	1.77	1.90	1.68	1.74
BankWest . . . . .	0.66	0.66	0.68	0.66	0.67
British Linen Bank . . . . .	1.93	1.66	1.57	1.77	1.36
Bank of Wales . . . . .	1.71	2.01	2.37	2.24	2.42
Countrywide . . . . .	0.45	0.45	n/a	0.54	n/a
Total . . . . .	1.75	1.55	1.50	1.45	1.41

(1) Total provisions as a percentage of total loans and advances to customers.

The following table provides an analysis of the movement in the Group's provisions for bad and doubtful debts over the periods indicated:

#### Movements in provisions for bad and doubtful debts

	As at February 28,						As at August 31,	
	1997		1998		1999		1999	
	Specific	General	Specific	General	Specific	General	Specific	General
	(\$ millions)							
Opening provisions . . . . .	441.3	238.9	389.9	270.9	369.4	307.7	369.7	337.8
Amounts written off . . . . .	(210.8)	—	(217.8)	—	(242.1)	—	(137.1)	—
Exchange movements . . . . .	(4.3)	(1.0)	(3.4)	(5.0)	(0.2)	(2.5)	0.1	0.6
Adjustments for acquisitions and disposals of subsidiaries . . . . .	—	—	0.8	2.0	(9.2)	(7.3)	—	—
New provisions less releases . . . . .	163.7	33.0	199.9	39.8	251.8	39.9	142.0	26.1
Closing provisions . . . . .	389.9	270.9	369.4	307.7	369.7	337.8	374.7	364.5
Total . . . . .	660.8		677.1		707.5		739.2	

The following table presents the ratio of cumulative provisions for bad and doubtful debts to average loans and advances as at the periods indicated:

#### Ratio of cumulative provisions to average loans and advances

	As at February 28/29					As at August 31,	
	1995	1996	1997	1998	1999	1998	1999
	(in percent)					(in percent)	
Cumulative provisions as a percentage of average loans and advances (net of provisions):							
Specific <sup>(1)</sup> . . . . .	2.17	1.54	1.12	0.92	0.83	0.76	0.76
General . . . . .	0.76	0.83	0.78	0.77	0.76	0.75	0.74
Total . . . . .	2.93	2.37	1.90	1.69	1.59	1.51	1.50

(1) Including specific provisions against lending exposure to borrowers in less developed countries.



### *Non-performing assets*

The following table sets forth the Group's non-performing assets, cumulative provisions and interest in suspense (which are deducted from advances in the balance sheet) together with their cover as a percentage of non-performing assets:

	As at February 28,			As at August 31,	
	1997	1998	1999	1998	1999
			(£	millions)	
Non-performing assets .....	<u>798</u>	<u>821</u>	<u>863</u>	<u>789</u>	<u>888</u>
Specific provisions .....	389.9	369.4	369.7	333	375
General provisions .....	270.9	307.7	337.8	327	364
Interest in suspense .....	<u>83.6</u>	<u>83.6</u>	<u>94.7</u>	<u>87</u>	<u>82</u>
Total .....	<u>744.4</u>	<u>760.7</u>	<u>802.2</u>	<u>747</u>	<u>821</u>
NPAs/total loans .....	2.2%	1.9%	1.9%	1.9%	1.7%
Cumulative provisions/NPAs .....	82.8%	82.5%	82.0%	83.7%	83.2%

*As at August 31, 1999 and February 28, 1999.* The Group's non-performing assets increased 3% to £888 million as at August 31, 1999 from £863 million as at August 31, 1998. As a percentage of customer advances, non-performing assets decreased to 1.7% as at August 31, 1999 from 1.9% as at February 28, 1999.

*As at February 28, 1999 and 1998.* The Group's non-performing assets increased 5% to £863 million as at February 28, 1999 from £821 million as at February 28, 1998. As a percentage of customer advances, non-performing assets remained unchanged at 1.9% at February 28, 1999 and February 28, 1998.

*As at February 28, 1998 and 1997.* The Group's non-performing assets increased 3% to £821 million as at February 28, 1998 from £798 million as at February 28, 1997. As a percentage of customer advances, non-performing assets decreased from 2.2% as at February 28, 1997 to 1.9% as at February 28, 1998.

### **Liabilities**

#### *Deposits*

The Group's assets are funded by the taking of both retail and wholesale deposits. Retail deposits are collected primarily through the Bank's U.K. Branch Network and Banking Direct or placed directly with Treasury Services or the Bank's other subsidiaries. Retail deposits are principally current (demand) accounts, a range of interest bearing accounts and sums placed for fixed periods. As at August 31, 1999, February 28, 1999 and February 28, 1998, approximately 4.7%, 4.8% and 5.6%, respectively, of the Group's sterling deposits from customers were non-interest bearing current accounts. The Group classifies deposits by customers as non-interest bearing (sterling or in other currencies) and interest bearing (sterling or in other currencies) and associated undertakings and joint ventures (sterling only). The Group classifies deposits by banks as sterling or other currencies. The following table shows the distribution of the Group's deposits by customers and banks and debt securities in issue for the periods indicated.

## Deposits by customers and banks and debt securities in issue

	As at February 28,			As at August 31,
	1997	1998	1999	1999
	(£ millions)			
<i>Customers</i>				
Non-interest bearing .....	1,408.1	1,447.7	1,370.1	1,561
Sterling .....	1,267.6	1,313.3	1,247.8	1,428
Other currencies .....	140.5	134.4	122.3	133
Interest bearing .....	25,684.0	28,401.8	27,197.7	26,998
Sterling .....	19,117.2	22,454.1	22,591.5	21,758
Other currencies .....	6,566.8	5,947.7	4,606.2	5,240
<i>Associated undertakings and joint ventures</i>				
Sterling .....	0.2	0.7	2.4	2
Total customers .....	27,092.3	29,850.2	28,570.2	28,561
<i>Banks</i>				
Sterling .....	2,163.4	3,420.9	2,580.2	4,305
Other currencies .....	1,999.0	2,520.5	3,571.4	4,075
Total banks .....	4,162.4	5,941.4	6,151.6	8,380
Total deposits from banks and customers .....	31,254.7	35,791.6	34,721.8	36,941
<i>Of which:</i>				
Sterling .....	22,548.4	27,189.0	26,421.9	27,493
Other currencies .....	8,706.3	8,602.6	8,299.9	9,448
<i>Debt securities in issue</i> .....				
	9,617.3	11,722.6	16,700.4	20,329
Total .....	40,872.0	47,514.2	51,422.2	57,270

The following table analyses the remaining maturities of the Group's deposits by customers and banks at the dates stated below:

### Maturity analysis of deposits

	As at February 28,			As at
	1997	1998	1999	August 31, 1999
	(£ millions)			
<i>Customer accounts</i>				
Repayable on demand .....	14,427.1	16,837.4	15,935.9	17,356
Repayable:				
in 3 months or less .....	10,675.5	10,562.9	10,742.3	8,784
between 3 months and 1 year .....	1,576.8	2,017.7	1,627.6	2,200
between 1 and 5 years .....	366.2	396.3	232.1	188
after 5 years .....	46.7	35.9	32.3	33
Total customer accounts .....	<u>27,092.3</u>	<u>29,850.2</u>	<u>28,570.2</u>	<u>28,561</u>
<i>Bank deposits</i>				
Repayable on demand .....	288.7	579.4	1,524.0	2,472
Repayable:				
in 3 months or less .....	2,510.0	3,853.4	3,264.5	4,126
between 3 months and 1 year .....	1,187.7	1,352.2	1,206.6	1,777
between 1 and 5 years .....	114.3	156.4	156.5	5
after 5 years .....	61.7	—	—	—
Total bank deposits .....	<u>4,162.4</u>	<u>5,941.4</u>	<u>6,151.6</u>	<u>8,380</u>
Total deposits .....	<u>31,254.7</u>	<u>35,791.6</u>	<u>34,721.8</u>	<u>36,941</u>

### Capital resources

The following table shows the Group's capital resources as at the dates stated below.

### Capital resources

	As at February 28,			As at
	1997	1998	1999	August 31, 1999
	(£ millions)			
Ordinary stockholders' equity .....	1,742.8	2,127.6	2,571.2	2,808
Preference stock .....	300.0	400.0	400.0	400
Proprietors' funds .....	2,042.8	2,527.6	2,971.2	3,208
Minority interests .....	130.9	122.4	132.6	150
Subordinated loan capital				
Undated .....	929.2	1,071.4	1,087.9	1,090
Dated .....	814.9	716.1	681.9	1,184
Total capital resources .....	<u>3,917.8</u>	<u>4,437.5</u>	<u>4,873.6</u>	<u>5,632</u>

### *Capitalisation and Indebtedness*

From March 1, 1990 to August 31, 1999, the Group has raised a total of £2,676 million of new capital through the issuance of the securities described below.

#### **Issuances of Capital Securities**

£98.8 million	9 <sup>3</sup> / <sub>4</sub> % Non-Cumulative Irredeemable Preference Stock
£194.5 million	Ordinary Stock (through the Rights Issue)
\$208.5 million	Floating Rate Notes Due 2000
Dfl35 million	9.72% Subordinated Registered Loans Due 1999/2001
\$300 million	8.80% Subordinated Guaranteed Notes Due 2004
£200 million	8.625% Perpetual Subordinated Notes
NZ\$50 million	10% Fixed Rate Bonds Due 2005
\$150 million	8.85% Subordinated Guaranteed Notes Due 2006
NZ\$75 million	8.75% Fixed Rate Bonds 2006
£100 million	10.25% Perpetual Subordinated Instruments
Yen 17 billion	4.25% Perpetual Subordinated Instruments
\$150 million	6.50% Subordinated Guaranteed Notes Due 2011
£111.4 million	9 <sup>1</sup> / <sub>4</sub> % Non-Cumulative Irredeemable Preference Stock
£75 million	Floating Rate Notes Due 2015
£60 million	9.00% Instruments Due 2006
Yen 9 billion	4.55% Perpetual Subordinated Instruments
£150 million	8.375% Perpetual Subordinated Instruments
A\$ 100 million	Callable Notes 2007
£118 million	9 <sup>1</sup> / <sub>4</sub> % Non-Cumulative Irredeemable Preference Stock
\$300 million	7% Reset Notes
£150 million	7.375% Perpetual Subordinated Instruments
€500 million	5.5% Subordinated Instruments Due 2009
£175 million	6.375% Subordinated Instruments Due 2019

See “*Capitalisation of Bank of Scotland.*”

### *Capital Adequacy*

The following table sets forth the development of the Group’s total capital and capital adequacy ratios as a percentage of risk-weighted assets based on BIS guidelines:

#### **Capital adequacy**

	As at February 28,			As at August 31,	
	1997	1998	1999	1998	1999
	(£ billions, except ratios)				
Tier I capital	2.2	2.7	3.2	2.9	3.4
Total capital	4.1	4.7	5.2	4.9	5.9
Risk-weighted assets	34.6	40.3	46.7	43.6	52.3
Tier I capital ratio	6.4%	6.8%	6.8%	6.8%	6.6%
Total capital ratio	11.8%	11.7%	11.1%	11.3%	11.3%

The minimum total capital ratio of 8% established by the Basle Committee serves as the base standard from which the Financial Services Authority sets individual bank's ratios, reflecting each institution's particular circumstances. As shown, the Group's capital ratios exceed the minimum requirements of the Basle Committee. Tier I capital increases year to year through retained profits and, as illustrated above, both Tier I and Tier II capital are periodically supplemented by new capital being raised. Retained earnings, which increased Tier I capital, amounted to £376 million in 1999 compared with £351 million in 1998. Tier II capital decreased by £13 million in 1999. In the six month period to August 31, 1999, Tier I capital increased by £267 million and Tier II capital increased by £475 million.

### *Contingent liabilities and commitments*

The Group's contingent liabilities consist of acceptances and endorsements, guarantees and assets pledged as collateral security and guarantees and irrevocable letters of credit. The Group's commitments consist of short term trade related transactions, undrawn note issuances and revolving underwriting facilities, undrawn formal standby facilities, credit lines and other irrevocable commitments to lend (classified as up to and including one year and over one year). The following table sets forth the Group's contingent liabilities and commitments for the dates indicated:

### **Contingent liabilities and commitments**

	As at February 28,						As at August 31,	
	1997		1998		1999		1999	
	Contract amount	Risk weighted amount	Contract amount	Risk weighted amount	Contract amount	Risk weighted amount	Contract amount	Risk weighted amount
	(£ millions)							
<i>Contingent Liabilities</i>								
Acceptances and endorsements . . . . .	300.6	241.7	205.7	195.1	214.6	198.0	162	148
Guarantees and irrevocable letters of credit . . . .	1,114.6	830.5	1,236.5	727.1	1,390.1	862.7	1,440	935
	<u>1,415.2</u>	<u>1,072.2</u>	<u>1,442.2</u>	<u>922.2</u>	<u>1,604.7</u>	<u>1,060.7</u>	<u>1,602</u>	<u>1,083</u>
<i>Commitments</i>								
Short term trade related transactions . . . . .	60.2	12.0	61.8	11.1	54.0	10.7	73	14
Undrawn note issuance and revolving underwriting facilities . . . . .	250.6	25.3	250.0	25.0	250.0	25.0	—	—
Undrawn formal standby facilities, credit lines and other irrevocable commitments to lend:								
up to and including 1 year . . . . .	2,253.5	—	2,546.4	—	2,987.7	—	3,033	—
over 1 year . . . . .	2,594.1	1,173.8	2,871.1	1,434.2	3,932.8	2,055.7	4,203	2,184
	<u>5,158.4</u>	<u>1,211.1</u>	<u>5,729.3</u>	<u>1,470.3</u>	<u>7,224.5</u>	<u>2,091.4</u>	<u>7,309</u>	<u>2,198</u>

### Geographical regions

The primary geographical split in the Group's business is between income and assets booked in the United Kingdom on the one hand, and outside the United Kingdom on the other. The following table sets forth segment information by geographical region, as determined by the domicile of the Group subsidiary or branch providing the credit, for the periods indicated and as at the dates specified:

#### Geographic segment analysis

	As at or for the year ended February 28,			As at or for the six months ended August 31,	
	1997	1998	1999	1998	1999
	(£ millions)				
<i>Interest receivable</i> . . . . .	3,400.6	3,814.8	4,126.6	1,874.0	2,112
U.K. . . . .	2,530.7	3,005.6	3,361.5	1,474.6	1,744
Non-U.K. . . . .	869.9	809.2	765.1	399.4	368
<i>Dividend income</i> . . . . .	4.9	5.4	5.0	2.5	3
U.K. . . . .	3.9	5.0	4.4	2.3	2
Non-U.K. . . . .	1.0	0.4	0.6	0.2	1
<i>Fees and commissions receivable</i> . . . . .	560.4	640.0	707.1	357.4	391
U.K. . . . .	464.6	551.4	619.5	312.6	345
Non-U.K. . . . .	95.8	88.6	87.6	44.8	46
<i>Dealing profits</i> . . . . .	19.6	25.1	36.3	16.4	13
U.K. . . . .	17.1	17.1	21.3	10.5	8
Non-U.K. . . . .	2.5	8.0	15.0	5.9	5
<i>Other operating income</i> . . . . .	47.1	39.0	40.6	17.3	19
U.K. . . . .	45.1	37.0	35.1	16.3	15
Non-U.K. . . . .	2.0	2.0	5.5	1.0	4
<i>Gross income</i> . . . . .	4,032.6	4,524.3	4,915.6	2,267.6	2,538
U.K. . . . .	3,061.4	3,616.1	4,041.8	1,816.3	2,114
Non-U.K. . . . .	971.2	908.2	873.8	451.3	424
<i>Operating profit</i> . . . . .	650.2	697.9	828.7	412.2	450
U.K. . . . .	525.0	587.9	702.7	354.9	383
Non-U.K. . . . .	125.2	110.0	126.0	57.3	67
<i>Total assets</i> . . . . .	47,232.9	54,616.0	59,693.8	56,978.9	66,389
U.K. . . . .	37,170.2	43,382.9	49,745.8	45,818.9	55,795
Non-U.K. . . . .	10,062.7	11,233.1	9,948.0	11,160.0	10,594
<i>Net assets (excluding minority interests)</i> . . . . .	2,042.8	2,527.6	2,971.2	2,747.8	3,208
U.K. . . . .	1,583.8	2,056.4	2,602.0	2,315.8	2,766
Non-U.K. . . . .	459.0	471.2	369.2	432.0	442

### Management of market risk and currency exposure

#### Market risk

Market risk leads to potential changes in the Group's financial condition as a result of movements in interest rates, foreign exchange rates or asset prices. The following paragraphs outline the Group's approach to the management of market risk. The Group Asset and Liability Committee (the "Group ALCO") has overall responsibility for the high level management of Group market risk. It ensures that market risk exposures arising from both Group trading activities and balance sheet structures are carefully monitored and managed. These exposures include structural interest rate risk, structural foreign exchange risk and liquidity risk. The Group Asset and Liability Unit ensures that the risk is transferred from the subsidiaries to Treasury Services by measuring and monitoring the residual risk in each subsidiary. Residual risk positions are controlled through limits and reported to subsidiary executive management and Group ALCO. The Group Asset and Liability Unit measures the

Group's overall market risk and this risk is monitored against approved policies. This Unit also oversees the consistency of all Group policies relating to market risk.

#### *Interest rate risk*

Structural interest rate risk arises naturally in the course of the Group's business and includes the interest rate risk inherent in offering a range of products to meet customer demands. The risk is defined as the risk to earnings and capital that arises from mismatches in the characteristics of those products including cashflows and repricing dates. A key objective of the Group ALCO is to reduce the volatility of net interest income caused by fluctuations in interest rates and this is achieved by positioning the structural balance sheet against detrimental movements. The Group ALCO approves limits for each subsidiary.

#### *Foreign exchange risk*

Structural foreign exchange risk arises from the Group's investments in overseas subsidiaries, branches and investments. The capital value of the assets and the income they generate is exposed to foreign exchange risk due to movements in foreign exchange rates. Regular reports of the structural foreign exchange risk are submitted to the Group ALCO. Investments in overseas subsidiary undertakings which may give rise to structural foreign currency exposures are reviewed regularly and, where appropriate, funded in local currencies.

The Group's policy is to minimise potential exposures to exchange rate movements which arise as a result of participation in foreign exchange markets. Consequently, individual currency exposures are continually monitored and action is normally taken to cover mismatches. Where intentional currency exposures are entered into, they are constantly monitored and managed to ensure they remain within formally approved open position limits.

#### *Liquidity risk*

Liquidity risk arises from the mismatch of the timing of cashflows relating to assets, liabilities and off balance sheet instruments. The Group's liquidity in the United Kingdom is managed by Treasury Services, a wholly owned and guaranteed subsidiary of the Bank, within guidelines laid down by the Group ALCO and within a framework set by the FSA. These guidelines ensure that the Group's funding requirements can be met at all times and that a stock of high quality liquid assets is maintained in a form and at a level which reflects prudent banking practice and meets the supervisory requirements. A further objective is to raise deposits cost effectively, while ensuring that no significant unintended mismatches arise between loans and deposits. Close control is exercised over both volume and quality of short term deposits, with the sources and maturities being managed to avoid a concentration of funding requirements at any one time or from any one source.

Treasury Services is actively involved in the London money markets and also accesses the U.S. and Euro markets through commercial paper and medium term note programmes. At August 31, 1999 the amount outstanding under these programmes was £3.3 billion, compared to £1.6 billion at February 28, 1999 and £1.8 billion at February 28, 1998.

Throughout the Group, regular reports are submitted to the relevant regulatory authorities and, where appropriate, to the Group ALCO. In BankWest, liquidity is managed by its treasury department within the policies set by its Asset and Liability Management Committee and approved by its Board. In addition to meeting regulatory criteria, liquidity management policy requires that sufficient liquid assets are held to meet fully and promptly all deposits and other liabilities as they mature.

#### *Credit risk*

Credit risk is the risk of financial loss arising from the failure of a customer to settle financial obligations to the Group as they fall due. It is the traditional or "natural risk" associated with the banking industry. The lending portfolio is reviewed within the lending divisions and through central credit monitoring to ensure the full understanding and control of credit risk throughout the Group.



Within the business and corporate portfolios there is continuous focus on the quality of individual credits both at the time of approval and throughout their lives. This is supplemented by analysis of the profile and trends within the aggregated portfolios, their industry sub-sectors and country risks. The consumer portfolio is increasingly based on the use of score card credit assessment techniques across the Group and from central monitoring as business expands.

The Group's lending book is reviewed regularly by a Credit Risk Committee, comprised of senior lending executives, and by executive boards across the Group. Taking cognisance of external or economic factors, this process may result in action being taken to adjust credit policies in line with product or sectoral needs.

#### *Derivative transactions*

The Group uses a limited number of derivative instruments for hedging and, to a limited extent, on behalf of certain of its customers. Derivative transactions are entered into by Treasury Services, for itself or on behalf of the Bank or individual U.K. subsidiaries, and by BankWest. The principal derivative instruments entered into are interest rate swaps, interest rate options, currency options and forward foreign exchange contracts.

The vast majority of the counterparties in the Group's derivative transactions are banks and other financial institutions. Trading transactions are predominantly customer driven and are generally matched.

Trading of derivatives is confined within strict parameters laid down by the respective Boards of Treasury Services in the United Kingdom and BankWest in Australia. Proprietary trading activity is restricted within modest limits. Non-trading transactions are used to hedge and reduce the interest rate and currency exposures that are inherent in any banking business.

The Group's accounting treatment of derivatives is described in the accounting policy note to the Consolidated Financial Statements included in this Offering Circular.

The risks associated with derivatives include possible counterparty default (credit risk), the effect of a sudden adverse movement in market prices for traded instruments (market risk) and unauthorised trading (operational risk). Supervision and management of these risks is undertaken by the Group ALCO and, when applicable, by the respective ALCOs of the Group companies within limits agreed by the Executive Boards and by the Group's Main Board. The Group's capital requirement to cover market risk as determined by the Capital Adequacy Directive is minimal in relation to the overall capital base reflecting the low level of trading risk undertaken.

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

### Analysis of derivatives contracts by maturity and risk-weighted amount

	As at February 28,					
	1997			1998		
	Notional Principal Amount	Repl. Cost	Risk Weighted Amount	Notional Principal Amount	Repl. Cost	Risk Weighted Amount
	(£ millions)					
<i>Exchange rate related contracts</i>						
expiring within 1 year .....	16,173.1	295.4	109.7	16,226.2	178.5	85.0
between 1 and 5 years .....	1,235.7	27.3	23.5	1,432.5	92.6	33.8
after 5 years .....	336.6	36.2	22.3	410.1	41.5	14.4
	<u>17,745.4</u>	<u>358.9</u>	<u>155.5</u>	<u>18,068.8</u>	<u>312.6</u>	<u>133.2</u>
<i>Interest rate related contracts</i>						
expiring within 1 year .....	10,369.0	78.7	16.2	13,455.5	129.9	24.8
between 1 and 5 years .....	10,207.1	94.1	38.3	14,371.9	94.5	42.8
after 5 years .....	2,534.1	57.2	28.2	3,624.3	134.2	33.4
	<u>23,110.2</u>	<u>230.0</u>	<u>82.7</u>	<u>31,451.7</u>	<u>358.6</u>	<u>101.0</u>
<i>Equity related contracts</i>						
between 1 and 5 years .....	—	—	—	—	—	—
<i>Total group derivatives</i> .....	<u>40,855.6</u>	<u>588.9</u>	<u>238.2</u>	<u>49,520.5</u>	<u>671.2</u>	<u>234.2</u>
	As at February 28,			As at August 31,		
	1999			1999		
	Notional Principal Amount	Repl. Cost	Risk Weighted Amount	Notional Principal Amount	Repl. Cost	Risk Weighted Amount
	(£ millions)					
<i>Exchange rate related contracts</i>						
expiring within 1 year .....	25,816.7*	476.6	148.2	24,046	299	127
between 1 and 5 years .....	2,398.3	49.9	41.1	1,824	58	39
after 5 years .....	361.0	35.5	13.8	333	55	24
	<u>28,576.0*</u>	<u>562.0</u>	<u>203.1</u>	<u>26,203</u>	<u>412</u>	<u>190</u>
<i>Interest rate related contracts</i>						
expiring within 1 year .....	15,893.7	175.2	35.3	19,753	155	31
between 1 and 5 years .....	19,552.3	209.2	43.3	26,783	236	45
after 5 years .....	4,273.4	232.1	42.6	5,642	189	38
	<u>39,719.4</u>	<u>616.5</u>	<u>121.2</u>	<u>52,178</u>	<u>580</u>	<u>114</u>
<i>Equity related contracts</i>						
between 1 and 5 years .....	173.6	2.1	3.2	174	28	8
<i>Total group derivatives</i> .....	<u>68,469.0*</u>	<u>1,180.6</u>	<u>327.5</u>	<u>78,555</u>	<u>1,020</u>	<u>312</u>

\* Amended

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

### Analysis of derivatives contracts by type and fair values

Group	As at February 28,							
	1997				1998			
	Non-Trading Notional Principal Amount	Trading			Non-Trading Notional Principal Amount	Trading		
		Notional Principal Amount	Fair Values			Notional Principal Amount	Fair Values	
		Asset	Liability		Asset	Liability		
	(£ millions)							
<i>Exchange rate related contracts</i>								
Forward foreign exchange .....	4,780.5	11,600.9	268.6	276.4	4,337.6	11,372.0	161.0	155.1
Cross currency swaps .....	1,089.6	143.4	—	—	2,144.9	143.6	—	0.3
Options .....	—	131.0	0.8	0.7	—	70.7	0.9	0.6
	<u>5,870.1</u>	<u>11,875.3</u>	<u>269.4</u>	<u>277.1</u>	<u>6,482.5</u>	<u>11,586.3</u>	<u>161.9</u>	<u>156.0</u>
<i>Interest rate related Contracts</i>								
Interest rate swaps .....	13,546.2	4,963.1	22.1	34.4	16,074.5	8,282.8	100.9	103.0
Forward rate agreements .....	98.3	884.8	0.3	0.8	733.9	775.6	0.3	0.2
Options .....	151.9	1,287.9	5.3	6.5	21.1	2,731.9	5.8	4.9
Futures .....	47.9	2,130.1	1.2	0.7	—	2,831.9	—	0.8
	<u>13,844.3</u>	<u>9,265.9</u>	<u>28.9</u>	<u>42.4</u>	<u>16,829.5</u>	<u>14,622.2</u>	<u>107.0</u>	<u>108.9</u>
<i>Equity related contracts</i>								
Options .....	—	—	—	—	—	—	—	—
	<u>19,714.4</u>	<u>21,141.2</u>			<u>23,312.0</u>	<u>26,208.5</u>		
<i>Total group derivatives</i> .....	<u>40,855.6</u>				<u>49,520.5</u>			

  

Group	As at February 28,				As at August 31,			
	1999				1999			
	Non-Trading Notional Principal Amount	Trading			Non-Trading Notional Principal Amount	Trading		
		Notional Principal Amount	Fair Values			Notional Principal Amount	Fair Values	
		Asset	Liability		Asset	Liability		
	(£ millions)							
<i>Exchange rate related contracts</i>								
Forward foreign exchange .....	4,542.9	19,858.1*	333.8	324.2	4,877	16,875	216	214
Cross currency swaps .....	4,017.1	51.1	1.9	—	4,178	51	2	—
Options .....	—	106.8	1.8	0.9	—	222	3	4
	<u>8,560.0</u>	<u>20,016.0*</u>	<u>337.5</u>	<u>325.1</u>	<u>9,055</u>	<u>17,148</u>	<u>221</u>	<u>218</u>
<i>Interest rate related contracts</i>								
Interest rate swaps .....	20,107.6	11,338.6	223.4	216.2	23,327	20,315	213	198
Forward rate agreements .....	353.8	1,167.8	0.6	0.7	471	1,638	1	1
Options .....	58.5	3,383.9	9.6	8.9	32	3,779	13	14
Futures .....	—	3,309.2	1.4	1.2	—	2,616	—	2
	<u>20,519.9</u>	<u>19,199.5</u>	<u>235.0</u>	<u>227.0</u>	<u>23,830</u>	<u>28,348</u>	<u>227</u>	<u>215</u>
<i>Equity related contracts</i>								
Options .....	173.6	—	—	—	174	—	—	—
	<u>29,253.5</u>	<u>39,215.5*</u>			<u>33,059</u>	<u>45,496</u>		
<i>Total group derivatives</i> .....	<u>68,469.0*</u>				<u>78,555</u>			

\* Amended

### *Credit Risk Analyses*

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

#### **Breakdown of replacement costs of derivative transactions by counterparty**

	Group			
	As at February 28,			As at August 31,
	1997	1998	1999	1999
	(£ millions)			
<i>Institutional</i>				
Financial institutions .....	490.6	577.9	950.1	882
Non-financial institutions .....	<u>98.3</u>	<u>93.3</u>	<u>230.5</u>	<u>138</u>
	<u>588.9</u>	<u>671.2</u>	<u>1,180.6</u>	<u>1,020</u>
<i>Geographical</i>				
U.K. ....	512.2	491.1	1,081.0	902
Non-U.K. ....	<u>76.7</u>	<u>180.1</u>	<u>99.6</u>	<u>118</u>
	<u>588.9</u>	<u>671.2</u>	<u>1,180.6</u>	<u>1,020</u>

### *Assets and Liabilities in Foreign Currencies*

The following table shows the aggregate amounts of assets and liabilities at the dates indicated denominated in currencies other than pounds sterling:

#### **Assets and liabilities in foreign currencies**

	Group		
	As at February 28,		
	1997	1998	1999
	(£ millions)		
Assets .....	12,074.7	14,760.5	14,338.8
Liabilities .....	16,695.9	17,026.1	19,185.8

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

## DESCRIPTION OF BUSINESS

### Bank of Scotland Group

Bank of Scotland and its subsidiaries are a diversified financial services group engaged in banking, insurance broking and financial services and finance-related activities throughout the United Kingdom and internationally. The Bank, which was established by an Act of the Parliament of Scotland in 1695, is headquartered in Edinburgh. It is a U.K. clearing bank and an “authorised institution” under the Banking Act 1987. In addition to clearing services, the Group provides a range of banking services to corporate and personal customers in the United Kingdom and abroad, including commercial loans, property finance, letters of credit, overdraft facilities, credit card services, foreign exchange, treasury services, lease financing and factoring services.

As at August 31, 1999, the Group operated from locations throughout the world including 320 branch outlets in Scotland and 23 branch outlets in London and other regional commercial centres in England, as well as from overseas branches in New York City, Hong Kong, Paris, Amsterdam and Frankfurt and representative offices in Chicago, Houston, Jacksonville, Los Angeles, Boston, Seattle, Minneapolis and Singapore. As at August 31, 1999 the Group employed approximately 20,000 people on a full-time equivalent basis.

### Historical Organisation

The Group’s business has historically been organised and as a result reported along the lines of its principal operating subsidiaries. In the United Kingdom, the Group operates through the Bank (which includes for operational and reporting purposes Treasury Services) and through its principal wholly-owned U.K. subsidiaries: Capital Bank, British Linen Bank and Bank of Wales. In Australia, the Group operates through BankWest, in which it has a 55.39% interest.

- *The Bank*, including Treasury Services, accounted for approximately 67% of the Group’s total assets as at February 28, 1999 and 73% (£730.9 million) of profit before taxation in the year ended February 28, 1999, and 67% (£313 million) of the Group’s profit before taxation in the six month period ended August 31, 1999.
- *Capital Bank* accounted for approximately 20% of the Group’s total assets as at February 28, 1999 and 17% (£166.1 million) of profit before taxation in the year ended February 28, 1999, and 22% (£103 million) in the six month period ended August 31, 1999.
- *BankWest* accounted for approximately 10% of the Group’s total assets as at February 28, 1999 and 7% (£71.2 million) of profit before taxation for the year ended February 28, 1999, and 9% (£43 million) of profit before taxation in the six month period ended August 31, 1999, after adjustment for minority interests.
- *British Linen Bank* accounted for 2% of the Group’s total assets as at February 28, 1999 and 2% (£23.3 million) of profit before taxation for the year ended February 28, 1999, and 1% (£7 million) of profit before taxation in the six month period ended August 31, 1999.
- *Bank of Wales* accounted for 1% of the Group’s total assets as at February 28, 1999 and 1% (£10.1 million) of profit before taxation for the year ended February 28, 1999, and approximately 1% (£5 million) of profit before taxation in the six month period ended August 31, 1999.

### U.K. Group Reorganisation

In January 1999, the Bank announced the creation of a new organisational structure for managing the businesses of the Bank and its direct and indirect U.K. subsidiaries. Since then, the various profit centres that were previously within divisions of the Bank have been realigned into and report through new structures, Personal Banking, Business Banking and Corporate Banking and Structured Banking, which are supported by the Services Division and the Group Office. During the course of 1999, the operations of the Bank’s direct and indirect U.K. subsidiaries, including Capital Bank, British Linen Bank and Bank of Wales, have largely been realigned to report for management purposes through this new structure. Financial information was reported by

corporate entity until the end of fiscal year ended February 29, 2000. The operations of BankWest are not affected by the new structure.

The objectives of the reorganisation are to:

- facilitate growth in the personal, business and corporate and structured markets by allowing a more focused approach to business development and the provision of products and services tailored for specific customer markets;
- strengthen and expand customer relationships by offering more products and services to customers throughout the Group which previously were offered only to customers of the Bank or a particular subsidiary;
- improve the Group's ability to enter and develop new markets and launch new products by combining previously segregated product development and marketing resources;
- employ the best business practices across the Group; and
- improve operational efficiency of both the business divisions and support services through integration and economies of scale.

### ***Personal Banking***

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

- residential mortgage products provided through branches and intermediaries, as well as directly through Bank of Scotland Mortgages Direct;
- credit cards and charge cards to branch-based customers, to other customers and to members of affinity groups;
- telephone banking services, including cheque accounts, savings accounts and unsecured personal loans; and
- other services, including offshore services, marketing at customers' workplaces, wire transfers, general insurance, trustee services and tax services.

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

### ***Business Banking***

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

- a range of core banking services available through business centres and branches in Scotland, England and Wales;

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

### ***Corporate Banking and Structured Banking***

The Group's Corporate Banking and Structured Banking functions are closely interrelated in terms of corporate customer base and cross-referrals of customers, as well as shared functions, including a common credit risk committee and common members of their respective management boards.

#### *Corporate Banking*

Corporate Banking, which is charged with developing the corporate business of the U.K. Group, provides a variety of banking services to corporate and institutional customers with an annual turnover of over £10 million. These services include loans and deposits in a range of currencies, project and specialist financing, particularly in the oil and gas industries, acquisition financing, and syndicated lending. Corporate Banking is organised into five business areas: Corporate Banking Scotland (with operations and a customer base in Scotland); Corporate Banking England (with operations and a customer base in England); International Business (with loan origination offices in Hong Kong, Singapore, Sydney, Paris, Amsterdam and Frankfurt); North America (with loan origination offices in New York, Chicago, Houston, Los Angeles, Jacksonville, Boston, Seattle and Minneapolis); and Specialist Functions (which provides project finance primarily in Europe).

At August 31, 1999, Corporate Banking operated in the United Kingdom, with main offices in Edinburgh, Glasgow and London, and internationally through its branch, subsidiary and representative offices. A subsidiary operation in Australia undertakes both corporate finance and treasury activities on behalf of Group companies.

#### *Structured Banking*

Structured Banking is responsible for the development and provision of structured finance services to medium-size and large corporations throughout the United Kingdom and in certain continental European markets. The key objectives of Structured Banking are to expand and strengthen the Group's corporate market share by creating new products and delivering specialist services to existing and new customers.

Structured Banking's activities are undertaken from corporate centres in Edinburgh and London, with additional representation in Frankfurt, Paris and Amsterdam.

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

As a result of the restructuring, numerous internal support functions have been amalgamated into two new areas, the Services Division and Group Office, which are expected to increase efficiency.

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

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



## Principal Group Subsidiaries

In the United Kingdom, the Group has historically organised and operated its businesses through four principal operating subsidiaries, Treasury Services, Capital Bank, British Linen Bank and Bank of Wales, and their respective subsidiaries. The operations of these principal subsidiaries have been largely integrated into the new operational structure of the Group through a process of realignment of management, personnel and assets in these subsidiaries along business lines. The Group will report its results along business lines, and not by principal subsidiaries, effective from March 1, 2000.

### *Treasury Services*

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

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

### *Capital Bank*

Capital Bank, which became a direct wholly-owned subsidiary of the Bank in 1958, has traditionally provided business and consumer financing. Its principal activities, undertaken either directly or by its subsidiaries and associated undertakings, have been the provision of loans and credit facilities to the U.K. personal sector by way of unsecured personal loans, hire purchase financing for motor vehicles and other equipment, revolving credit facilities and residential mortgages and the provision of asset finance to the business sector through medium term loans, finance and operating leases, contract hire facilities and invoice discounting. Capital Bank's activities have been managed, on a product and customer-segment basis, by four independent business operations groups which cover the Personal, Motor Vehicle, Business and Large Corporate sectors within the United Kingdom and which have now been integrated into the Group's new operational structure.

- The Personal Operation specialises in consumer lending using direct marketing and telesales from its operational bases in Chester, Manchester and Warrington and provides residential mortgages through Capital Bank's wholly-owned subsidiary, The Mortgage Business plc, based in Chester. A key strategy of the Personal Operation has been the development of affinity relationships with groups and organisations, such as the Automobile Association and Great Universal Stores plc, whose substantial proprietary customer databases are used to sell the Group's products and services.
- The Motor Operation provides retail motor vehicle finance and wholesale vehicle stocking facilities to motor vehicle dealers. As at August 31, 1999, the Motor Operation's principal centres were in Liverpool, Chester, Manchester and Cardiff, with 11 additional branches. The Motor Operation has important affinity relationships with Renault, with whom the Motor Operation operates a joint venture company through a dedicated network of eight branches, Inchcape, International Motors, Daewoo and Porsche.

- The Business Finance Operation is administered from Purley and, as at August 31, 1999, operated through a mainland U.K. network of 20 business centres. In addition, the Group's contract hire business operates through three wholly-owned subsidiaries based in Bushey, Cardiff and Edinburgh. Its invoice discounting business is operated through a wholly-owned subsidiary based in Reading with six branches.
- The Corporate Operation services major U.K. corporate customers from Capital Bank's headquarters in Chester and focuses primarily on asset finance for the aviation, commercial shipping, commercial property and corporate car fleet markets.

Credit protection insurance services are provided to all Capital Bank's business operations by a wholly-owned insurer, St Andrew's Group plc, based in New Malden.

Outside the United Kingdom, Capital Bank conducts business through Equity Bank Limited, a Republic of Ireland regulated bank based in Dublin; Capital Finance Australia Limited in Australia, with branches in Sydney, Melbourne, Brisbane, Adelaide and Perth; and NEWS BANQUE, a branch of Capital Bank, which commenced its trading activities in February 1998 in Tours, France. The activities of the international businesses are similar to those undertaken in the United Kingdom.

#### *BankWest*

BankWest, which is based in Perth, Western Australia, is listed on the Australian Stock Exchange. The Bank currently holds 55.39% of its outstanding shares. BankWest provides a range of retail and commercial products through its branches, of which there were 87 as at August 31, 1999, and through electronic and telephone banking channels. In its home state of Western Australia, BankWest is a market leader, with 24.7% of all bank loans and advances in September 1999. In Australia's interstate markets, BankWest markets a selected range of products primarily through third parties. It has offices in Sydney, Melbourne, Brisbane and Adelaide. BankWest's goals include strengthening its market leadership in Western Australia and expanding its interstate operations, with the aim of becoming a leading national provider of financial services.

BankWest has appointed an advisor with a view to exploring options regarding the future of BankWest. No decision has been taken by the Bank regarding its investment in BankWest.

#### *British Linen Bank*

British Linen Bank is a wholly owned subsidiary of the Bank and, prior to the restructuring, was engaged in a range of financial services including corporate banking, property funding, infrastructure project advice and funding, corporate finance advice, asset finance, treasury services and venture and development capital. As a result of the structural reorganisation of the Group, since July 1999 the financial services previously provided by British Linen Bank have been progressively realigned and integrated with similar operations undertaken elsewhere in the Group. With effect from September 1, 1999, the asset finance business of British Linen Asset Finance Group Limited and its subsidiaries was transferred to Capital Bank and the property funding and venture and development capital subsidiaries of British Linen Bank were transferred to other companies within the Group. The corporate banking and infrastructure advice and funding services of British Linen Bank were integrated with those of the Bank. The sale of the corporate finance advisory business was completed on February 4, 2000.

#### *Bank of Wales*

Bank of Wales, a wholly owned subsidiary of the Bank, is a regional bank headquartered in Cardiff. As at August 31, 1999, it had eight branch offices. Its primary activity is business lending. It also provides personal loans, deposit accounts, international services and venture capital funding.

### **Employees**

In the six month period ended August 31, 1999, the Group employed over 20,000 people on a full-time equivalent basis. Certain of the Group's employees in the United Kingdom are members of the union UNIFI

(formerly the Banking, Insurance & Finance Union), which is recognised by the Group as representing the interests of such employees. The Group considers its relations with its employees to be satisfactory.

## **Properties**

As at February 28, 1999, the Group operated throughout the world, principally in the United Kingdom, including 320 branch outlets of the Bank in Scotland. The majority of the Group's properties are owned by the Bank.

## **Legal Proceedings**

There are no legal proceedings pending or, so far as the Bank is aware, threatened against the Bank or any of its subsidiaries, the result of which is likely to have a material effect on the Bank or any of its subsidiaries.

## **Competition**

### *United Kingdom*

The banking market in the United Kingdom is characterised by continuing structural change which has increased competition in recent years from a variety of sources, including merged banks, demutualised life insurers and building societies and diversified consumer services companies. The impact of these changes is still being felt, particularly in the form of more aggressive competition and drives to greater productivity through reductions in branch networks and employees with greater use of technology.

In addition, the U.K. financial services industry has continued to attract new entrants, often well-established non-financial companies with large customer bases or insurance companies. Technology has lowered many traditional barriers to such new entrants. For example, several supermarkets have started banks, generally as joint ventures with existing banks and life insurance companies, that provide certain banking products and services using new technology and their established brand names to reach existing customer bases. Sainsbury's Bank plc, in which the Bank has a 45% shareholding, is a successful example of such a "supermarket" bank.

As at August 31, 1999 the Bank had 320 branch outlets in Scotland and 23 branch outlets in London and other regional commercial centres in England. In Scotland, the Bank has a significant share of a number of products in the retail banking market, where the Bank's principal competitors are the other Scottish clearing banks, The Royal Bank of Scotland plc, Clydesdale Bank plc and TSB Bank Scotland plc. Elsewhere in the United Kingdom, the Bank competes with U.K. clearing banks, the major international banks represented there and the U.K. building societies.

The U.K. markets for Capital Bank, the Group's largest U.K. subsidiary, are characterised by intense competition in a generally over-supplied market which has moderated growth in demand for Capital Bank's products, particularly in the commercial sector, putting pressure on new business lending margins. Capital Bank has pursued a strategy of asset and industry specialisation in order to achieve asset growth and increased net income.

### *Australia*

BankWest is the largest bank in its home state of Western Australia, where it has a market share of approximately 25%, and active in other Australian states, where it is pursuing growth through an extensive network of finance brokers and a growing number of affinity programmes with power utilities, professional associations and other groups.

### *International*

The Group's other overseas operations are conducted through its branches in New York, Hong Kong, Paris, Amsterdam and Frankfurt and representative offices in Boston, Chicago, Houston, Jacksonville, Los Angeles, Minneapolis, Seattle and Singapore. In these locations, the Group competes with a wide variety of large domestic and international banks.

## Regulation and Supervision

The Bank has entered into customary understandings with relevant supervisory authorities that, among other things, will ensure that its subsidiaries comply with the regulatory requirements of the appropriate jurisdictions.

### *Regulation and Supervision in the United Kingdom*

As part of recent reforms to financial regulation in the U.K., responsibility for banking supervision was transferred from the Bank of England to the FSA (formerly known as the Securities and Investments Board) on June 1, 1998, pursuant to the Bank of England Act 1998.

Following the transfer of banking supervision, the Bank of England and the FSA have maintained close working relationships and the agreed framework for co-operation in the field of financial stability 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. The Memorandum of Understanding explains how the three authorities work together towards the common objective of financial stability and sets out how their respective responsibilities are to be discharged. The division of responsibilities is based on four guiding principles:

- (i) clear accountability;
- (ii) “transparency” (*i.e.*, the U.K. Parliament, the markets and the public must know who is responsible for what);
- (iii) no duplication; and
- (iv) regular information exchange.

The respective responsibilities of the Bank of England, the FSA and HM Treasury may be summarised as follows:

#### (i) Bank of England

The Bank of England is responsible for the overall stability of the financial system as a whole which involves:

- (a) monitoring the stability of the monetary system;
  - (b) the financial system infrastructure, in particular payments systems at home and abroad;
  - (c) maintaining a broad overview of the financial system through its monetary stability role and the Deputy Governor’s membership of the Financial Services Authority’s Board;
  - (d) the undertaking of official financial operations; and
  - (e) the efficiency and effectiveness of the financial sector, with particular regard to international competitiveness.
- #### (ii) The Financial Services Authority

The FSA’s powers and responsibilities are set out in statute such as the Bank of England Act 1998. It is currently responsible for:

- (a) the authorisation and prudential supervision of banks, building societies, investment firms, insurance companies and friendly societies;
- (b) the supervision of financial markets, clearing and settlement systems;
- (c) the conduct of operations in response to problem cases affecting firms, markets, clearing and settlements systems; and
- (d) regulatory policy in the foregoing areas.

#### (iii) HM Treasury

HM Treasury is responsible for the overall institutional structure of regulation and the legislation which governs it. It has no operational responsibility for the activities of the FSA or the Bank of England and will not be involved in them. However, there are a variety of circumstances where the FSA and the Bank of England will

need to alert HM Treasury about possible problems *e.g.*, where there may be a need for a support operation or a problem arises which could cause wider economic disruption.

The FSA seeks to maintain the standards of banking supervision set by the Bank of England and will continue to implement the changes designed to improve the overall effectiveness of the predecessor Bank of England Supervision and Surveillance Division identified following the review of the Division's operation by Arthur Andersen in 1995. The FSA has published a revised version of the Statements of Principles together with a new Guide to Banking Supervision Policy.

The FSA monitors the operations of the Bank and its U.K. banking subsidiaries, including Treasury Services, Capital Bank, British Linen Bank and Bank of Wales, all of which are "authorised institutions" under the Banking Act 1987.

The FSA is broadly empowered to request information from and give directions to banks and also sets standards that serve as guidelines for banks under its supervision. Each bank is obliged to submit regular reports to the FSA which provide material for supervisory assessment. The approach being adopted by the FSA in supervising banks is risk-based with the objectives of (i) systematic assessment of whether a bank meets Banking Act 1987 authorisation criteria, (ii) understanding the quality of the management and the risks banks face, (iii) using appropriate supervisory tools to identify risks such as reporting accountants reports on internal controls and (iv) allocating resources proportionate to risk by focusing on banks with a high risk profile.

Under the Banking Act 1987 (as amended by the Bank of England Act 1998), a Board of Banking Supervision advises the FSA with respect to its banking supervisory duties. In addition, banks must report, and in some cases obtain consent for, large single exposures (consent being required for any single exposure exceeding 25% of a bank's capital) and large exposures to related borrowers. Such legislation also permits the FSA to obtain independent confirmation from reporting accountants as to the accuracy of accounting records and prudential returns and the adequacy of internal controls.

With effect from July 1, 1995 under the EC Deposit Guarantee Directive the level of U.K. deposit compensation (similar to deposit insurance in the United States) was set at 90% of aggregate protected deposits up to a maximum total payment the greater of £18,000 and €20,000.

The Group's securities and investment businesses in the United Kingdom, including the sale of personal financial services in the investment field through its bank branches, are regulated under the U.K. Financial Services Act 1986 (the "Financial Services Act"), which established a framework for investor protection by the regulation of investment businesses and securities markets. The Financial Services Act vested principal regulatory authority in HM Treasury, which delegated certain powers to the then Securities and Investments Board (the "SIB"), the principal regulatory agency under the statutory scheme.

In turn, the SIB authorised a number of self-regulating organisations ("SROs") and professional bodies, which authorise and supervise most individual securities and investment businesses. Many of the activities of the Group are regulated by SROs. Pursuant to rules promulgated under the Financial Services Act, the Bank was required to decide whether to market through its branches the investment products of only one company or, alternatively, to become an independent intermediary to provide its customers with impartial advice. The Bank has chosen, from March 5, 1999, to market through its branches the investment products of its own Marketing Group, comprising St. Andrew's Life Assurance plc, for life and pension products, and Bank of Scotland Open Ended Investment Company, for Collective Investment products.

The U.K. Government is proposing further reforms which would establish the FSA as the single statutory regulator for all financial services business in the U.K. Proposed legislation, the Financial Services and Markets Bill, is likely to come into force in 2000. According to U.K. Government announcements, the FSA will, in due course, combine the regulatory and registration functions of the following regulatory bodies; the Building Societies Commission, the Friendly Societies Commission, the Insurance Directorate of HM Treasury, the Investment Management Regulatory Organisation, Personal Investment Authority, Registry of Friendly Societies, the Securities and Futures Authority and the SIB. As discussed above, the FSA has already assumed responsibility for banking supervision from the Supervision and Surveillance Division of the Bank of England.



The FSA will also be given responsibility for the authorisation of firms currently authorised to do investment business by virtue of their membership of a recognised professional body.

As at August 31, 1999, the Bank met and exceeded the minimum capital requirements of the Basle Guidelines and the FSA relating to capital adequacy. It does not expect that continued compliance with the Basle Guidelines will impede the development of the Group's activities.

### ***Regulation and Supervision in the United States***

Because of its federally-licensed branch located in New York City (the "New York Branch"), the Bank is subject to the International Banking Act of 1978, as amended (the "IBA") and thus to various federal statutes, including the Bank Holding Company Act of 1956, as amended (the "BHCA") and to certain provisions of the Federal Reserve Act, as amended. The IBA and the BHCA restrict the U.S. non-banking activities of the Bank (and any company that controls the Bank within the meaning of the IBA) in a manner similar to the restrictions currently applicable to U.S. domestic bank holding companies.

On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act (the "GLBA"), sweeping legislation that generally could allow bank holding companies and foreign banks with U.S. branches, like the Bank, to engage in a wider range of nonbanking activities, including greater authority to engage in securities and insurance activities. Prior to its amendment by the GLBA, the BHCA generally prohibited the Bank from directly or indirectly acquiring more than 5% of the voting shares of any company engaged in non-banking activities in the United States unless the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") has determined, by order or regulation, that such proposed activities were so closely related to banking or managing or controlling banks as to be a proper incident thereto.

The GLBA makes significant changes in U.S. banking law, principally by repealing certain restrictive provisions of the 1933 Glass-Steagall Act and the BHCA. Under the GLBA, the Bank could qualify to become a "financial holding company" and, as such it would be permitted to engage in any activity that the Federal Reserve Board determines by regulation or order is (1) financial in nature, (2) incidental to any such financial activity, or (3) complementary to any such financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally; provided that any determination made by the Federal Reserve Board in connection with (1) or (2) above must be made in consultation with the Secretary of the Treasury. The GLBA specifies certain activities that are deemed to be financial in nature, including lending, exchanging, transferring, investing for others, or safeguarding money or securities; underwriting and selling insurance; providing financial, investment, or economic advisory services; underwriting, dealing in or making a market in, securities; and any activity currently permitted for bank holding companies by the Federal Reserve Board under section 4(c)(8) or 4(c)(13) of the BHCA. The GLBA does not authorise banks or their affiliates to engage in commercial activities that are not financial in nature.

Under the GLBA, to qualify as a financial holding company the Bank would be required to satisfy certain criteria to be set forth in the Federal Reserve Board regulations, but which criteria are required to be "comparable" to the well-capitalized and well-managed standards applicable to U.S. bank subsidiaries of domestic bank holding companies electing to qualify as financial holding companies "giving due regard to the principle of national treatment and equality of competitive opportunity". On January 19, 2000, the Federal Reserve Board issued an interim rule setting forth the "well-capitalized" and "well-managed" standards that international banks with U.S. branches and agencies, such as the Bank, must satisfy to elect to be treated as a financial holding company under the GLBA. The interim rule provides two methods for applying the well-capitalized standard to international banks with U.S. branches or agencies. Under the first method, such an international bank is regarded as well-capitalized if (1) its home country supervisor has adopted risk-based capital standards that are consistent with the Basle Capital Accord; (2) the bank's Tier I and total risk-based capital ratios, as calculated under its home country standards, are at least 6% and 10%, respectively; (3) the bank's ratio of Tier I capital to total assets (a so-called "leverage test") is at least 3% and (4) the Federal Reserve Board determines that the bank's capital is "comparable to the capital required for a U.S. bank owned by a financial holding company". Under the second method, which is available to any international bank whose home country supervisor has not adopted risk-based capital standards consistent with the Basle Capital Accord and to any

international bank that is eligible for the first method but does not meet the prescribed minimum standards, the bank may request a prior determination from the Federal Reserve Board that its capital is “otherwise comparable to the capital that would be required of a U.S. bank owned by a financial holding company”. The interim rule provides that the Federal Reserve Board will endeavor to make a determination on such request within 30 days of receipt. In assessing an international bank’s capital under the rule, the Board may take into account such factors as the composition of capital, accounting standards, long-term debt ratings, reliance on government support to meet capital requirements and the extent to which the bank is subject to comprehensive consolidated supervision. The interim rule also sets forth three criteria for applying the well-managed standard to international banks: (1) each U.S. branch and agency of the bank must have received at least a “satisfactory” composite rating at its most recent examination; (2) the bank’s home country supervisor must consider the overall operations of the bank to be “satisfactory or better” and (3) the Federal Reserve Board must determine that the management of the bank “meets standards comparable to those required of a U.S. bank owned by a financial holding company”. The preamble to the interim rule notes that the Federal Reserve Board will consult with home country supervisors regarding the capital and management of an international bank “as appropriate”. The interim rule becomes effective March 11, 2000; however, the Federal Reserve Board is soliciting comments on the interim rule which could result in changes in the currently published requirements. An international bank that is not a financial holding company may continue to engage in activities in the United States subject to the BHCA requirements applicable to companies which choose not to be designated as a financial holding company. The Bank has not yet determined whether to qualify as a financial holding company under the GLBA.

The GLBA also contains a number of other provisions that will affect the Bank’s operations (regardless of whether the Bank elects to qualify as a financial holding company) and the operations of all financial institutions. One of the new provisions relates to the financial privacy of consumers. In addition, effective 18 months after enactment (May 2001) of the GLBA, the so-called “push-out” provisions of the GLBA will eliminate the exclusion of banks (including U.S. branches of foreign banks) from the definitions of “broker” and “dealer” under the Securities Exchange Act of 1934. In effect, this change will generally require most securities activities currently permissible for the New York Branch itself to be conducted in a U.S.-registered broker-dealer affiliate of the Bank. Numerous provisions of the GLBA have delayed effective dates and require implementing regulations. At this time, the Bank is unable to predict the impact the GLBA may have on its or its subsidiaries’ financial condition or results of operations.

BHCA restrictions on the acquisition of U.S. banks are unaffected by the GLBA. Accordingly, as was the case prior to enactment of the GLBA, the Bank is required to obtain the prior approval of the Federal Reserve Board before acquiring, directly or indirectly, the ownership or control of more than 5% of the voting shares of any U.S. bank or bank holding company. Under regulations issued by the Federal Reserve Board, the Bank is also restricted from engaging in tying arrangements involving certain products and services.

The IBA imposes restrictions on the establishment by the Bank of a branch or agency outside its home state (which is New York). In addition, the Bank’s New York Branch is subject to the Federal Reserve Board reserve requirements on deposits and to restrictions on the payments of interest on demand deposits. Deposits with the Bank’s New York Branch are not insured (or eligible for deposit insurance) with the Federal Deposit Insurance Corporation.

Pursuant to, and subject to the conditions of, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, the Bank may acquire a bank outside New York without regard to whether the acquisition is authorized by state law.

In addition, the New York Branch, licensed by the Comptroller of the Currency (the “Comptroller”), is subject to regulation by the Comptroller under the IBA, similar in many respects to regulations imposed on national banks. The Bank’s U.S. representative offices located in Chicago, Illinois; Jacksonville, Florida; Houston, Texas; Seattle, Washington; Boston, Massachusetts and Los Angeles, California; Minneapolis, Minnesota are state-licensed and regulated by state banking authorities in the states in which they are located. These offices must comply with the banking regulations of such states, as well as the IBA. In addition, these offices are subject to the authority of the Federal Reserve Board.



### *Regulation and Supervision in Australia*

Australian banks operate under the prudential guidelines of the Australian Prudential Regulation Authority (“APRA”), which is a new statutory body that assumed this role from the Reserve Bank of Australia in July 1998. The prudential guidelines have been developed to reflect the important role of banks within the Australian economy, to ensure that the banking system remains stable and to protect Australian depositors. Australian banks, other than state owned banks, are required by the Banking Act 1959 (Commonwealth) to hold a banking authority. BankWest was granted such an authority from December 1, 1995.

A review of the prudential guidelines in April 1998 resulted in a new Prudential Statement on Liquidity Management. This statement placed the emphasis on banks’ internal management practices and required banks to have systems in place to manage liquidity under different scenarios, including normal day-to-day operations and a bank-specific (“name”) crisis. In particular, banks must be able to demonstrate that they would have sufficient liquidity to keep operating for at least five business days under a “name” crisis. Banks can use a range of strategies to manage liquidity, including holding liquid assets, setting limits on maturity mismatches, diversifying liability sources and developing asset sale strategies.

In addition to liquidity management, Australian Banks must report large loan exposures to APRA. Each bank is required to provide a large exposure policy statement, report quarterly all large exposures of more than 10% of its capital base, review and limit the size of large exposures, and notify any intention to enter into an exceptionally large exposure (defined as an exposure in excess of 30% of its capital base), to ensure this would not result in excessive risk. APRA regularly meets senior management of each bank to discuss a wide range of issues, including the bank’s strategic plan, recent performance, prudential compliance and management.

## MANAGEMENT

The Board of Directors of the Bank, under the chairmanship of the Governor, is responsible to the Bank's proprietors. The Board meets once a month and on other occasions as required, to consider major policy matters and developments, large lending proposals and other relevant business. Supporting the Governor on the Board are three executive directors (including the Group Chief Executive, and the Treasurer and Managing Director), a non-executive Deputy Governor and eleven non-executive directors from a wide range of commercial and industrial backgrounds. In January 1999, the Bank announced the creation of a new organisational structure for managing the businesses of the Bank (including Treasury Services) and its direct and indirect UK subsidiaries. The reorganisation of the Group was largely completed during the course of 1999, and the Group's businesses and operations are now managed through the new structure. See "*Description of Business — U.K. Group Reorganisation*".

Responsibility for the day-to-day management of the Group has been delegated by the Board and by the boards of the principal UK Group Companies to the Group Management Board. The nine members of the Group Management Board are the three executive Directors of the Bank together with the Divisional Chief Executives of each of Personal Banking, Business Banking, Corporate Banking and Structured Banking, the Divisional Chief Executive of Group Treasury and Finance and the Divisional Chief Executive of the Services Division. The Group Management Board meets monthly and (where decisions are beyond its delegated powers) makes recommendations to the Board for its determination.

Within the Bank there are, at any given time, a number of developments and projects which require co-ordinated attention, effort and expertise from across the Group. Often such matters are dealt with through specially established working parties or committees of the Group Management Board or the management boards of the Divisions.

### Board of Directors

Name	Principal Occupations	Director since	Beneficially owned at	Executive Options	Non-beneficially owned at
			February 29, 2000 Ordinary Stock		February 29, 2000 Ordinary Stock
Sir John Shaw†	Governor of Bank of Scotland, Company Director	1990	109,833	—	—
Sir Bob Reid	Deputy Governor of Bank of Scotland, Company Director	1987	22,705	—	—
Peter A. Burt†	Group Chief Executive of Bank of Scotland	1995	302,158	455,000	—
Gavin G. Masterton†*	Treasurer and Managing Director of Bank of Scotland	1997	299,005	372,000	—
John A. Mercer**	Executive Director of Bank of Scotland	1999	34,016	59,500	—
Sir Ronald Garrick***	Chairman of the Weir Group PLC	2000	2,000	—	—
Allan G. Gormly****	Company Director	1997	6,936	—	1,440
Sir Alistair Grant	Chairman of Scottish & Newcastle plc	1992	49,664	—	—
Sir Russell Hillhouse	Company Director	1998	1,209	—	—
Ian B. Inglis†	Company Director	1997	7,500	—	—
Brian G. Ivory	Company Director	1998	10,000	—	18,000
Lesley M. S. Knox	Company Director	1993	1,759	—	—
John N. Maclean	Company Director	1995	5,000	—	—
James Miller†	Company Director	1993	17,525	—	10,165
Angus M. Pelham Burn	Company Director	1977	108,649	—	11,310
Sir Robert Smith	Chief Executive of Deutsche Asset Management Group Limited	1998	5,500	—	—

† As at February 29, 2000, Sir John Shaw, Mr. Peter Burt, Mr. Gavin Masterton, Mr. Ian Inglis and Mr. James Miller all had a non-beneficial interest in 7,792,957 Ordinary Stock Units, as Trustees of the Bank's Profit Sharing Stock Ownership Scheme.

\* As at February 29, 2000, Mr. Gavin Masterton held Savings-Related Stock Options in respect of 3,161 Ordinary Stock units of the Bank.

\*\* As at February 29, 2000, Mr. John Mercer held Savings-Related Stock Options in respect of 7,201 Ordinary Stock units of the Bank.

\*\*\* Sir Ronald Garrick's stock interest is stated as at 1st March 2000, the date of his appointment to the Board.

\*\*\*\* As at February 29, 2000, Mr. Allan Gormly was beneficially interested in 60,669 £1.00 units of 9¾% Non Cumulative Irredeemable Preference Stock.

## Group Management Board

<u>Name</u>	<u>Title</u>	<u>Beneficially owned at February 29, 2000 Ordinary Stock</u>	<u>Executive Options</u>	<u>Savings Related Options</u>
Peter A. Burt*	Group Chief Executive	302,158	455,000	—
Gavin G. Masterton*	Treasurer and Managing Director	299,005	372,000	3,161
John A. Mercer	Executive Director	34,016	59,500	7,201
Colin D. Leslie	Divisional Chief Executive — Structured Banking	52,973	133,500	—
Roy Littler	Divisional Chief Executive — Services	39,541	108,500	9,099
Colin S. McGill	Divisional Chief Executive — Corporate Banking	107,685	235,000	—
W. Gordon McQueen	Divisional Chief Executive — Treasury & Finance	52,731	160,000	—
Colin Matthew	Divisional Chief Executive — Business Banking	37,408	161,000	—
George E. Mitchell	Divisional Chief Executive — Personal Banking	30,410	125,000	—

\* As at February 29, 2000, Mr. Peter Burt and Mr. Gavin Masterton each had a non-beneficial interest in 7,792,957 Ordinary Stock Units as Trustees of the Bank's Profit Sharing Stock Ownership Scheme.

### Terms of Office of Directors

At each Annual General Meeting of stockholders of the Bank, a Governor, and not more than two Deputy Governors are required to be re-elected. All Directors are required to submit themselves for re-election every three years in accordance with the Bank's constitution.

### Remuneration of Directors

The aggregate remuneration paid to the Directors by any member of the Group for the year ended February 28, 1999 was £1,841,219 including bonuses, pension contributions and benefits in kind.

### Advances to Directors, Officers and Connected Persons

As at February 28, 1999, there were loans by the Group outstanding to 19 Directors, officers and connected persons in the aggregate principal amount of £1.2 million.

## **STOCK OWNERSHIP**

As at February 29, 2000, no notification had been received by the Bank of any single interest in more than 10% of the issued Ordinary Stock of the Bank.

As at February 29, 2000, the Directors and Group Management Board of the Bank beneficially held approximately 0.10% of the issued Ordinary Stock of the Bank.

## DESCRIPTION OF CAPITAL STOCK

*The following information is a summary of the material terms of the capital stock of the Bank and is qualified in its entirety by reference to the Regulations. Holders of the Preferred Securities are encouraged to read the full Regulations, which are available as described under "General Information".*

### General

During the period from March 1, 1996 to February 29, 2000, the following changes in the number of authorised and issued Bank of Scotland Ordinary Stock Units have occurred:

	Authorised	Issued
<b>As at March 1, 1996</b> .....	1,380,793,137	1,183,011,272
<i>Changes during year:</i>		
Issued under Ordinary Dividend Stock Alternative Scheme .....		2,156,677
Issued under Savings-Related Stock Option Schemes .....		2,832,307
Issued under Executive Stock Option Schemes .....		3,576,054
Issued under Profit Sharing Scheme .....		5,035,495
<b>As At March 1, 1997</b> .....	1,380,793,137	1,196,611,805
<i>Changes during year:</i>		
Issued under Ordinary Dividend Stock Alternative Scheme .....		2,417,115
Issued under Savings-Related Stock Option Schemes .....		4,169,650
Issued under Executive Stock Option Schemes .....		2,876,509
Issued as consideration for acquisition of EFT Group plc .....		21,157,289
<b>As At March 1, 1998</b> .....	1,403,193,137	1,227,232,368
<i>Changes during year:</i>		
Issued under Ordinary Dividend Stock Alternative Scheme .....		4,212,782
Issued under Savings-Related Stock Option Schemes .....		3,419,529
Issued under Executive Stock Option Schemes .....		3,239,982
Issued under Profit Sharing Scheme .....		1,928,336
Issued under EFT Rollover Option Scheme .....		5,386
<b>As At March 1, 1999</b> .....	1,524,593,137	1,240,038,383
<i>Changes during year:</i>		
Issued under Ordinary Dividend Stock Alternative Scheme .....		3,304,807
Issued under Savings-Related Stock Option Schemes .....		3,876,904
Issued under Executive Stock Option Schemes .....		2,974,806
Issued under EFT Rollover Option Scheme .....		5,386
<b>As at February 29, 2000</b> .....	1,524,593,137	1,250,200,286

The Ordinary Stock Units of the Bank are in registered form, are listed on the London Stock Exchange and have been admitted as participating securities in CREST.

As at March 1, 1996 the authorised preference stock of Bank of Scotland was £500,000,000 divided into £250,000,000 nominal amount of 9¼% non-cumulative irredeemable preference stock (the "9¼% Preference Stock"), £125,000,000 nominal amount of 9¾% non-cumulative irredeemable preference stock (the "9¾% Preference Stock") and £125,000,000 nominal amount of additional preference stock of which £200,000,000 nominal amount of 9¼% Preference Stock and £100,000,000 nominal amount of 9¾% Preference Stock was issued and fully paid.

On March 4, 1997 the Board designated in accordance with the Regulations the £125,000,000 nominal amount of additional preference stock as 9¼% Preference Stock and on March 6, 1997 £100,000,000 nominal amount of 9¼% Preference Stock was allotted and issued fully paid at 119.806 pence by way of a private placing.

Under Section 15 of the Bank of Scotland Order 1954, the capital stock of the Bank may be increased by resolution of the proprietors of the Bank in general meeting. Following a resolution approved at an extraordinary general meeting of proprietors of the Bank held on July, 31 1997, the Bank's nominal capital was increased from £845,198,284.25 to £850,798,284.25 by the creation of £5,600,000 nominal amount of Ordinary Stock having the rights set out in the Regulations. Following a resolution approved at an extraordinary general meeting of proprietors of the Bank held on May 29, 1998, the Bank's capital was increased from £850,798,284.25 nominal amount to £881,148,284.25 nominal amount by the creation of £30,350,000 nominal amount of Ordinary Stock having the rights set out in the Regulations.

Following a resolution approved at an extraordinary general meeting of proprietors of the Bank held on June 20, 1995, the Board is authorised to allot and issue Ordinary Stock Units in respect of subscriptions under any of the Bank of Scotland stock schemes. The maximum nominal amount available for further issues under that authority, as amended by a resolution approved at an extraordinary general meeting of proprietors of the Bank held on June 11, 1996, amounted to £27,747,985.00 as at February 29, 2000.

Following a resolution approved at an extraordinary general meeting of proprietors of the Bank held on June 20, 1995, the Board is authorised to allot and issue Ordinary Stock Units to proprietors electing to receive additional Ordinary Stock Units credited as fully paid instead of all or part of a cash dividend (the "Ordinary Dividend Stock Alternative Scheme"). The maximum nominal amount available for further issues under that authority, as amended by a resolution approved at an extraordinary general meeting of proprietors of the Bank held on May 29, 1998, amounted to £10,192,243.00 as at February 29, 2000.

Following a resolution approved at an extraordinary general meeting of proprietors of the Bank held on July 31, 1997, the Board is authorised to allot and issue Ordinary Stock Units in respect of the exercise of options granted to former holders of options under the EFT Group plc stock option schemes (the "EFT options") in consideration of the release of their EFT options. The maximum nominal amount available for further issues under that authority, as amended by a resolution approved at an extraordinary general meeting of proprietors of the Bank held on May 29, 1998, amounted to £538.50 as at February 29, 2000.

Following a resolution approved at the 303rd annual general meeting of proprietors of the Bank held on June 15, 1999, the Board is authorised to allot and issue any part of the unissued Ordinary Stock of the Bank, up to a maximum nominal amount of £15,500,000 of Ordinary Stock in aggregate, for such price in cash or for such non-cash consideration as the Board shall determine, for the purposes of effecting or facilitating (including by the raising of funds for the purposes of) the acquisition of (or of any interest in) any one or more companies, undertakings, businesses or assets, at any time prior to the close of the annual general meeting of the Bank to be held in 2000 without being required, prior to making any allotment and issue, to offer the relevant Ordinary Stock Units to existing proprietors in proportion to their existing holdings of Ordinary Stock Units or otherwise.

The Board has no present intention of issuing any of the authorised but unissued Ordinary Stock or Existing Preference Stock of the Bank other than pursuant to the Bank of Scotland Group stock schemes or pursuant to elections under the Ordinary Dividend Stock Alternative Scheme.

## **Summary of Rights Attaching to the Ordinary Stock**

### ***Voting Rights***

Votes may be given either personally or by proxy. Subject to restrictions arising pursuant to the Regulations, every proprietor present in person and entitled to vote shall have one vote on a show of hands. On a poll, every proprietor of Ordinary Stock present in person or by proxy and entitled to vote shall have one vote for each complete 25 pence nominal amount of Ordinary Stock held by him. On a poll, a person entitled to more than one vote need not use all his votes or cast all the votes he uses in the same way.

For the purposes of determining which proprietors are entitled to attend or vote at a general meeting and the number of votes a proprietor may cast at such meeting, the Board may specify in the notice of meeting a time (not more than 48 hours before the time fixed for the meeting) by which a person must be entered in, or (as the case may be) be registered as holding a particular amount of stock on, the stock ledger in order to have the right to attend or vote.

### ***Disclosure of Interests***

The Bank may give notice in writing to require any proprietor to give full particulars in respect of any and all Ordinary Stock in respect of which his name is entered in the stock ledger and in respect of all Ordinary Stock in which he is interested (a “Disclosure Notice”). Upon receipt of a Disclosure Notice, the particulars to be given by a proprietor include:

- (a) the identity and address of every person interested in such Ordinary Stock;
- (b) the nature and extent of each interest in such Ordinary Stock, and the identity and address of the registered proprietor thereof; and
- (c) whether persons interested in any of such Ordinary Stock are parties to any agreement (within the meaning of that term for the purposes of Section 204 of the Companies Act 1985) to which the said Section 204 would apply if the Bank were a public company for the purposes of that Act or any agreement or arrangement relating to the exercise of any rights conferred by the holding of Ordinary Stock and, if so, the identity and address of each other party to any such agreement or arrangement.

Where a proprietor whose registered holding of Ordinary Stock represents not less than 0.25% of the Ordinary Stock then in issue has been served with a Disclosure Notice and the proprietor has failed to comply in full with such notice within fourteen days (or such longer period as the Board may specify in the notice), the Bank may give such proprietor a further notice (a “Sanctions Notice”). Upon service of the Sanctions Notice the following restrictions (the “Restrictions”) apply to all Ordinary Stock registered in the name of the proprietor (or such lesser amount of Ordinary Stock as may be specified in the Sanctions Notice):

- (a) such stock shall not confer any right to attend and vote either personally or by proxy at any general meeting of the Bank or at any separate meeting of the holders of Ordinary Stock or to exercise any other right conferred by membership in relation to such meetings;
- (b) any dividend (or part thereof) or other moneys which would otherwise be payable on such stock shall be retained by the Bank until such time as the Restrictions cease to have effect (without any liability on the part of the Bank to pay interest thereon); and
- (c) any transfer, other than by way of sale of the whole beneficial interest in stock to a person unconnected with the proprietor or with other persons appearing to be interested in such stock, shall be prohibited.

The Restrictions shall end on whichever is the first to occur of:

- (a) the Bank notifying the proprietor in writing that the Restrictions are removed from such stock or that the Sanctions Notice has been cancelled;
- (b) the expiry of seven days after the proprietor has complied in full with the Disclosure Notice; and
- (c) the Board having received satisfactory evidence of the transfer of such stock by way of sale of the whole beneficial interest in such stock to a person unconnected with the proprietor or with other persons appearing to be interested in such stock.

### ***Dividends***

For a description of policies and other requirements relating to dividends on Ordinary Stock, see “*Dividend Policy*”.

### ***Distribution in the event of a Sequestration or Winding-up***

On a distribution of assets on a sequestration or winding-up of the Bank, the surplus assets, after payment of the Bank’s liabilities and amounts due to proprietors of Existing Preference Stock are to be applied in repaying to the proprietors of Ordinary Stock the amounts paid up or credited as paid up on the Ordinary Stock Units held by them (excluding any premium paid) in respect of such stock and thereafter any remaining surplus is to be divided



amongst the proprietors of Ordinary Stock in proportion to the nominal amount of Ordinary Stock Units held by them respectively.

### Summary of Rights Attaching to the Existing Preference Stock

#### *Income*

The Existing Preference Stock entitles the proprietors thereof to receive a fixed non-cumulative preferential dividend (the "Preference Dividend"), which is calculated at the rate of 9 $\frac{1}{4}$ % per annum in respect of the 9 $\frac{1}{4}$ % Preference Stock and 9 $\frac{3}{4}$ % per annum in respect of the 9 $\frac{3}{4}$ % Preference Stock (exclusive of any imputed tax credit available to such proprietors) on the amounts (excluding any premium) from time to time paid up or credited as paid up thereon. The Preference Dividend is payable in each year in equal half-yearly instalments on May 31 in respect of the half-yearly period ending on the preceding February 28 (or in a leap year February 29) and on November 30 in respect of the half-yearly period ending on the preceding August 31. The Preference Dividend payable in respect of any financial year shall be paid in priority to the payment of any dividend on the Ordinary Stock in respect of that financial year.

If, on any date on which instalments of the Preference Dividend would fall to be paid as set out above, the distributable profits and distributable reserves of the Bank are together insufficient to enable payment in full to be made of such instalments and, if applicable, of any instalments of dividends payable on such date on any other preference stock ranking *pari passu* with the Existing Preference Stock as regards dividend, then no such instalments shall be paid and the proprietors of Existing Preference Stock shall have no claim in respect of such shortfall.

Where any instalment of the Preference Dividend is payable as described above, the Board shall resolve to make payment of such instalment, provided, however, that such instalment shall not be payable if in the judgment of the Board the payment of such instalment would breach or cause a breach of the capital adequacy requirements applicable to the Bank, in which case the proprietors of Existing Preference Stock shall have no claim in respect of such shortfall.

Where any instalment of the Preference Dividend is not to be payable for the reasons described above and the amount (if any) at credit of the profit and loss account of the Bank together with the amount of the reserves of the Bank available for the purpose are sufficient to enable the allotments of additional preference stock referred to in the following provisions of this sub-paragraph to be made in full, then:

- (a) Each affected proprietor of Existing Preference Stock (and any preference stock of the Bank ranking *pari passu* with the Existing Preference Stock as regards dividend in respect of which an instalment of preference dividend which would have been payable on the same date is not to be paid) shall, on the date when the relevant instalment of preferential dividend should have been paid had it been paid in cash, be allotted such additional nominal amount of preference stock of the class in question, credited as fully paid, as is equal to an amount determined by multiplying the cash amount that would have been payable to him, had such instalment been payable in cash, by four-thirds and rounding the resulting sum down to the nearest integral multiple of £1.00.
- (b) For the purpose of paying up preference stock to be so allotted, the Board shall capitalise out of the sums standing to the credit of the profit and loss account of the Bank and/or to the credit of the Bank's reserve accounts (including share premium account) available for the purpose, as the Board may determine, a sum equal to the aggregate nominal amount of the additional preference stock then to be allotted and apply the same in paying up in full the appropriate amount of unissued preference stock of the class or classes in question.
- (c) The additional preference stock so allotted shall rank *pari passu* in all respects with the fully paid preference stock of the same class then in issue.

Save as described above, the Existing Preference Stock carries no further right to participate in the profits and reserves of the Bank other than the Preference Dividend.

### ***Ranking for Dividend***

The 9<sup>1</sup>/<sub>4</sub>% Preference Stock ranks for dividend *pari passu* with the 9<sup>3</sup>/<sub>4</sub>% Preference Stock and both rank for dividend *pari passu* with any further preference stock created and issued either as a result of the non-payment of the Preference Dividend, as described above in the paragraph titled “Income”, or in the circumstances described below in the paragraph titled “Further Issues of Capital Stock”, and otherwise in priority to any other capital stock of the Bank.

### ***Capital***

On a distribution of assets on a sequestration or winding-up of the Bank, proprietors holding Existing Preference Stock shall in respect thereof be entitled to receive, out of the surplus assets remaining after payment of the Bank’s liabilities, an amount equal to the amount paid up or credited as paid up on the Existing Preference Stock (excluding any premium paid to the Bank in respect thereof). In addition, with respect to the Existing Preference Stock, there shall be payable:

- (a) the amount of any half-yearly instalment of the Preference Dividend which is properly payable in accordance with the provisions described above in the paragraph titled “Income” in respect of a period ending prior to the date of commencement of the sequestration or winding-up of the Bank but in respect of which the date for payment had not occurred prior to the date of such commencement; and
- (b) a sum equal to the Preference Dividend which would have been payable by the Bank in accordance with the provisions described above in the paragraph titled “Income” calculated at the rate of 9<sup>1</sup>/<sub>4</sub>% for the 9<sup>1</sup>/<sub>4</sub>% Preference Stock and of 9<sup>3</sup>/<sub>4</sub>% for the 9<sup>3</sup>/<sub>4</sub>% Preference Stock in respect of the number of days included in the period commencing with whichever of March 1 or September 1 shall more recently have occurred prior to the date of commencement of the sequestration or winding-up of the Bank and ending with the date of such commencement, as though such period had been one in relation to which a half-yearly instalment of the Preference Dividend would have been payable, but subject always to any restrictions on payment of dividends described above in the paragraph titled “Income”.

The amounts so payable or repayable in the event of a sequestration or winding-up of the Bank shall be so paid *pari passu* with any amounts payable or repayable in that event upon or in respect of any preference stock of the Bank ranking *pari passu* with the Existing Preference Stock as regards repayment of capital, and shall be so paid in priority to any repayment of capital on any other class of capital stock of the Bank. The proprietors of the Existing Preference Stock shall not be entitled in respect thereof to any further or other right of participation in the assets of the Bank upon a sequestration or winding-up.

### ***Voting***

Proprietors holding Existing Preference Stock are entitled to receive notice of and to attend any general meeting of the Bank but shall not, in respect of the Existing Preference Stock, be entitled to speak and/or vote upon any resolution other than:

- (a) a resolution for, or in relation to, the sequestration or winding-up of the Bank; or
- (b) a resolution varying, altering or abrogating any of the rights, privileges, limitations or restrictions attached to the Existing Preference Stock;

unless at the date of such meeting the most recent half-yearly instalment of the Preference Dividend due to be paid prior to such meeting has not been paid in cash.

On a show of hands every proprietor of Existing Preference Stock who is entitled to vote and who (being an individual) is present in person or (being a corporation) is present by a representative shall have one vote. On a poll each proprietor of Existing Preference Stock present in person (or, in the case of a corporation, by representative) or by proxy and entitled to vote shall have one vote for each complete £1.00 nominal amount of Existing Preference Stock held by him.

### ***Further Issues of Capital Stock***

Except as described above in the paragraph titled "Income" and in this paragraph, the Bank may not create or issue any further stock ranking as regards participation in the profits or assets of the Bank *pari passu* with or in priority to the Existing Preference Stock.

The Bank may from time to time create and issue further preference stock ranking as regards participation in the profits and assets of the Bank *pari passu* with the Existing Preference Stock but so that any such further preference stock may carry as regards participation in the profits and assets of the Bank only rights identical in all respects to those attaching to the Existing Preference Stock or rights differing therefrom in one or more of the following respects:

- (i) the rate of dividend may differ;
- (ii) the dates for payment of dividend and/or the periods by reference to which dividend is payable may differ;

provided that an issue of such further preference stock may only be made if the auditors of the Bank have certified in writing to the Bank that immediately following such issue:

- (i) the aggregate nominal amount of the existing Existing Preference Stock and all further preference stock then in issue and ranking *pari passu* therewith will not exceed an amount equal to 25% of the Adjusted Capital and Reserves (as defined in the Regulations); and
- (ii) the average of the profits after taxation and before extraordinary items and dividends, on an annualised basis, for the three most recent financial years of the Bank to have ended prior to the date of such issue, as shown in the audited consolidated accounts relating thereto, shall exceed four and one half times the aggregate annual amount of the dividends (exclusive of any imputed tax credit available to proprietors) payable on the Existing Preference Stock and any further preference stock of the Bank which is in issue immediately following such issue and ranks *pari passu* with the Existing Preference Stock.

### ***Class Consent***

The Board shall not, without the consent in writing of proprietors holding a majority of the stock of each class of the issued Existing Preference Stock or the sanction of a resolution passed by proprietors of each class of Existing Preference Stock at separate meetings of proprietors holding each class of Existing Preference Stock, capitalise for appropriation to proprietors holding Ordinary Stock any part of the sums standing at credit of the profit and loss account and at credit of any of the reserve accounts of the Bank available for distribution if after such capitalisation the aggregate of the sums standing to the credit of the profit and loss account and to the credit of the Bank's reserve accounts available for distribution would be a sum less than ten times the aggregate amount of the annual preferential dividends (exclusive of any imputed tax credit available to such proprietors) payable on the issued Existing Preference Stock and any other issued preference stock ranking *pari passu* therewith.

### **Summary of Rights Common to the Ordinary Stock and the Existing Preference Stock**

#### ***Dividends***

Any dividend which has remained unclaimed for 12 years from the date when it became due for payment may be forfeited by resolution of the Board, whereupon it ceases to remain owing by the Bank.

#### ***Variation of Rights***

The rights attached to stock of any class may (unless otherwise provided by the terms of issue) be varied or abrogated either with the consent in writing of proprietors holding a majority of the issued stock of that class or with the sanction of a resolution passed at a separate meeting of the proprietors holding stock of that class but not otherwise. The quorum for the purposes of any such separate meeting shall be at least two proprietors holding stock of that class present in person or by proxy and entitled to vote at the meeting holding at least one-third of

the issued stock of that class; however, if at any adjourned meeting of such proprietors, a quorum as defined above is not present within half an hour from the time appointed for the meeting, those proprietors of the relevant class of stock who are present in person or by proxy shall be a quorum.

### *Transfers of Stock*

The instrument of transfer of any stock which is in certificated form may be in any usual or common form or in any form which the Board may approve. Title to stock which is in uncertificated form will be transferred by means of the relevant system in accordance with the U.K. Uncertificated Securities Regulations 1995 (the “USR”). The Board may make such arrangements as it thinks fit in relation to transfer of stock in uncertificated form, subject always to the USR.

No transfer of stock shall have any force or effect as between the Bank on the one hand and the transferor or transferee on the other unless and until registered and the transferor shall remain the holder of the stock until the name of the transferee is entered in the stock ledger of the Bank in respect thereof.

Subject to the provisions described below, the Board may refuse to register a transfer:

- (a) which is of partly paid stock to a person of whom it does not approve;
- (b) which is of stock (not being fully paid stock) on which the Bank has a lien;
- (c) which is not in an appropriate form or is not lodged at the Head Office or other place appointed by the Board accompanied by the stock certificate in respect of the stock to be transferred and by such other evidence as the Board may require to prove the title of the transferor or which is in favour of any person under 16 years of age;
- (d) which is in favour of more than four transferees;
- (e) which relates to more than one class of stock;
- (f) which in the case of Ordinary Stock is for a nominal amount which is not an integral multiple of 25 pence, or in the case of Existing Preference Stock is for a nominal amount which is not an integral multiple of £1.00.

Notwithstanding the foregoing, a transfer of title to stock held in uncertificated form in accordance with an operator-instruction (within the meaning of the USR) shall be registered where such registration is required in terms of the USR. No transfer of title to stock held in uncertificated form shall be registered except in accordance with the provisions of the USR.

As referred to under “Disclosure of Interests”, a transfer is prohibited if it is of Ordinary Stock Units registered in the name of a proprietor holding not less than 0.25% of the Ordinary Stock then in issue who has failed to comply with a Disclosure Notice and on whom a Sanctions Notice prohibiting transfer has been served, unless:

- (a) otherwise resolved by the Board;
- (b) such transfer is by way of a sale to a person unconnected with the proprietor or with other persons who appear to be interested in such Ordinary Stock Units; or
- (c) (in relation to Ordinary Stock Units in uncertificated form) the sanctions notice is ineffective as inconsistent with the USR, the transfer of title to such stock by means of a relevant system, or the rules and requirements of the relevant system.

If and to the extent that the prohibition on transfer described above is or may be ineffective in relation to Ordinary Stock Units which are in uncertificated form, the Board may, subject to certain limitations, take such further steps (including requiring that the Ordinary Stock Units are converted into certificated form) as the Board shall think fit for giving effect so far as practicable to the prohibition.

### ***Lien on Stock***

The Bank has a first and paramount lien on all stock not fully paid for all moneys payable in respect of that stock. The Board may at any time waive the lien in whole or in part.

### ***Calls on Stock***

The Board may from time to time make calls on proprietors for any amounts unpaid on their stock. These calls can be made only after the provision of not less than 14 days' advance notice specifying the time and place of payment, which may include payment in instalments. The person on whom a call is made remains liable for the call despite any subsequent transfer of the stock on which the call was made. Joint holders of stock are jointly and severally liable for the payment of all calls.

The Board may retain and apply the dividends or interest payable to any proprietor in satisfaction *pro tanto* of all such sums of money as may be due from him to the Bank on account of calls or otherwise in relation to stock of the Bank. No proprietor shall, unless the Board otherwise determines, be entitled to attend, vote or act at any general meeting of the Bank unless all calls or other sums presently payable by him in respect of stock of the Bank have been paid.

### ***Meetings of Proprietors***

An annual general meeting of the Bank shall be held in every calendar year, not more than fifteen months after the holding of the last preceding annual general meeting. The Board may when it deems fit, and must, upon the requisition of proprietors holding in the aggregate not less than 10% of the Ordinary Stock of the Bank upon which all calls or other sums then due have been paid, convene an extraordinary general meeting of the Bank.

Proprietors must receive at least 14 days' written notice of any general meeting. The ordinary business of an annual general meeting is to receive and consider the balance sheet and profit and loss account, the reports of the Board and auditors, to elect a governor, deputy governors, ordinary directors and auditors in place of those retiring and to fix the remuneration of the auditors and to declare dividends. The notice convening an extraordinary general meeting must state the general nature of the business intended to be transacted, and the notice convening an annual general meeting shall state the general nature of any special business to be transacted.

Two proprietors present in person or by proxy and entitled to vote shall constitute a quorum at a general meeting.

### ***Notices***

The Bank may serve any notice required to be served upon any proprietor either personally or by posting it in a prepaid letter addressed to the proprietor at his registered address. The registered address of a proprietor shall be the latest address in the United Kingdom which has been notified to the secretary and is registered in the stock ledger as the address of the proprietor. A proprietor residing out of the United Kingdom may name an address within the United Kingdom at which all notices requiring or falling to be served upon him shall be served, otherwise he shall not be entitled to any notices which would otherwise require to be served upon him.

### ***Registrar***

The Bank's Registrar is Lloyds TSB Registrars Scotland, 117 Dundas Street, Edinburgh, EH3 5ED.

## DESCRIPTION OF THE PREFERRED SECURITIES

*The Preferred Securities are limited partnership interests in the Issuer. The following summary should be read in conjunction with, and is subject to the terms of the Partnership Agreement, a copy of which is available as described under "General Information".*

### Description of the Class A Preferred Securities

#### 1. Definitions

In this Description of the Class A Preferred Securities (referred to below as "Preferred Securities"), except to the extent that the context otherwise requires:

"Actual/Actual Basis" means, in respect of any Distribution Period, the number of days from and including the day on which a Distribution was paid in respect of the immediately preceding Distribution Period (or the Issue Date) to but excluding the day on which a Distribution is paid in respect of that Distribution Period, divided by the number of days in the Distribution Period multiplied by the number of Distribution Periods in the year. References to a Distribution being paid on a particular day shall include any day on which a Distribution would, but for the restrictions in paragraph 2, have been paid.

"Additional Amounts" has the meaning given to that term in paragraph 6;

"Adjusted Distributable Reserves" means at any time the lawful distributable reserves of Bank of Scotland at such time less the cumulative amount since the Issue Date of all redemptions of and payments on (a) any preference stock or other obligations of Bank of Scotland that are accounted for under then generally accepted accounting practice in the United Kingdom as proprietors' funds in Bank of Scotland's accounts and (b) all securities or other obligations of an undertaking which are accounted for under then generally accepted accounting practice in the United Kingdom as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or otherwise) to, Bank of Scotland that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Obligations, except in each case for such amounts as have been either charged to the lawful distributable reserves of Bank of Scotland or funded at that time by an issue of Replacement Capital as described in item (ii)(b) of the definition of "Redemption Conditions";

"Bank of Scotland" means the Governor and Company of the Bank of Scotland and its successors and assigns;

"Calculation Agent" means Citibank, N.A. or any successor Calculation Agent appointed under the Agency Agreement dated March 14, 2000 between, *inter alia*, Bank of Scotland, the General Partner and the Calculation Agent;

"Clearstream, Luxembourg" means Clearstream Banking, société anonyme;

"Distribution Date" means May 31 and November 30 in each year;

"Distribution Determination Date" means the day ten London Business Days prior to each Distribution Date;

"Distribution Period" means the period from (and including) the Issue Date to (but excluding) the first Distribution Date and each period thereafter from (and including) one Distribution Date to (but excluding) the next following Distribution Date;

"Distribution Rate" means (i) in respect of each Distribution Period until May 31, 2010, 8.117 per cent. per annum; and (ii) in respect of each Distribution Period from May 31, 2010, a rate determined in accordance with paragraph 2.2.2 as being equal to the sum of the Reference Rate in effect during the relevant Distribution Period plus the Margin;

"Distributions" has the meaning given to that term in paragraph 2 and "Distribution" has a corresponding meaning;



“Early Redemption Date” means any date designated for redemption for tax or regulatory reasons of the Preferred Securities as described under paragraphs 4.3 or 4.4;

“Euroclear” means Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear system or its successor;

“Existing Preference Stock” means the 9<sup>1</sup>/<sub>4</sub> per cent. sterling non-cumulative irredeemable preference stock and the 9<sup>3</sup>/<sub>4</sub> per cent. sterling non-cumulative irredeemable preference stock issued by Bank of Scotland and shall include any further preference stock required to be issued pursuant to the terms thereof;

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

“General Partner” means Bank of Scotland Capital Funding (Jersey) Limited;

“Group” means Bank of Scotland together with its Subsidiaries;

“Guarantee” means the subordinated guarantee in respect of the Preferred Securities to be executed by Bank of Scotland on March 14, 2000 as a deed poll and shall include any other guarantee issued by Bank of Scotland in respect of any other class of preferred securities issued by the Issuer ranking as regards participation in the profits and assets of the Issuer *pari passu* with the Preferred Securities;

“Guaranteed Payments” means collectively (i) all Distributions as due on the Preferred Securities, (ii) any Liquidating Distribution to which the Preferred Securities are entitled, (iii) the Optional Redemption Price, the Tax Redemption Price and the Regulatory Redemption Price and (iv) any Additional Amounts, payment of which is in each case guaranteed by Bank of Scotland under the Guarantee;

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

“Issue Date” means March 14, 2000;

“Issuer” means Bank of Scotland Capital Funding L.P.;

“Jersey” means the Island of Jersey;

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

“Limited Partnerships Registrar” means the person appointed as Registrar of Limited Partnerships pursuant to the Law;

“Liquidating Distribution” means an amount equal to the Liquidation Preference together with any accrued but unpaid Distribution from and including the commencement of the Distribution Period in which the date of the dissolution or winding up falls (taking into account any interim liquidation distribution that may have been paid);

“Liquidation Preference” means the liquidation preference of £1,000 per Preferred Security;

“London Business Day” means a day other than a Saturday or Sunday on which commercial banks and foreign exchange markets settle payments and are open for general business in London;

“Make Whole Amount” means an amount equal to the sum of (i) the present value of the Liquidation Preference at the next succeeding Optional Redemption Date plus (ii) the present values of the scheduled semi-annual non-cumulative Distributions from and including the Early Redemption Date to and including the next succeeding Optional Redemption Date in each case discounted to the Early Redemption Date at a rate equal to the sum of 0.50% and the gross redemption yield (as calculated by the Calculation Agent on the basis set out by the Joint Index and Classification Committee of the Institute and Faculty of Actuaries as reported in the Journal of the Institute of Actuaries, Vol 105, Part 1, 1978, page 18 (as amended or updated)) on a semi-annual compounding basis (rounded to four



decimal places) of such U.K. government gilt-edged security as has prior to the Early Redemption Date a maturity nearest to the next succeeding Optional Redemption Date (the “Relevant Gilt”) with the price of the Relevant Gilt for this purpose being the arithmetic average of the bid and offered prices of the Relevant Gilt quoted (to four decimal places) at 3.00 p.m. (London time) on the fifth London Business Day prior to the Early Redemption Date by three brokers of gilts or gilt-edged market makers chosen by the Calculation Agent for the purpose on a dealing basis for settlement on the next London Business Day;

“Margin” means 3.85% per annum;

“Optional Redemption Date” means May 31, 2010 and each fifth anniversary thereafter;

“Optional Redemption Price” means an amount equal to the Liquidation Preference;

“Parity Obligations” means (i) in relation to Bank of Scotland, any preference stock (other than the Existing Preference Stock) issued by Bank of Scotland that is not expressly stated to rank in all material respects senior or junior to Bank of Scotland’s obligations under the Guarantee and any other guarantee given or support agreement entered into by Bank of Scotland in respect of any preference shares, or other preferred securities (not constituting debt obligations) having in all material respects the same ranking as preference shares, issued by any Subsidiary that is not expressly stated to rank in all material respects senior or junior to the Guarantee and (ii) in relation to the Issuer, any preferred securities (other than the Preferred Securities) issued by it or other obligations of it which are entitled to the benefit of the Guarantee;

“Partnership Agreement” means the limited partnership agreement dated March 10, 2000 between the General Partner, Uberior Investments plc, Bank of Scotland and Paribas Luxembourg, as Common Depository pursuant to which the Issuer was established, as the same may be amended from time to time;

“Paying and Transfer Agents” means each of Citibank, N.A. and Banque Internationale à Luxembourg S.A. or such other entity as is appointed by the General Partner on behalf of the Issuer and notified to the Holders in the manner described in paragraph 10;

“QIB” means a qualified institutional buyer within the meaning of Rule 144A under the Securities Act;

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

“Preferential Right” means the preferential limited partnership interest in the Issuer initially held by Uberior Investments plc and entitling it to receive in preference to the rights of the General Partner all amounts received by the Issuer under the Subordinated Notes in excess of those required to make payments of any Distribution (and, if relevant, Additional Amounts) on any Distribution Date or any Liquidating Distribution or relevant proportion thereof (and, if relevant, Additional Amounts) to Holders in accordance with paragraphs 2 or 3 below;

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

“Preferred Securities” means the £250,000,000 8.117% Non-Cumulative Perpetual Preferred Securities, Class A representing the interest of a Holder in the Issuer attributable to the relevant proportion of the Preferred Capital Contribution (being a whole multiple of £1,000) and includes any further preferred securities of the Issuer of the same class issued after the Issue Date and ranking *pari passu* with the Preferred Securities as regards participation in the profits and assets of the Issuer;

“Recognised Stock Exchange” has the meaning given to that term in section 841 of the Income and Corporation Taxes Act 1988 of the United Kingdom;

“Redemption Conditions” means (i) that the consent of the FSA to the redemption, if then required, has been obtained and (ii) that Bank of Scotland either has (a) Adjusted Distributable Reserves or (b) proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the redemption, in either of cases (ii)(a) or (b) in an amount at least equal to the aggregate Optional Redemption Price, Tax Redemption Price or Regulatory Redemption Price, as the case may be;

“Redemption Date” means an Early Redemption Date or an Optional Redemption Date, as applicable;

“Reference Rate”, “Reference Rate Determination Date”, “Reference Rate Market Makers”, “Reference Rate Period”, “Reference Security” and “Reset Date” have the respective meanings given to such terms in paragraph 2.2.2;

“Register” means the register of Holders maintained outside the United Kingdom on behalf of the Issuer under the Law;

“Registrar” means, in relation to the Preferred Securities, Citibank Channel Islands Limited or such other entity appointed by the General Partner on behalf of the Issuer having its office outside the United Kingdom and notified to the Holders in the manner described in paragraph 10;

“Regulatory Event” means a change in any applicable law or regulation, or in the official interpretation or application thereof, which results in more than an insubstantial risk that for the purposes of the FSA’s capital adequacy requirements applicable to banks in the United Kingdom at that time an amount equal to the total Liquidation Preference of the Preferred Securities will not be included in the Tier 1 capital of Bank of Scotland on a solo-consolidated basis;

“Regulatory Redemption Price” means the higher of an amount equal to the Liquidation Preference and the Make Whole Amount determined by the Calculation Agent;

“Relevant Proportion” means (a) in relation to any partial payment of a Distribution, the amount of Adjusted Distributable Reserves (as determined in accordance with paragraph 2.9) as of the Distribution Determination Date (for this purpose, reduced by the aggregate amount of the dividend to be paid on the Existing Preference Stock on the next following Distribution Date) divided by the sum of (i) the total amount originally scheduled to be paid by way of Distribution on the Preferred Securities on the relevant Distribution Date and (ii) the sum of any dividends or other distributions or payments in respect of Bank of Scotland’s Parity Obligations due and payable on that Distribution Date, converted where necessary into the same currency in which Adjusted Distributable Reserves are reported by Bank of Scotland; and (b) in relation to any partial payment of any Liquidating Distribution, the total amount available for any such payment and for making any liquidating distribution on any Parity Obligations divided by the sum of (i) the full Liquidating Distribution before any reduction or abatement hereunder and (ii) the amount (before any reduction or abatement hereunder) of the full liquidating distribution on any Parity Obligations of Bank of Scotland, converted where necessary into the same currency in which liquidation payments are made to creditors of Bank of Scotland;

“Replacement Capital” means stock issued by Bank of Scotland or shares or other securities issued by a Subsidiary which would, under then generally accepted accounting practice in the United Kingdom, qualify for treatment as a minority interest or proprietors’ funds in Bank of Scotland’s consolidated accounts;

“Restricted Person” means a person to whom Substitute Stock will not be available for issue being (a) DTC, Euroclear, Clearstream, Luxembourg, First Chicago Clearing Center or any other person providing a clearance service within Section 96 of the Finance Act 1986 of the United Kingdom or any nominee thereof or (b) a person, or nominee or agent for a person, whose business is or includes issuing depositary receipts within Section 93 of the Finance Act 1986 of the United Kingdom, or

(c) any other person the issue to whom would give rise to an equivalent charge to Stamp Duty Reserve Tax in the United Kingdom;

“Securities Act” means the U.S. Securities Act of 1933, as amended;

“Special Representative” has the meaning given to that term in paragraph 8;

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

“Subordinated Notes” means the £250,000,000 subordinated cumulative undated instruments, Series No. BOS 0009 in bearer form issued by Bank of Scotland subscribed by the Issuer using the proceeds of the issue of the Preferred Securities;

“Subsidiary” means any entity which is for the time being a subsidiary or a subsidiary undertaking of Bank of Scotland (within the respective meanings given to these terms in the Companies Acts 1985 and 1989);

“Substitute Stock” has the meaning given to that term in paragraph 5.1;

“Substitution Event” means that either (i) Bank of Scotland’s solo-consolidated total capital ratio and/or its consolidated total capital ratio, in each case calculated in accordance with applicable U.K. bank capital adequacy regulations, has fallen below the then applicable minimum ratio required by such regulations (currently 8%); or (ii) Bank of Scotland’s board of directors in its sole discretion has notified the FSA and the Issuer that it has determined, in view of Bank of Scotland’s deteriorating financial condition, that (i) above is expected to occur in the near term;

“Tax Event” means that, as a result of a change in any law or regulation of the United Kingdom or Jersey, or in any treaty to which the United Kingdom or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in the United Kingdom or Jersey (i) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) profits arising to it as a result of payments received by it from the Issuer or (b) activities (if any) carried on by it other than those permitted or contemplated in the Partnership Agreement) in Jersey or the United Kingdom, (ii) payments to Holders would be subject to deduction or to withholding tax or would give rise to any obligation to account for any tax in Jersey or the United Kingdom, (iii) payments by Bank of Scotland in respect of the Subordinated Notes would be subject to deduction or to withholding tax in the United Kingdom or (iv) Bank of Scotland would not obtain relief for the purposes of United Kingdom corporation tax for any payment of interest in respect of the Subordinated Notes; and

“Tax Redemption Price” means, in the case of a Tax Event described in clauses (ii) or (iii) of the definition of “Tax Event”, an amount equal to the Liquidation Preference and, in the case of a Tax Event described in clauses (i) or (iv) of the definition of “Tax Event”, the higher of an amount equal to the Liquidation Preference and the Make Whole Amount determined by the Calculation Agent. If a Tax Event described in clauses (i) and/or (iv) occurs and, prior to notice of redemption being given pursuant to paragraph 4.3 in that respect, a Tax Event described in clause (ii) and/or (iii) occurs, the General Partner on behalf of the Issuer may elect which Tax Event to specify in the notice of redemption.

## **2. Distributions**

- 2.1 Subject as provided by the Law and in paragraphs 2.3 and 2.10, non-cumulative preferential cash distributions on the Preferred Securities (“Distributions”) shall accrue from the Issue Date (or, in the case of any further preferred securities issued so as to rank *pari passu* with the Preferred Securities as regards participation in the profits and assets of the Issuer, their respective dates of issue) and shall be payable in arrear on each Distribution Date.

2.2 Subject to the Law, Distributions in respect of any Distribution Period will be payable at the applicable Distribution Rate on the amount of the Liquidation Preference. Distributions will be non-cumulative and will accrue on a day by day basis. Accrued Distributions in respect of each Distribution Period shall be calculated on an Actual/Actual Basis.

2.2.1 Distributions in respect of periods from (and including) the Issue Date to (but excluding) May 31, 2010 will be calculated at a Distribution Rate of 8.117% per annum.

2.2.2 Distributions in respect of periods from (and including) May 31, 2010 will be calculated at a Distribution Rate equal to the sum of the Reference Rate plus the Margin. On each Reference Rate Determination Date, the Calculation Agent shall calculate the Reference Rate in accordance with the following:

“Reference Rate” shall mean, in respect of any Reference Rate Period, the gross redemption yield (as calculated by the Calculation Agent on the basis set out by the Joint Index and Classification Committee of the Institute and Faculty of Actuaries as reported in the Journal of the Institute of Actuaries, Vol. 105, Part 1, 1978, page 18 (as amended or updated)) on a semi-annual compounding basis (rounded, if necessary, to four decimal places) of the Reference Security, with the price of the Reference Security for this purpose being the arithmetic average of the bid and offered prices of the Reference Security quoted (to four decimal places) by the Reference Rate Market Makers at 3:00 p.m. (London time) on the relevant Reference Rate Determination Date on a dealing basis for settlement on the next following London Business Day;

“Reference Rate Determination Date” shall mean the day that is five London Business Days prior to the beginning of each Reference Rate Period;

“Reference Rate Market Makers” shall mean three brokers of gilts and/or gilt-edged market makers chosen by the Calculation Agent for the purpose of calculating the Reference Rate;

“Reference Rate Period” shall mean each five-year period from (and including) one Reset Date to (but excluding) the next Reset Date;

“Reference Security” shall mean such U.K. government security having a maturity date on or about the last day of the relevant Reference Rate Period as may be selected by the Calculation Agent with the advice of the Reference Rate Market Makers; and

“Reset Date” shall mean May 31, 2010 and each fifth anniversary thereafter.

The Calculation Agent will at or as soon as practicable after each time at which the Reference Rate is to be determined, determine the Reference Rate for the relevant Reference Rate Period. Each such determination will be notified to the Issuer, the Registrar, the Luxembourg Stock Exchange and the Holders before the commencement of the relevant Reference Rate Period.

2.3 Distributions will be payable out of the Issuer’s own legally available resources on each Distribution Date. Notwithstanding receipt of any interest due under the Subordinated Notes or any other resources legally available for distribution by the Issuer, neither the Issuer nor Bank of Scotland will, save to the extent provided in paragraph 2.4, pay a Distribution or make any payment in respect of a Distribution under the Preferred Securities or the Guarantee if, on the relevant Distribution Date:

2.3.1 Bank of Scotland is prevented by applicable U.K. banking regulations or other requirements from making payment in full (a) of dividends or other distributions on its Parity Obligations or (b) under the Guarantee; or

2.3.2 the amount of such Distribution (if paid in full), together with the sum of any dividends and other distributions on Bank of Scotland’s Parity Obligations due and payable on that Distribution Date, would exceed the Adjusted Distributable Reserves of Bank of Scotland (for this purpose, reduced by the aggregate amount of the dividend to be paid on the Existing Preference Stock on that Distribution Date) as of the Distribution Determination Date immediately preceding the relevant Distribution Date.

- 2.4 If, whether by reason of the provisions of paragraph 2.3 or any equivalent article or term of a Parity Obligation, on any Distribution Date Distributions are not paid in full on the Preferred Securities or dividends or other distributions are not paid in full on any Parity Obligations, but Adjusted Distributable Reserves are sufficient (after deduction of the aggregate amount of the dividend to be paid on the Existing Preference Stock on the relevant Distribution Date) so as to allow payment of part of any Distribution, then each Holder will be entitled to receive the Relevant Proportion of any such Distribution. No Holder shall have any claim in respect of any Distribution or part thereof not payable as a result of the limitations set out in paragraph 2.3. Accordingly, such amount will not cumulate for the benefit of the Holders or entitle the Holders to any claim in respect thereof against the Issuer or Bank of Scotland under the Guarantee.
- 2.5 Bank of Scotland has covenanted in the Guarantee in favour of Holders that, in the event that any Distribution is not paid in full as a result of paragraph 2.3, it will not (a) declare or pay any dividends or other distributions in respect of its ordinary stock or (if permitted) effect any repurchase of its ordinary stock or any other security of Bank of Scotland ranking junior to the Guarantee (or contribute any moneys to a sinking fund for the redemption of any such stock or securities) until after the second consecutive following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distributions to be paid in respect of the next two Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders) or (b) (if permitted) repurchase or redeem Parity Obligations which are securities until after the second consecutive following Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distributions to be paid in respect of the next two Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).
- 2.6 Bank of Scotland will determine whether as of each Distribution Determination Date sufficient Adjusted Distributable Reserves exist (after deduction of the aggregate amount of the dividend to be paid on the Existing Preference Stock on the next following Distribution Date) to allow a payment of some or all of the relevant Distribution. In the event that any Distribution cannot be paid in full, Bank of Scotland will notify or procure notification to the Stock Exchange, the General Partner, the Registrar and the Paying and Transfer Agent, and to Holders in accordance with paragraph 10, of the fact and of the amount, if any, to be paid in respect of that Distribution.
- 2.7 Save as described above, Holders will have no right to participate in the profits of the Issuer or Bank of Scotland and, in particular, will have no rights to receive from the Issuer amounts paid under the Subordinated Notes in excess of Distributions due and payable under the Preferred Securities. In the event that any amounts paid in respect of the Subordinated Notes exceed the amount (if any) then due by way of Distribution under the Preferred Securities, the amount of such excess will be paid to the holder of the Preferential Right and Holders will have no rights in respect thereof.
- 2.8 The liability of a Holder to contribute to the debts or obligations of the Issuer (if any) shall (subject to the Law) not exceed the amount of that Holder's Preferred Capital Contribution.
- 2.9 For the purposes of the definition of "Relevant Proportion" in paragraph 1 and paragraphs 2.3.2., 2.4 and 2.6, Adjusted Distributable Reserves as of each Distribution Determination Date shall be determined by reference to whichever is the latest available at that date of the audited accounts for the previous financial year of Bank of Scotland or interim accounts for the previous half year of Bank of Scotland, adjusted in either case for any of the following events occurring since the date to which such accounts were prepared: (i) any known net losses and (ii) any further redemptions of or payments on (a) any preference stock or other obligations of Bank of Scotland that are accounted for under then generally accepted accounting practice in the United Kingdom as proprietors' funds in Bank of Scotland's accounts and (b) all securities or other obligations of an undertaking which are accounted for under then generally accepted accounting practice in the United Kingdom as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or otherwise) to, Bank of Scotland that are similar in material respects to the Preferred Securities and the Guarantee, taken together, whether or not Parity Obligations, except in each case for such amounts as have been either charged to the lawful distributable reserves of Bank of Scotland in such accounts or



funded at that time by an issue of Replacement Capital as described in item (ii)(b) of the definition of “Redemption Conditions”.

- 2.10 If at any time the General Partner becomes aware that an investor in the Preferred Securities owns, directly or indirectly, 10% or more of the ordinary stock of Bank of Scotland, the General Partner on behalf of the Issuer will have the right to suspend payment of Distributions in respect of such investor’s Preferred Securities. Investors are required to provide written notice to the General Partner on behalf of the Issuer if at any time any such investor owns, directly or indirectly, 10% or more of the ordinary stock of Bank of Scotland. Any amounts so suspended will be forfeited and may not be subsequently claimed.

### **3. Liquidating Distributions**

- 3.1 In the event of the commencement of any dissolution or winding up of the Issuer before any redemption of the Preferred Securities or any substitution of the Preferred Securities by Substitute Stock under paragraph 5, the Holders at that time will be entitled, subject as set out in paragraph 3.4, to receive the Liquidating Distribution, in respect of each Preferred Security held, out of the assets of the Issuer available for distribution to such Holders under the Law. Such entitlement will arise (i) before any distribution of assets is made to the General Partner or to the holder of the Preferential Right and (ii) *pari passu* with the equivalent claims under all outstanding Parity Obligations of the Issuer but (iii) after the claims of all other creditors of the Issuer and holders of obligations of the Issuer which are not Parity Obligations nor subordinated to the Preferred Securities.

Notwithstanding the availability of sufficient assets of the Issuer to pay the Liquidating Distribution, if, at the time the Liquidating Distribution is to be paid, proceedings have been commenced for the sequestration or winding-up of Bank of Scotland other than pursuant to a Permitted Reorganisation, the Liquidating Distribution paid to Holders shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of Bank of Scotland had the Preferred Securities been directly issued preference stock issued by Bank of Scotland with equivalent rights of participation in the capital of Bank of Scotland (whether or not Bank of Scotland could in fact have issued such securities) and ranked (i) junior to depositors, the holders of the Existing Preference Stock and all other creditors (including the holders of subordinated debt) of Bank of Scotland, (ii) *pari passu* with all Parity Obligations of Bank of Scotland and (iii) senior to the holders of Bank of Scotland’s ordinary stock and any other securities or obligations of Bank of Scotland which are subordinated to the Guarantee.

- 3.2 If the Liquidating Distribution and any other such liquidation distributions cannot be made in full by reason of the limitation described in paragraph 3.1 or any equivalent article or term of a Parity Obligation, but there are funds available for payment so as to allow payment of part of the Liquidating Distribution then each Holder will be entitled to receive the Relevant Proportion of the Liquidating Distribution. After payment of the Liquidating Distribution, or the Relevant Proportion thereof, if applicable, the holder of the Preferential Right will be entitled to any remaining assets of the Issuer available for distribution and Holders will have no right or claim to any of the remaining assets of the Issuer or against Bank of Scotland under the Guarantee.
- 3.3 In the event that proceedings are commenced for the sequestration or winding-up of Bank of Scotland other than pursuant to a Permitted Reorganisation, the General Partner shall file a statement of dissolution of the Issuer with the Limited Partnerships Registrar and the amount to which Holders shall be entitled as a Liquidating Distribution will be as set out in paragraphs 3.1 and 3.2.
- 3.4 Subject to paragraph 3.3, unless (i) the FSA has given its approval, if then required and (ii) Bank of Scotland either has (a) Adjusted Distributable Reserves or (b) proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidating Distribution (in either of cases (ii)(a) or (b) in an amount at least equal to the aggregate Liquidating Distribution), the General Partner will not permit, or take any action that would or might cause, the dissolution or winding up of the Issuer. Notwithstanding the foregoing restriction imposed on the General Partner, if for any other reason the Issuer is dissolved or wound up in circumstances where proceedings have not been commenced for the sequestration or winding up of Bank of Scotland, the Liquidating Distribution shall only be payable to the extent that either of cases (ii)(a) or (b) above apply. No Holder shall have any claim (whether against the

Issuer or under the Guarantee) in respect of any Liquidating Distribution or part thereof not paid when it would, but for the operation of this paragraph 3.4, otherwise have become due.

- 3.5 Paragraph 3.4 will not apply in circumstances where a Substitution Event has occurred and the Substitute Stock has been issued.

#### **4. Redemption and Purchase**

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

- 4.2 The Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions and to the Law, on any Optional Redemption Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable) at the Optional Redemption Price. Upon the expiry of such notice, the Issuer shall be bound to redeem the Preferred Securities accordingly by payment of the Optional Redemption Price in accordance with and subject to the Law.

- 4.3 If at any time a Tax Event has occurred and is continuing, the effect of which cannot be avoided by the Issuer or Bank of Scotland taking reasonable measures available to it, then the Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions and to the Law, at any time upon not less than 30 nor more than 60 days' notice to the Holders specifying the Early Redemption Date (which notice shall be irrevocable), at the Tax Redemption Price (together with any accrued but unpaid Distribution in respect of the Distribution Period in which the Early Redemption Date falls). Where a notice of redemption has been given in accordance with the foregoing sentence, the General Partner on behalf of the Issuer shall also notify Holders of the Tax Redemption Price as soon as reasonably practicable after it has been determined (and in any event not later than the second London Business Day before the Early Redemption Date). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar a certificate signed by two Directors of Bank of Scotland stating that the Issuer is entitled to effect such redemption and an opinion of counsel to Bank of Scotland experienced in such matters to the effect that a Tax Event has occurred (and specifying which of clauses (i) to (iv) as set out in the definition of "Tax Event" is applicable). Upon the expiry of such notice, the Issuer shall be bound to redeem the Preferred Securities accordingly by the payment of the Tax Redemption Price (together with any accrued but unpaid Distribution in respect of the Distribution Period in which the Early Redemption Date falls) in accordance with and subject to the Law.

- 4.4 If at any time a Regulatory Event has occurred and is continuing, either (i) the General Partner may (provided that proceedings have not been commenced for the sequestration or winding up of Bank of Scotland) elect to substitute the Substitute Stock for the Preferred Securities in the manner provided in paragraph 5 or (ii) the Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to satisfaction of the Redemption Conditions and to the Law, at any time upon not less than 30 nor more than 60 days' notice to the Holders specifying the relevant Early Redemption Date (which notice shall be irrevocable), at the Regulatory Redemption Price (together with any accrued but unpaid Distribution in respect of the Distribution Period in which the Early Redemption Date falls). Where a notice of redemption has been given in accordance with the foregoing sentence, the General Partner on behalf of the Issuer shall also notify Holders of the Regulatory Redemption Price as soon as reasonably practicable after it has been determined (and in any event not later than the second London Business Day before the Early Redemption Date). Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar a certificate signed by two Directors of Bank of Scotland stating that the Issuer is entitled to effect such redemption and an opinion of counsel to Bank of Scotland experienced in such matters to the effect that a Regulatory Event has occurred. Upon the expiry of such notice, the Issuer shall be bound to redeem the Preferred Securities accordingly by the payment of the Regulatory Redemption Price (together with any accrued but unpaid Distribution in respect of the Distribution Period in which the Early Redemption Date falls) in accordance with and subject to the Law.



- 4.5 Under FSA requirements at the date hereof, the Issuer may not redeem, and neither the Issuer nor Bank of Scotland nor any of its Subsidiaries may purchase, any Preferred Securities unless the FSA gives its prior written consent, and the FSA may impose conditions on any such redemption or purchase.
- 4.6 Once a notice to redeem the Preferred Securities has been given under any of paragraphs 4.2, 4.3 or 4.4, no similar notice may be given under either of the other paragraphs. If at any time the Preferred Securities may be redeemed under more than one such paragraph, the General Partner may elect under which paragraph the notice of redemption is to be given.

## **5. Substitution by Substitute Stock**

- 5.1 As soon as reasonably practicable following the occurrence of a Substitution Event (provided that proceedings have not been commenced for the sequestration or winding up of Bank of Scotland), the General Partner shall take all reasonable steps to cause the substitution for the Preferred Securities of fully-paid non-cumulative sterling perpetual preference stock issued directly by Bank of Scotland having in all material respects equivalent terms (as more fully set out in the following paragraph) to those of the Preferred Securities and the Guarantee taken together (the “Substitute Stock”).

The Substitute Stock shall, among other things, provide terms that are equivalent to those of the Preferred Securities in respect of the non-cumulative nature of the distributions thereon, the status of the securities and the rights attaching to the securities in respect of rights on a sequestration or winding up of Bank of Scotland. The Substitute Stock shall be redeemable or effectively redeemable and will contain provisions similar to those contained in paragraphs 2.2 and in paragraphs 4.2, 4.3 and 4.4.

- 5.2 Prior to the issue of any Substitute Stock, application will be made by Bank of Scotland for admission of such Substitute Stock to listing on the Stock Exchange or another Recognised Stock Exchange. As soon as practicable after the occurrence of a Substitution Event (provided that proceedings have not been commenced for the sequestration or winding up of Bank of Scotland), Bank of Scotland will give written notice to the Holders enclosing a substitution confirmation which each Holder will be required to complete. To receive Substitute Stock, each Holder must deliver to the Paying and Transfer Agent the duly completed substitution confirmation together with the certificate representing its holding of Preferred Securities or an account statement issued by a clearing system and an authorisation to such clearing system to debit its securities account containing any Preferred Securities and to transfer such Holder’s interest in the Preferred Securities to Bank of Scotland or as Bank of Scotland may direct (such transferee, the “Exchange Holder”). Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. Following such substitution, the Substitute Stock allotted will rank for any dividend from the immediately preceding Distribution Date and will have no entitlement to any accrued Distribution or any other payment on the Preferred Securities. On allotment in full of such Substitute Stock and the removal of such Holder (a “former Holder”) from the Register, all rights of the former Holders to participate in the assets of the Issuer or to be returned any amount in respect of the Preferred Securities (including the Preferred Capital Contribution made by or on behalf of the former Holders) will be extinguished and each former Holder shall thereupon cease to be a limited partner of the Issuer. Substitute Stock will not be allotted to Restricted Persons.
- 5.3 Bank of Scotland will pay any taxes or capital duties or stamp duties payable in the United Kingdom or Jersey arising on the allotment and issue of the Substitute Stock other than to Restricted Persons. Bank of Scotland will not be obliged to pay, and each Holder delivering Preferred Securities and a duly completed substitution confirmation to the Paying and Transfer Agent must pay, any other taxes, stamp duty reserve taxes and capital, stamp, issue and registration duties arising on the relevant substitution. Bank of Scotland will not be obliged to pay, and each Holder must pay, all, if any, taxes arising by reference to any disposal or deemed disposal of a Preferred Security in connection with such substitution.
- 5.4 Certificates (if any) for Substitute Stock issued on substitution will be despatched by mail free of charge (but uninsured and at the risk of the person entitled thereto) within one month after receipt of a duly completed substitution confirmation. If Substitute Stock is required to be issued, Holders will continue to be entitled to receive Distributions and/or a Liquidating Distribution in respect of the Preferred Securities until such time

as notice is given by Bank of Scotland in accordance with paragraph 10 that Substituted Stock is available for issue upon substitution and that the Exchange Holder has been registered as a holder of the Preferred Securities. Thereafter the former Holders will have no further rights, title or interest in or to their Preferred Securities. Upon an involuntary dissolution of the Issuer occurring after the occurrence of a Substitution Event but prior to the substitution being effected, Holders will have no further rights, title or interest in or to Preferred Securities except the right to have their respective Preferred Securities substituted in the manner described above.

## **6. Additional Amounts**

All payments in respect of the Preferred Securities by the Issuer will be made without withholding or deduction for, or on account of, any tax in Jersey, unless the withholding or deduction of such tax is required by law. In the event of such withholding or deduction, each Holder will, if permitted by the FSA, be entitled to receive, as a further Distribution, such additional amounts (“Additional Amounts”) as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable in respect of the Preferred Securities in the absence of such withholding or deduction; except that no such Additional Amounts will be payable to a Holder (or to a third party on his or her behalf) with respect to any Preferred Security to the extent that such tax is imposed or levied by virtue of such Holder (or the beneficial owner) of such Preferred Security having some connection with Jersey other than being a Holder (or beneficial owner) of such Preferred Security, and except that the Issuer’s obligation to make any such payments is subject to the Law and to the limitations provided in paragraphs 2.3 and 3.1.

## **7. Payments**

7.1 Distributions will be payable subject to the Law on the relevant Distribution Date (or, where any Distribution Date is not a London Business Day, on the next London Business Day immediately following the Distribution Date, without interest in respect of such delay) to the Holders of record as they appear on the Register on the relevant record date, which will be five London Business Days prior to the relevant Distribution Date. If the General Partner gives a notice of redemption pursuant to paragraph 4.2, 4.3 or 4.4 in respect of the Preferred Securities, then, on the Redemption Date, the General Partner shall procure that the Optional Redemption Price, the Tax Redemption Price or the Regulatory Redemption Price, as the case may be, will be paid by the Registrar or by the Paying and Transfer Agents on behalf of the Issuer to the Holders. Upon such payment, all rights of Holders to participate in the assets of the Issuer or to be returned any amount in respect of the Preferred Securities (including the Preferred Capital Contribution made by or on behalf of the Holders) will be extinguished and each Holder shall thereupon cease to be a limited partner of the Issuer provided its holding of Preferred Securities is redeemed in accordance with the foregoing and the Preferred Capital Contribution will, on payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Redemption Price, as the case may be, be deemed repaid.

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

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

7.2.2 any payment of amounts in respect of the Optional Redemption Price, the Tax Redemption Price, the Regulatory Redemption Price or the Liquidating Distribution (or relevant proportion thereof) in respect of any Preferred Security will be made by cheque against presentation and surrender of the relevant certificate of entitlement at the office of the Registrar or any Paying and Transfer Agent,

provided, however, that a Holder may receive such payment by direct transfer arranged by a Paying and Transfer Agent if appropriate direct transfer instructions have been received by the Registrar in sufficient time prior to the relevant date of payment. Holders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a London Business Day, if the

Holder is late in surrendering certificates (if required to do so) or if a cheque mailed in accordance with this paragraph arrives after the due date for payment.

In the event that payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Redemption Price is improperly withheld or refused and not paid by the Issuer, Distributions on such Preferred Security, subject as described in paragraph 2.3, will continue to accrue, on a day by day basis compounding annually, from the Redemption Date to the date of actual payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Redemption Price, as the case may be.

- 7.3 The Issuer will not, and Bank of Scotland has undertaken in the Guarantee that it will not and that it will procure that no member of the Group will, make any payment to Holders, or procure or permit to be made such a payment, in respect of the Preferred Securities or the Guarantee, except for payments to which the Holders are expressly entitled under the terms of the Preferred Securities and the Guarantee.
- 7.4 The General Partner will, and Bank of Scotland has undertaken in the Guarantee that it will procure that the General Partner will, maintain at all times whilst the Preferred Securities are in issue (a) a Paying and Transfer Agent outside the United Kingdom, (b) for so long as the Preferred Securities are listed on the Stock Exchange, a Paying and Transfer Agent in Luxembourg and (c) a Registrar having its office outside the United Kingdom.

## **8. Voting Rights**

- 8.1 Except as described below and provided for in the Law, Holders will not be entitled to receive notice of or attend or vote at any meeting of partners in the Issuer or participate in the management of the Issuer.

- 8.2 If for two consecutive Distribution Periods:

8.2.1 Distributions have not been paid in full on the Preferred Securities by the Issuer; and/or

8.2.2 Bank of Scotland has not made any payments under the Guarantee in respect of such Distributions, then the Holders together with the holders of any other preferred securities of the Issuer having the right to vote for the election of a special representative (the "Special Representative") in such event, acting as a single class without regard to class, will be entitled to appoint a Special Representative, by written notice to the Issuer given by the holders of a majority by Liquidation Preference of such Preferred Securities and any other preferred securities having the said right or by resolution passed by the holders of a majority by Liquidation Preference of such Preferred Securities and any other such preferred securities present in person or by proxy at a separate general meeting of such holders convened for the purpose. The Special Representative shall be authorised to represent the Holders (for this purpose as defined in the Guarantee) to enforce their statutory rights as limited partners including provision of information on the affairs of the Issuer; however, it has no rights in addition to those held by Holders. The Special Representative shall not, by virtue only of acting in such capacity, be admitted or authorised to act as a general partner in relation to the Issuer or be admitted as a Holder or otherwise be deemed to be a general partner or a Holder in the Issuer and shall have no liability for the debts, obligations or liabilities of the Issuer or for any unpaid contribution of a partner in its capacity as Special Representative.

Not later than 30 days after such entitlement arises, if the written notice of the Holders of outstanding Preferred Securities and the holders of any other preferred securities of the Issuer having the right to vote for the election of a Special Representative in the circumstances described in the preceding paragraph has not been given as provided for in the preceding paragraph, the General Partner will convene a separate general meeting for the purpose. If the General Partner fails to convene such meeting within such 30-day period, the holders of 10% by Liquidation Preference of the Preferred Securities and such other preferred securities will be entitled to convene such a meeting for the purpose. The Partnership Agreement contains provisions concerning the convening and conduct of meetings of Holders. Any Special Representative so appointed shall, subject to the terms of such other preferred securities, vacate office if, after its appointment, full Distributions are made by the Issuer or by Bank of Scotland under the Guarantee for two consecutive Distribution Periods or an amount equivalent to the Distributions to be paid in respect of two consecutive Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders.

- 8.3 The consent in writing of the Holders of at least a majority of the issued Preferred Securities or the sanction of a resolution, passed at a separate meeting at which the quorum shall be Holders holding at least one-third in Liquidation Preference of the issued Preferred Securities present or represented, shall be required in order to give effect to any variation or abrogation of the rights, preferences and privileges of the Preferred Securities by way of amendment of the Partnership Agreement or otherwise (including, without limitation, the authorisation or creation of any securities or ownership interests of the Issuer ranking, as to participation in the profits or assets of the Issuer, senior to the Preferred Securities) (unless otherwise required by applicable law). No such sanction shall be required if the change is solely of a formal, minor or technical nature or is to correct an error or cure an ambiguity, provided that the change does not reduce the amounts payable to Holders, impose any obligation on the Holders or adversely affect their voting rights.
- 8.4 Notwithstanding the foregoing, provided that the two most recent Distributions have been paid in full by the Issuer (or Bank of Scotland pursuant to the Guarantee), the General Partner may, without the consent or sanction of the Holders, take such action as is required in order to amend the Partnership Agreement:
- 8.4.1 to allow an increase in the level of Preferred Capital Contributions and the corresponding number of Preferred Securities or to authorise and create limited partnership interests represented by one or more other classes of preferred securities of the Issuer ranking *pari passu* with the Preferred Securities as regards participation in the profits and assets of the Issuer and to admit if relevant new limited partners and holders in respect thereof; or
- 8.4.2 to authorise and create limited partnership interests represented by one or more other classes of securities or partnership interests in the Issuer ranking junior, as regards participation in the profits and assets of the Issuer, to the Preferred Securities and to admit if relevant new limited partners and holders in respect thereof.
- 8.5 Notwithstanding the foregoing, no vote of the Holders will be required for the redemption, cancellation or substitution of the Preferred Securities in accordance with the Partnership Agreement.
- 8.6 Subject to the Law, the Issuer may not be dissolved by the General Partner whilst any Preferred Security is in issue, unless all the Holders and the General Partner have approved such action. Such approval shall not be required if the dissolution of the Issuer is proposed or initiated because of the liquidation, dissolution, sequestration or winding-up, as the case may be, of the General Partner or Bank of Scotland.
- 8.7 Any Preferred Security, and any preferred security of a type referred to in paragraph 8.2, that is at any time owned by Bank of Scotland, or any entity of which Bank of Scotland, either directly or indirectly, owns 20% or more of the voting shares or similar ownership interests, shall not carry a right to vote in a meeting of Holders or at any meeting called to vote for the election of a Special Representative pursuant to paragraph 8.2 and shall, for voting purposes, be treated as if it were not in issue other than in the case of the approval required by paragraph 8.6.
- 8.8 The General Partner will cause a notice of any meeting at which Holders are entitled to vote and any voting forms to be mailed to each Holder. Each such notice will include a statement setting forth (a) the date, time and place of such meeting, (b) a description of any resolution to be proposed for adoption at such meeting on which such Holders are entitled to vote and (c) instructions for the delivery of proxies.

## **9. Covenant of the General Partner**

The General Partner has undertaken not to incur any indebtedness in the name of the Issuer other than costs and expenses incidental to creating the Preferred Securities and the Issuer, performing its obligations in respect of the Partnership Agreement, maintaining the listing of the Preferred Securities, the Register, the Registrar and Paying and Transfer Agents in respect of the Preferred Securities, its holding of the Subordinated Notes or any securities substituted therefor and the maintenance of a custodian thereof, the exercise of the Issuer's rights in respect of the Subordinated Notes or any securities substituted therefor and the administration of the Issuer.

## 10. Notices

All notices to the Holders will be mailed to each Holder of record and, so long as the Preferred Securities are listed on the Stock Exchange and the rules of the Stock Exchange so require, published in a leading Luxembourg daily newspaper which is expected to be the *Luxemburger Wort*. Any mailed notice shall be deemed to have been given one clear day after the date on which it was posted and any notice published in a newspaper shall be deemed to have been given on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

## 11. Transfers and Form

11.1 The Preferred Securities will be in registered form.

11.2 Preferred Securities sold in offshore transactions in reliance on Regulation S will be represented by a permanent global certificate in fully registered form (the “Regulation S Global Certificate”) and will be registered in the name of a nominee of, and deposited with a common depository for, Clearstream, Luxembourg and Euroclear.

11.3 Preferred Securities sold in reliance on Rule 144A will be represented by a permanent global certificate in fully registered form (the “Restricted Global Certificate” and, together with the Regulation S Global Certificate, the “Global Certificates”) and will be registered in the name of a nominee of, and deposited with, a common depository for Clearstream, Luxembourg and Euroclear. The Preferred Securities represented by the Restricted Global Certificate (and any Preferred Securities represented by a definitive certificate issued in exchange therefor) will be subject to certain restrictions on transfer as described in “*Notice to Investors*.”

11.4 Interests in Preferred Securities represented by the Restricted Global Certificate may be transferred to a person whose interest in such Preferred Securities is subsequently represented by the Regulation S Global Certificate, only upon receipt by the Registrar of a written certificate from the transferor to the effect that such transfer is being made in accordance with Regulation S under the Securities Act. Until and including the 40th day after the Issue Date, interests in the Preferred Securities represented by the Regulation S Global Certificate may be transferred to a person whose interest in such Preferred Securities is subsequently represented by the Restricted Global Certificate only upon receipt by the Registrar of a written certificate from the transferor to the effect that such transfer is being made to a QIB in a transaction meeting the requirements of Rule 144A under the Securities Act. Any interest in Preferred Securities which is represented by one of the Global Certificates and which is transferred to a person whose interest in such Preferred Securities is subsequently represented by the other Global Certificate will, upon transfer, cease to be an interest in Preferred Securities represented by such Global Certificate and become an interest in the Preferred Securities represented by the other Global Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to interests in Preferred Securities represented by such other Global Certificate for as long as it remains such an interest.

11.5 Except in the limited circumstances described below, owners of interests in the Preferred Securities represented by a Global Certificate will not be entitled to receive physical delivery of definitive certificates. The Preferred Securities and certificates are not issuable in bearer form.

11.6 If (i) either of Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days or more (other than for purposes of a public holiday) or announces an intention permanently to cease business or does in fact do so or (ii) as a result of a change in law, transfer duties or similar taxes become payable on transfers of the Preferred Securities in Euroclear and/or Clearstream, Luxembourg, the Issuer will issue individual definitive certificates in respect of Preferred Securities in registered form in exchange for the Global Certificates. Upon receipt of such notice from Euroclear and/or Clearstream, Luxembourg, the Issuer will use its best efforts to make arrangements with Euroclear and Clearstream, Luxembourg for the exchange of the Global Certificates for individual definitive certificates and cause the requested individual definitive certificates to be executed and delivered to the Registrar in sufficient quantities and authenticated by the Registrar for delivery to holders of Preferred Securities. Persons



exchanging interests in the Global Certificates for individual definitive certificates will be required to provide the Registrar with written instructions and other information required by the Issuer and the Registrar to complete, execute and deliver such individual definitive certificates and to make appropriate entries in the Register in respect of the Preferred Securities. In all cases, definitive certificates delivered in exchange for a Global Certificate or an interest in the Preferred Securities represented thereby will be registered in the names, and issued in any approved denominations, requested by Euroclear and Clearstream, Luxembourg.

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

## **12. Replacement Certificates**

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

## **13. Prescription**

Unclaimed Distributions, Optional Redemption Price, Tax Redemption Price, Regulatory Redemption Price and Liquidating Distribution will be prescribed after ten years in accordance with Jersey law.

## **14. Redenomination**

In the event that the United Kingdom participates in the third stage of European economic and monetary union, the General Partner may, without the consent of Holders, on giving prior notice to Bank of Scotland, the Luxembourg Stock Exchange, the Paying and Transfer Agents, Euroclear and Clearstream, Luxembourg and at least 30 days' prior notice to Holders, elect that, with effect from the date (the "Redenomination Date") so specified in the notice, the Liquidation Preference shall be redenominated in euro.

The election will have effect as follows:

- (i) the Liquidation Preference shall be deemed to be redenominated into euro at the rate for the conversion of sterling (including compliance with rules relating to rounding in accordance with applicable European Community regulations) into euro established by the Council of the European Union pursuant to Article 123 of the Treaty establishing the European Community, as amended by the Treaty on European Union;
- (ii) if issued prior to the Redenomination Date, the payment obligations contained in any Preferred Securities issued in definitive certificated form will become void on that date although those certificates will continue to constitute valid exchange obligations of the Issuer. New euro-denominated certificates in respect of those Preferred Securities will be issued in exchange for certificates denominated in sterling at the rate specified in paragraph (i) above in such manner as the Paying and

Transfer Agents may specify and as shall be notified to the Holders. No such notice of exchange may be given less than 15 days prior to any date for any payment on the Preferred Securities;

- (iii) after the Redenomination Date, all payments in respect of the Preferred Securities, other than any Distribution in respect of a period commencing before the Redenomination Date, will be made solely in 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, if no such account is specified, by a euro cheque; and
- (iv) such other changes shall be made to the terms of the Preferred Securities as the Issuer may decide, after consultation with the Paying and Transfer Agents, and as may be specified in the notice, to conform them to conventions then applicable to instruments denominated in euro.

## **15. Governing Law**

The Preferred Securities and the Partnership Agreement shall be governed by, and construed in accordance with, Jersey law. Determinations in respect of amounts of Adjusted Distributable Reserves shall, however, be made subject to Scots law.



### **Description of the Class B Preferred Securities**

The Class B Preferred Securities have identical terms to those summarised for the Class A Preferred Securities on pages 80 to 95 of this Offering Circular, except that in:

- (i) the preamble to the definitions, the words “Class A” are deleted and replaced by “Class B”;
- (ii) the definition of “Distribution Rate” and paragraph 2.2.1, the rate “8.117%” is deleted and replaced by “7.754%”;
- (iii) the definition of “Margin”, the rate of “3.85%” is deleted and replaced by “4.20%”;
- (iv) the definition of “Preferred Securities”, the amount “£250,000,000” is deleted and replaced with the amount “£150,000,000”, the rate “8.117%” is deleted and replaced by “7.754%” and the words “Class A” are deleted and replaced by “Class B”;
- (v) the definition of “Subordinated Notes”, the amount “£250,000,000” is deleted and replaced with the amount “£150,000,000” and the series number “BOS 0009” is deleted and replaced by “BOS 0010”;  
and
- (vi) all instances, the date “2010” is replaced by the date “2021”.

## **SUMMARY OF PROVISIONS RELATING TO THE PREFERRED SECURITIES IN GLOBAL FORM**

### **Initial Issue of Preferred Securities**

The Preferred Securities of each class will be issued in registered form and will be initially represented by interests in a Restricted Global Certificate and a Regulation S Global Certificate which will each be registered in the name of a nominee of, and deposited with a common depository for, Euroclear and Clearstream, Luxembourg on or about the Issue Date. Upon the initial registration of Preferred Securities in the name of a nominee of Euroclear and Clearstream, Luxembourg and delivery of the Global Certificates to the common depository for Euroclear and Clearstream, Luxembourg, Euroclear or Clearstream, Luxembourg will credit each subscriber with such number of Preferred Securities equal to the number thereof for which it has subscribed and paid.

### **Accountholders**

So long as the Preferred Securities are registered in the name of a common nominee for Euroclear and Clearstream, Luxembourg, the nominee for Euroclear and Clearstream, Luxembourg will be the sole registered owner or holder of the Preferred Securities represented by the Global Certificates for all purposes under the Limited Partnership Agreement. Except as set forth under “*Description of Preferred Securities — Transfers and Form*” and under “— *Transfers of Interests*”, the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system (an “Alternative Clearing System”) as the holders of the Preferred Security evidenced by the Global Certificates (each an “Accountholder”) will not be entitled to have Preferred Securities registered in their names, will not receive or be entitled to receive physical delivery of definitive Certificates evidencing interests in the Preferred Securities and will not be considered registered owners or holders thereof under the Limited Partnership Agreement. Accordingly, each Accountholder must rely on the rules and procedures of Euroclear and Clearstream, Luxembourg, as the case may be, to exercise any rights and obligations of a holder of Preferred Securities under the Limited Partnership Agreement.

### **Payments**

Each Accountholder must look solely to Euroclear, Clearstream, Luxembourg or such Alternative Clearing System, as the case may be, for its share of each payment made by the Issuer to the registered holder of the Preferred Securities and in relation to all other rights arising under the Global Certificates, subject to and in accordance with the respective rules and procedures of Euroclear, Clearstream, Luxembourg or such Alternative Clearing System, as the case may be. Such persons shall have no claim directly against the Issuer in respect of payments due on the Preferred Securities for so long as the Preferred Securities are represented by such Global Certificates and such obligations of the Issuer will be discharged by payment to the registered holder of the Preferred Securities in respect of each amount so paid.

### **Transfers of Interests**

Accountholders will only be able to transfer their beneficial interests in the Preferred Securities in accordance with the restrictions described under “*Description of Preferred Securities — Transfers and Form*” and with the rules and procedures of Euroclear, Clearstream, Luxembourg or the Alternative Clearing System, as the case may be.

### **Settlement**

Initial settlement for the Preferred Securities and settlement of any secondary market trades in the Preferred Securities will be made in same-day funds.

### **Euroclear and Clearstream, Luxembourg**

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate 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 deals with domestic securities markets in several countries through established depositary 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 worldwide 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.

## DESCRIPTION OF THE GUARANTEE

The following is the form of the Guarantee to be executed by Bank of Scotland:

THIS DEED OF GUARANTEE (the "Guarantee"), dated March 14, 2000, is executed and delivered by THE GOVERNOR AND COMPANY OF THE BANK OF SCOTLAND ("Bank of Scotland"), established by an Act of the Parliament of Scotland in 1695, for the benefit of the Holders (as defined below).

WHEREAS:

- (i) Bank of Scotland desires to issue this Guarantee for the benefit of the Holders, as provided herein; and
- (ii) this Guarantee is intended to provide the Holders, on a dissolution or winding up of the Issuer (as defined below) or on a default by the Issuer in discharging its obligations in respect of the Preferred Securities (as defined below), with rights against Bank of Scotland in respect of the Guaranteed Payments (as defined below) which are as nearly as possible equivalent to those which they would have had if the Preferred Securities had been directly issued preference stock of Bank of Scotland (whether or not Bank of Scotland could in fact have issued such securities)

NOW, THEREFORE Bank of Scotland executes and delivers this Guarantee as a deed poll for the benefit of the Holders.

### 1. Definitions

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

"Guaranteed Payments" means collectively (i) all Distributions as due on the Preferred Securities, (ii) any Liquidating Distribution to which Holders are entitled, (iii) the Optional Redemption Price, the Tax Redemption Price and the Regulatory Redemption Price and (iv) any Additional Amounts;

"Holder" means, in respect of each Preferred Security, each person registered on the Register as the limited partner holding such Preferred Security at the relevant time save for as long as the Preferred Securities are registered in the name of a common depository for Clearstream, Luxembourg and Euroclear, in which case each person (other than Euroclear and Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear and Clearstream, Luxembourg as the holder of any Preferred Securities (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the number of Preferred Securities standing to the account of any person shall be conclusive and binding for all purposes) other than with respect to payments, the right to which shall be vested in the name of the person appearing as the relative limited partner in the Register;

"Issuer" means Bank of Scotland Capital Funding L.P.;

"Partnership Agreement" means the Limited Partnership Agreement dated March 10, 2000 between, *inter alia*, Bank of Scotland and Bank of Scotland Capital Funding (Jersey) Limited establishing the Issuer; and

"Preferred Securities" means collectively the £250,000,000 8.117% Non-cumulative Perpetual Preferred Securities, Class A and the £150,000,000 7.754% Non-cumulative Perpetual Preferred Securities, Class B, of the Issuer, whether or not in issue on the date of this Guarantee, the Holders of which are entitled to the benefits of this Guarantee as evidenced by the execution of this Guarantee.

### 2. Guarantee

- 2.1 Subject to the exceptions and limitations contained in the following provisions of this clause 2, Bank of Scotland irrevocably agrees to pay in full to the Holders the Guaranteed Payments, as and when due, to the extent that such payments shall not have been paid when due and payable by the Issuer regardless of any defence, right of set-off or counterclaim which the Issuer may have or assert. This Guarantee is continuing,

irrevocable and absolute. The rights and claims of the Holders against Bank of Scotland under this Guarantee are subordinated to the claims of the Senior Creditors (as defined herein) in that payment of the Guaranteed Payments is conditional upon satisfaction of the conditions set out in the following provisions of this clause 2.

- 2.2 Notwithstanding clause 2.1, Bank of Scotland will not, save to the extent provided in clause 2.5, be obliged to make any Guaranteed Payment if Bank of Scotland is prevented by applicable U.K. banking regulations or other requirements from making payment in full under this Guarantee. In addition, notwithstanding clause 2.1, Bank of Scotland will not, save to the extent provided in clause 2.5, be obliged to make any Guaranteed Payment in respect of Distributions on any Preferred Securities if, on the relevant Distribution Date:
- (a) Bank of Scotland is prevented by applicable U.K. banking regulations or other requirements from making payment in full of dividends or other distributions on its Parity Obligations; or
  - (b) the amount of such Distribution (if paid in full), together with the sum of any dividends and other distributions on Bank of Scotland's Parity Obligations due and payable on that Distribution Date, would exceed the Adjusted Distributable Reserves (for this purpose, reduced by the aggregate amount of the dividend to be paid on the Existing Preference Stock on that Distribution Date) of Bank of Scotland determined as of the Distribution Determination Date immediately preceding the relevant Distribution Date.
- 2.3 Notwithstanding clause 2.1, if, at the time that the Liquidating Distribution is to be paid by Bank of Scotland under this Guarantee in respect of any Preferred Securities, proceedings have been commenced for the sequestration or winding-up of Bank of Scotland other than pursuant to a Permitted Reorganisation, payment under this Guarantee of such Liquidating Distribution shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of Bank of Scotland had the Preferred Securities been directly issued preference stock issued by Bank of Scotland with equivalent rights of participation in the capital of Bank of Scotland (whether or not Bank of Scotland could in fact have issued such securities) and ranked (i) junior to depositors, the holders of the Existing Preference Stock and all other creditors (including the holders of subordinated debt) of Bank of Scotland, (ii) *pari passu* with all Parity Obligations of Bank of Scotland and (iii) senior to the holders of Bank of Scotland's ordinary stock or any other securities or obligations of Bank of Scotland which are subordinated to the Guarantee.
- 2.4 All Guaranteed Payments made hereunder will be made without withholding or deduction for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the United Kingdom or any political sub-division thereof or by any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event, Bank of Scotland will, if permitted by the FSA, pay such additional amounts ("Guarantor Additional Amounts") as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable under this Guarantee in the absence of such withholding or deduction; except that no such Guarantor Additional Amounts will be payable to a Holder (or a third party on his behalf) to the extent that such taxes, duties, assessments or governmental charges are imposed or levied by virtue of such Holder (or the beneficial owner of a Preferred Security) having some connection with the United Kingdom other than being a Holder (or beneficial owner) of a Preferred Security, and except that Bank of Scotland's obligation to pay any Guarantor Additional Amounts is subject to the exceptions relating to Guaranteed Payments set out in clauses 2.2 and 2.3.
- 2.5 In the event that the amounts described in clauses 2.1 and 2.4 cannot be made in full by reason of either of the conditions referred to in clause 2.2 or 2.3, such amounts will be payable *pro rata* in the Relevant Proportion and the obligations of Bank of Scotland in respect of any such unpaid balance shall lapse.
- 2.6 Bank of Scotland hereby waives notice of acceptance of this Guarantee and of any liability to which it applies or may apply, presentment, demand for payment, protest, notice of non-payment, notice of dishonour, notice of redemption and all other notices and demands.

- 2.7 The obligations, covenants, agreements and duties of Bank of Scotland under this Guarantee shall in no way be affected or impaired by reason of the happening from time to time of any of the following:
- (a) the release or waiver, by operation of law or otherwise, of the performance or observance by the Issuer of any express or implied agreement, covenant, term or condition relating to the Preferred Securities to be performed or observed by or on behalf of the Issuer; or
  - (b) the extension of time for the payment by or on behalf of the Issuer of all or any portion of any Distribution, the Optional Redemption Price, the Tax Redemption Price, the Regulatory Redemption Price, the Liquidating Distribution or any other sums payable under the terms of the Preferred Securities or the extension of time for the performance of any other obligation under, arising out of, or in connection with, the Preferred Securities; or
  - (c) any failure, omission, delay or lack of diligence on the part of Holders to enforce, assert or exercise any right, privilege, power or remedy conferred on the Holders pursuant to the terms of the Preferred Securities, or any action on the part of the Issuer granting indulgence or extension of any kind; or
  - (d) the voluntary or involuntary winding up, dissolution, amalgamation, reconstruction, sale of any collateral, receivership, insolvency, bankruptcy, assignment for the benefit of creditors, reorganisation, arrangement, composition or readjustment of debt of, or other similar proceedings affecting, the Issuer or any of the assets of the Issuer; or
  - (e) any invalidity of, or defect or deficiency in, the Preferred Securities; or
  - (f) the settlement or compromise of any obligation guaranteed hereby or hereby incurred.

There shall be no obligation on the Holders to give notice to, or obtain consent of, Bank of Scotland with respect to the happening of any of the foregoing.

- 2.8 This Guarantee shall be deposited with and held by the Registrar until all the obligations of Bank of Scotland have been discharged in full. Bank of Scotland hereby acknowledges the right of every Holder to the production of, and the right of every Holder to obtain a copy of, this Guarantee from the Registrar.
- 2.9 A Holder may enforce this Guarantee directly against Bank of Scotland, and Bank of Scotland waives any right or remedy to require that any action be brought against the Issuer or any other person or entity before proceeding against Bank of Scotland. Subject to clause 2.10, all waivers contained in this Guarantee shall be without prejudice to the right to proceed against the assets of the Issuer and the General Partner as permitted by the terms of the Preferred Securities. Bank of Scotland agrees that this Guarantee shall not be discharged except by complete performance of all obligations of Bank of Scotland under this Guarantee.
- 2.10 Bank of Scotland shall be subrogated to any and all rights of the Holders against the assets of the Issuer in respect of any amounts paid to the Holders by Bank of Scotland under this Guarantee. Bank of Scotland shall not (except to the extent required by mandatory provisions of law) exercise any rights which it may acquire by way of subrogation or any indemnity, reimbursement or other agreement, in all cases as a result of a payment under this Guarantee, if, at the time of any such payment, any amounts are due and unpaid under this Guarantee. If Bank of Scotland shall receive or be paid any amount with respect to the Preferred Securities in violation of the preceding sentence, Bank of Scotland agrees to pay over such amount to the Holders.
- 2.11 Bank of Scotland acknowledges that its obligations hereunder are several and independent of the obligations of the Issuer with respect to the Preferred Securities and that Bank of Scotland shall be liable as principal and sole obligor hereunder to make Guaranteed Payments pursuant to the terms of this Guarantee, notwithstanding the occurrence of any event referred to in clause 2.7.
- 2.12 Subject to applicable law, Bank of Scotland agrees that its obligations hereunder constitute unsecured obligations of Bank of Scotland and rank and will at all times rank (i) senior to the rights of the holders of the ordinary stock of Bank of Scotland or any other securities or obligations of Bank of Scotland which are subordinated to the Guarantee, (ii) *pari passu* with the equivalent claims under all outstanding and future Parity Obligations of Bank of Scotland and (iii) junior to the claims of depositors, the holders of the Existing

Preference Stock and all other creditors (including holders of subordinated debt) of Bank of Scotland (together, the “Senior Creditors”).

- 2.13 Following a breach by Bank of Scotland of its payment obligations under this Guarantee, a Holder may petition for the winding-up or sequestration of Bank of Scotland and claim in the liquidation of Bank of Scotland but no other remedy shall be available to the Holder.
- 2.14 No Holder shall following any breach by Bank of Scotland of any of its obligations under this Guarantee be entitled to exercise any right of set-off or counterclaim which may be available to it against amounts owing by Bank of Scotland to such Holder. Notwithstanding the provisions of the foregoing sentence, if any of the said rights and claims of any Holder against Bank of Scotland is discharged by set-off, such Holder will immediately pay an amount equal to the amount of such discharge to Bank of Scotland or, in the event of its sequestration or winding-up, the trustee or liquidator of Bank of Scotland and until such time as payment is made will hold a sum equal to such amount in trust for Bank of Scotland, or the trustee or liquidator of Bank of Scotland and accordingly any such discharge will be deemed not to have taken place.
- 2.15 In the event of the sequestration or winding-up of Bank of Scotland if any payment or distribution of assets of Bank of Scotland of any kind or character, whether in cash, property or securities, including any such payment or distribution which may be payable or deliverable by reason of the payment of any other indebtedness of Bank of Scotland being subordinated to the payment of amounts owing under this Guarantee, shall be received by any Holders, before the claims of Senior Creditors have been paid in full, such payment or distribution shall be held in trust by the Holder, as applicable, and shall be immediately returned by it to the trustee or liquidator of Bank of Scotland and in that event the receipt by the trustee or liquidator shall be a good discharge to the relevant Holder. Thereupon, such payment or distribution will be deemed not to have been made or received.

### **3. Undertakings**

- 3.1 Unless with the prior consent of the Holders, Bank of Scotland agrees that it will neither (1) issue any preference stock which would rank (as regards dividends and/or distributions on a return of assets) senior to this Guarantee (other than any bonus stock that may require to be issued pursuant to the terms of the Existing Preference Stock) nor (2) give any guarantee or enter into any support agreement in respect of any preference shares or other preferred securities (not constituting debt obligations) having in all material respects the same ranking as preference shares, issued by any subsidiary or subsidiary undertaking of the Bank, which guarantee or support agreement would rank (as regards dividends and/or distributions on a return of assets) senior to this Guarantee, unless, in either case, this Guarantee is amended so as to rank *pari passu* in all material respects with such stock, guarantee or other support, as the case may be.
- 3.2 Bank of Scotland undertakes that, in the event that Distributions have not been paid in full to Holders by reason of the limitations set out in the terms of the Preferred Securities and in the Partnership Agreement, Bank of Scotland will not (a) declare or pay any dividends or other distributions in respect of its ordinary stock or (if permitted) effect any repurchase of its ordinary stock or any other security of Bank of Scotland ranking junior to the Guarantee (or contribute any moneys to a sinking fund for the redemption of any such stock or securities) until after the second consecutive Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distributions to be paid in respect of the next two Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders) or (b) (if permitted) repurchase or redeem Parity Obligations which are securities until after the second consecutive Distribution Date on which a Distribution in respect of the Preferred Securities is paid in full (or an amount equivalent to the Distributions to be paid in respect of the next two Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).
- 3.3 Bank of Scotland undertakes that, so long as any of the Preferred Securities is outstanding (a) unless Bank of Scotland is itself being sequestered or wound up, it will not permit, or take any action that would or might cause, the liquidation, dissolution or winding-up of the General Partner or the Issuer otherwise than (i) with the prior approval of the FSA (if then required) and (ii) if either (A) Bank of Scotland has sufficient



Adjusted Distributable Reserves or (B) Bank of Scotland has proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidating Distribution (in either of cases (ii)(A) or (B) in an amount at least equal to the aggregate Liquidating Distribution) and (b) the General Partner will at all times be a directly or indirectly wholly owned subsidiary of Bank of Scotland, unless in the case of (a) or (b), otherwise approved by all Holders.

- 3.4 Bank of Scotland undertakes to take all reasonable steps to ensure that, with effect from the date of its annual general meeting to be held in 2000, it will at all times have a sufficient amount of authorised but unissued Substitute Stock to permit the substitution thereof for all outstanding Preferred Securities and undertakes to take all reasonable steps to ensure that all corporate authorisations will have been taken for the allotment and issue of the same free from pre-emptive rights. Bank of Scotland further undertakes that (a) to the extent it is legally able to do so at the relevant time, it will allot, issue and deliver Substitute Stock (whether created on or after the date of its annual general meeting to be held in 2000) in satisfaction of the rights of the Holders in the circumstances described in the Partnership Agreement, such Substitute Stock having the rights and being subject to the conditions set out in the Partnership Agreement, (b) it will take all reasonable steps to procure that such Substitute Stock will at the relevant time be listed on a Recognised Stock Exchange and (c) it will pay any taxes or capital duties or stamp duties payable in the United Kingdom or Jersey arising on the allotment and issue of such Substitute Stock other than to Restricted Persons.
- 3.5 Bank of Scotland will not, and will procure that neither the Issuer nor any other member of the Group will, make any payment to Holders, or procure or permit to be made such a payment, in respect of the Preferred Securities or under this Guarantee, except for payments to which the Holders are expressly entitled under the terms of the Preferred Securities or this Guarantee.
- 3.6 Bank of Scotland undertakes that it will procure that the General Partner will maintain at all times whilst the Preferred Securities are in issue (a) a Paying and Transfer Agent outside the United Kingdom, (b) for so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, a Paying and Transfer Agent in Luxembourg and (c) a Registrar having its office outside the United Kingdom.

#### **4. Termination**

With respect to the Preferred Securities, this Guarantee shall terminate and be of no further force and effect upon (i) payment of the Optional Redemption Price, the Tax Redemption Price or the Regulatory Redemption Price, as the case may be, on all Preferred Securities, (ii) on purchase and cancellation of all Preferred Securities, (iii) on payment of the Liquidating Distribution, or the Relevant Proportion thereof, or (iv) upon issue and allotment in full of Substitute Stock, as the case may be, and dissolution of the Issuer, provided however that this Guarantee will continue to be effective or will be reinstated, as the case may be, if at any time payment of any sums paid in respect of the Preferred Securities or under this Guarantee must be restored by a Holder for any reason whatsoever.

#### **5. Transfer; Amendment; Notices**

- 5.1 Subject to operation of law, all guarantees and agreements contained in this Guarantee shall bind the successors, assigns, receivers, trustees and representatives of Bank of Scotland and shall inure to the benefit of the Holders. Bank of Scotland shall not transfer its obligations hereunder without the prior approval of the Holders of not less than a majority in Liquidation Preference of issued Preferred Securities (excluding any Preferred Securities held by Bank of Scotland or any entity of which Bank of Scotland, either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests), which approval shall be obtained in accordance with the procedures contained in the Partnership Agreement and the Law.
- 5.2 Except for those changes (a) required by clause 3.1 or (b) which do not adversely affect the rights of Holders (in either of which cases no agreement will be required), this Guarantee shall be changed only by agreement in writing signed by Bank of Scotland with the prior approval of the Holders of not less than a majority in Liquidation Preference of issued Preferred Securities (excluding any Preferred Securities held by Bank of Scotland or any entity of which Bank of Scotland, either directly or indirectly, owns 20% or more of the

voting shares or similar ownership interests), which approval shall be obtained in accordance with the procedures contained in the Partnership Agreement.

- 5.3 Any notice, request or other communication required or permitted to be given hereunder to Bank of Scotland shall be given in writing by delivering the same against receipt therefor or by pre-paid post addressed to Bank of Scotland at:

Bank of Scotland  
The Mound  
Edinburgh EH1 1YZ  
Attn: Company Secretary's Department  
Tel: 0131 442 7777  
Fax: 0131 243 5516

The address of Bank of Scotland may be changed at any time and from time to time and shall be the most recent such address furnished in writing by Bank of Scotland to the Registrar and notified to the Holders.

Any notice, request or other communication required or permitted to be given hereunder to the Holders shall be given by Bank of Scotland in the same manner as notices sent on behalf of the Issuer to Holders.

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

## **6. Governing Law**

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

IN WITNESS WHEREOF this Guarantee has been executed as a deed poll on behalf of the Governor and Company of the Bank of Scotland.

## TAXATION

### General

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

### Jersey Taxation

Holders of Preferred Securities (other than residents of Jersey) are not subject to any tax in Jersey in respect of the holding, exchange, sale or other disposal of the Preferred Securities. Distribution payments may be made by the Issuer without withholding or deduction for, or on account of, and without, any payment of Jersey income tax.

No stamp duties are payable in Jersey on the acquisition, ownership, exchange, sale or other disposal of Preferred Securities. Probate or letters of administration may be required to be obtained in Jersey on the death of a holder of a Preferred Security with an estate in Jersey, including Preferred Securities. Stamp duty is payable in Jersey on the registration of such probate or such letters of administration on the value of the deceased’s estate in Jersey.

### United Kingdom Taxation

**U.K. investors who are in any doubt as to their tax position in respect of the Preferred Securities (or on exchange of Preferred Securities for Substitute Stock) are strongly recommended to take independent professional advice.**

#### (a) Position of U.K. Investors

##### *Classification of the Issuer*

Bank of Scotland has been advised that the Issuer should be classified as a partnership for U.K. tax purposes. Accordingly, holders of Preferred Securities who are resident in the United Kingdom for tax purposes should, broadly, be taxed as if they hold their proportionate share of the Issuer’s assets. It is possible, however, that the Inland Revenue may seek to treat U.K. investors in the Issuer as holding interests in a “unit trust scheme” and/or apply the “offshore fund” rules. **The following paragraphs summarise the anticipated tax consequences for certain categories of U.K. investor if these alternative classifications of the Issuer were to prevail.**

##### *U.K. Pension Funds*

Whether the Issuer is classified as a partnership, unit trust or offshore fund, exempt approved pension funds should not be subject to U.K. tax on any return from their holding of Preferred Securities (including any profit on transfer or redemption) provided that such returns do not constitute trading profits.

##### *U.K. Traders/Dealers*

The U.K. tax treatment of U.K. persons holding the Preferred Securities on trading account should be unaffected by the classification of the Issuer for U.K. tax purposes.

### *U.K. Authorised Unit Trusts*

Whether the Issuer is classified as a partnership, unit trust scheme or offshore fund, authorised unit trusts which hold Preferred Securities should be subject to U.K. tax as income on their receipt of Distributions on the Preferred Securities.

If the Issuer is classified as a partnership or unit trust scheme, any gain made on transfer or redemption of Preferred Securities by a U.K. authorised unit trust should be exempt from U.K. tax on chargeable gains. If the Issuer is classified as an offshore fund, it will not be capable of constituting a “distributing fund” (as its assets consist of interests in Bank of Scotland) and accordingly any profit made on transfer or redemption of Preferred Securities will constitute an “offshore income gain” which is subject to U.K. tax as income under Case VI of Schedule D.

### *U.K. Corporate Investors including Investment Trusts*

If the Issuer is classified as a partnership, then the tax position of U.K. resident corporate holders of Preferred Securities should be computed under Inland Revenue Statement of Practice SP4/98. In practice, it is probable, since the Issuer’s only or main asset is expected to be the Subordinated Notes, that holders of Preferred Securities within the charge to U.K. corporation tax will be subject to tax as income under the “loan relationships” rules in respect of profits and gains arising from, and fluctuations in the value of, Preferred Securities, including any profit on transfer or redemption. Such holders would generally be able, within certain constraints, to opt for either an authorised accruals basis of accounting or an authorised mark to market basis of accounting in the relevant computation.

If the Issuer is classified as a unit trust scheme and/or the offshore fund rules apply, then holders of Preferred Securities within the charge to U.K. corporation tax will be treated as set out in the preceding paragraph but, under paragraph 4 of Schedule 10 to the Finance Act 1996, only an authorised mark to market basis of accounting can be used in the relevant computation.

### *U.K. Individuals*

If the Issuer is classified as a partnership, an individual resident in the United Kingdom and holding Preferred Securities should be subject to U.K. income tax as a partner in respect of Distributions on the Preferred Securities. U.K. individuals disposing of Preferred Securities may in practice be treated as if they had disposed of their underlying share of the Subordinated Notes held by the Issuer. Any relevant charge to capital gains tax on the profit or gain on transfer or redemption of the Preferred Securities will depend on whether each Subordinated Note is a qualifying corporate bond. A transfer of a Preferred Security by a U.K. individual could also give rise to a charge under the “accrued income scheme”.

If the Issuer is classified as a unit trust scheme, a U.K. resident individual holding Preferred Securities would be charged to income tax on Distributions. Any profit or gain on disposal of the Preferred Securities would be liable to capital gains tax and the accrued income scheme could not apply.

If the Issuer is classified as an offshore fund, then a U.K. resident individual would be liable to income tax on Distributions and on any profit on disposal of Preferred Securities.

### *U.K. Life Companies*

The tax position of a U.K. life company depends on many factors, and in particular on the fund in which the company holds the Preferred Securities, and the vehicle (if any) through which the Preferred Securities are held. It is assumed that the Preferred Securities are held directly by the U.K. life company.

Very broadly, if the Issuer is classified as a partnership, a life company should be liable to corporation tax on the same basis as U.K. corporate investors described above. If, however, the Issuer is classified as a unit trust scheme or offshore fund, then the tax position in respect of unrealised and realised gains and losses may be different and may result in such gains being taxed or losses being relieved on a mark to market basis.

**(b) Distributions on the Preferred Securities**

Payments of Distributions made by a paying agent outside the United Kingdom to Euroclear and Clearstream, Luxembourg, or their nominee, may be made without withholding for or on account of U.K. tax.

**(c) Stamp Duty and Stamp Duty Reserve Tax (“SDRT”)**

Although a liability to U.K. stamp duty would arise on certain agreements to transfer or a transfer of Preferred Securities which is executed in the United Kingdom or which relates, wherever executed, to any property situate in, or to any matter or thing done or to be done in, the United Kingdom, it is not likely that any such duty will need to be paid in practice.

No liability to SDRT will arise in respect of agreements to transfer the Preferred Securities.

**(d) Proposed EU Directive on the Taxation of Savings Income**

In June 1998, the European Commission presented to the Council of Ministers of the European Union a proposal to oblige Member States to adopt either a “withholding tax system” or an “information reporting system” in relation to interest, discounts and premiums. It is unclear whether this proposal will be adopted, and if it is adopted, whether it will be adopted in its current form. The “withholding tax system” would require a paying agent established in a Member State to withhold tax at a minimum rate of 20% from any interest, discount or premium paid to an individual resident in another Member State unless such an individual presents a certificate obtained from the tax authorities of the Member State in which he is resident confirming that those authorities are aware of the payment due to that individual. The “information reporting system” would require a Member State to supply, to the other Member States, details of any payment of interest, discount or premium made by paying agents within its jurisdiction to an individual resident in another Member State. For these purposes, the term “paying agent” is widely defined and includes an agent who collects interest, discounts or premiums on behalf of an individual beneficially entitled thereto. If this proposal is adopted, it will not apply to payments of interest, discounts and premiums made before January 1, 2001.

**United States Taxation**

The following is a summary of the principal U.S. federal income tax consequences relating to an investment in the Preferred Securities. This summary addresses the tax consequences to a holder of Preferred Securities that acquired those securities on their original issue at their original offering price and is (i) an individual who is a citizen or resident of the United States, (ii) a U.S. domestic corporation or (iii) any other person that is subject to U.S. federal income tax on a net income basis in respect of its investment in the Preferred Securities (a “U.S. holder”).

This summary does not address all of the tax considerations that may be relevant to a U.S. holder. Thus, the summary does not address tax considerations that arise from rules of general application or that are generally assumed to be known by investors. In particular, the following discussion does not address (i) persons that may be subject to special treatment under U.S. federal income tax law, such as banks, insurance companies, thrift institutions, regulated investment companies, real estate investment trusts, dealers in securities or currencies, and traders in securities that elect mark to market treatment, (ii) persons that will hold Preferred Securities as part of a position in a “straddle” or as part of a “hedging”, “conversion” or other integrated investment transaction for federal income tax purposes, (iii) persons whose functional currency is not the United States dollar or (iv) persons that do not hold Preferred Securities as capital assets. This summary is based upon the Internal Revenue Code of 1986, as amended (the “Code”), Treasury Regulations, Internal Revenue Service rulings and pronouncements and judicial decisions as of the date hereof, all of which are subject to change (possibly with retroactive effect).

**Prospective investors are urged to consult with their tax advisors as to the U.S. federal income tax consequences of the purchase, ownership and disposition of Preferred Securities, as well as the effect of any state, local and non-U.S. tax laws.**

### *Income from the Preferred Securities*

The Issuer will be treated as a partnership for U.S. federal income tax purposes, and the Preferred Securities will represent partnership interests in the Issuer.

A partnership is not itself a taxable entity. Instead, each partner is required to take into account its allocable share of items of income, gain, loss and deduction of the partnership in computing its U.S. federal income tax liability, regardless of whether distributions are made to the partner. Such income will be treated as if it were realised by the U.S. holder directly from the same source from which it was realised by the Issuer. Accordingly, each U.S. holder will be required to include in gross income its allocable share of the Issuer's income in respect of the underlying Subordinated Notes. The Partnership Agreement will provide that an appropriate portion of income realised by the Issuer in respect of the Subordinated Notes will be assigned to each day of its taxable year and allocated to the Holders based on their interest on such day. Accordingly, U.S. holders generally should include as ordinary income their distributive share of amounts accruing in respect of the Subordinated Notes during the period in which they hold Preferred Securities, without regard to the date on which payments are received by the Issuer or distributions are made on the Preferred Securities. A U.S. Holder who sells less than all of their Preferred Securities and whose taxable year differs from that of the Issuer should consult its tax advisor about the tax consequences of such a sale.

No portion of the income derived by a U.S. holder will be eligible for the dividends received deduction.

In the case of a U.S. holder that is a tax-exempt employee's pension trust or other domestic tax-exempt entity, the U.S. holder's allocable share of the Issuer's net income will not constitute "unrelated business taxable income" unless the U.S. holder has borrowed to acquire or carry its Preferred Securities or otherwise holds the Preferred Securities in connection with an unrelated business.

### *Disposition or Redemption of Preferred Securities or Liquidation of the Issuer*

A U.S. holder generally will recognise gain or loss on a sale, exchange, redemption or other disposition of Preferred Securities or in liquidation of the Issuer in an amount equal to the difference between its adjusted tax basis in the Preferred Securities and the amount realised on the disposition of such Preferred Securities. Any gain or loss so recognised generally will be capital gain or loss. Capital gains recognised by an individual U.S. holder in respect of Preferred Securities held for more than one year generally are subject to a maximum tax rate of 20%.

A U.S. holder's adjusted tax basis in Preferred Securities generally will equal the amount paid for the Preferred Securities, increased by the amount of income allocated to the U.S. holder and reduced by the amount of any cash distributed to the U.S. holder with respect to the Preferred Securities.

### *Information Reporting and Backup Withholding*

U.S. persons who purchase Preferred Securities from the Issuer in an aggregate amount greater than \$100,000 during any 12 month period or who own 10% or more of the Preferred Securities after any purchase must report the payment (and may be required to provide additional information) to the U.S. tax authorities. U.S. persons must also report any acquisition or disposition by them of 10% or more of the Preferred Securities or any proportionate change in their interest equivalent to a 10% interest in the Preferred Securities.

Payments on the Preferred Securities and payments of the proceeds of a sale of Preferred Securities that are paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding at a 31% rate unless the holder (i) is a corporation or other exempt recipient or (ii) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding. However, such a holder may be required to provide a certification to establish its non-U.S. status in connection with payments received within the United States or from U.S.-related payors.

For purposes of this section, a “U.S. person” means a citizen or resident of the United States, a corporation, partnership or other entity created or organised in or under the laws of the United States or any political subdivision thereof, an estate the income of which is subject to U.S. federal income taxation regardless of its source or a trust if (i) a U.S. court is able to exercise primary supervision over the trust’s administration and (ii) one or more United States persons have the authority to control all of the trust’s substantial decisions, and the term “United States” means the United States of America (including the States and the District of Columbia).



## SUBSCRIPTION AND SALE

Under a Subscription Agreement (the “Subscription Agreement”) dated March 10, 2000, Credit Suisse First Boston (Europe) Limited, Morgan Stanley & Co. International Limited and Lehman Brothers International (Europe) (the “Managers”) have agreed to subscribe for the Class A Preferred Securities at a price of £1,000 per Preferred Security and the Class B Preferred Securities at a price of £1,000 per Preferred Security. The Managers will receive a combined selling, management and underwriting commission of £10 per Preferred Security and will be indemnified against certain liabilities by Bank of Scotland. The Managers are entitled to terminate the Subscription Agreement in certain circumstances before the issue of the Preferred Securities.

The Bank has been advised by the Managers that they propose to offer the Preferred Securities for resale in transactions not requiring registration under the Securities Act or applicable state securities laws, including sales pursuant to Rule 144A under the Securities Act. Specifically, the Managers will only offer or sell the Preferred Securities in the United States to persons they reasonably believe to be QIBs in reliance on Rule 144A. Any offer or sale of Preferred Securities in reliance on Rule 144A will be made by broker-dealers who are registered as such under the Exchange Act. Each purchaser of the Preferred Securities offered hereby will, by its purchase, be deemed to have made certain acknowledgements, representations, warranties and agreements as set forth under “*Notice to Investors*”. The offering price and other selling terms may be changed at any time without notice.

The Bank has been advised by the Managers that they may resell a portion of the Preferred Securities offered hereby outside the United States in offshore transactions in reliance on Regulation S and in accordance with applicable law. Terms used above have the meanings assigned to them in Regulation S and Rule 144A.

In addition, until the expiration of the period ending 40 days after the later of the commencement of the offering and the date of issue of the Preferred Securities, an offer or sale within the United States by a 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 Rule 144A or pursuant to another exemption from registration under the Securities Act.

The Bank has agreed to indemnify the Managers against certain liabilities, including liabilities under the Securities Act, or to contribute to payments that the Managers may be required to make in respect thereof.

The Preferred Securities have not been registered under the Securities Act and neither as a matter of U.S. law may be offered or sold within the United States except in certain transactions exempt from or not subject to the registration requirements of the Securities Act. There is no existing market for the Preferred Securities offered hereby, and although application has been made to list the Preferred Securities on the Luxembourg Stock Exchange, there can be no assurance as to the liquidity of any market that may develop for the Preferred Securities, the ability of the holders of the Preferred Securities to sell their Preferred Securities or the price at which holders would be able to sell their Preferred Securities. Future trading prices of the Preferred Securities will depend on many factors, including, among other things, prevailing interest rates, the Bank’s operating results and the market for similar securities. The Bank has been advised by the Managers that they intend to make a market in the Preferred Securities, subject to the limits imposed by the Securities Act and the Exchange Act; however, they are not obligated to do so, and may discontinue such market making at any time without notice. Therefore, no assurance can be given as to the liquidity of the trading market for the Preferred Securities.

No action has been taken in any jurisdiction (including the United States) by the Bank or the Managers that would permit a public offering of the Preferred Securities offered hereby in any jurisdiction where action for that purpose is required. The Preferred Securities offered hereby may not be offered or sold, directly or indirectly, nor may this Offering Circular or any other offering material or advertisements in connection with the offer and sale of the Preferred Securities be distributed or published in any jurisdiction, except under circumstances that will result in compliance with the applicable rules and regulations of such jurisdiction. Persons into whose possession this Offering Circular comes are advised to inform themselves about and to observe any restrictions relating to the offering and the distribution of this Offering Circular. This Offering Circular does not constitute an offer to sell or a solicitation of an offer to buy any of the Preferred Securities offered hereby in any jurisdiction in which such an offer or solicitation is unlawful.

The Managers have also represented and agreed that:

- (i) they have not offered or sold and will not offer to sell any of the Preferred Securities in the United Kingdom prior to the expiry of the period of six months from the issue date of the Preferred Securities, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended).
- (ii) they have complied with and will comply with all applicable provisions of the Financial Services Act 1986 with respect to anything done by them in relation to the Preferred Securities in, from or otherwise involving the United Kingdom;
- (iii) they have only issued or passed on and will only issue or pass on in the United Kingdom any document received by them in connection with the issuance of the Preferred Securities to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996 (as amended) and is also a permitted person of a kind described in the Financial Services (Promotion of Unregulated Schemes) Regulations 1991 or is a person to whom such document may otherwise lawfully be issued or passed on;
- (iv) they will solicit offers for the Preferred Securities only from, and will offer the Preferred Securities only to, persons they reasonably believe to be (a) in the case of offers inside the United States, QIBs or (b) in the case of offers outside the United States, persons other than U.S. persons (as defined in Regulation S); and
- (v) with respect to offers and sales outside the United States, they will send to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases Preferred Securities from them during the distribution compliance period a confirmation or notice substantially to the following effect:

“The Securities covered hereby have not been registered under the U.S. Securities Act of 1933 (the “Securities Act”) and may not as a matter of U.S. law be offered and sold within the United States or to, or for the account or benefit of, U.S. persons (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the closing date, except in either case in accordance with Regulation S (or Rule 144A if available) under the Securities Act. Terms used above have the meaning given to them by Regulation S”.

Until the expiration of the period ending 40 days after the later of the commencement of the offering and the date of issue of the Preferred Securities, an offer or sale of Preferred Securities within the United States by a 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 Rule 144A under the Securities Act or pursuant to another exemption from registration under the Securities Act.

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

In connection with the offering, Morgan Stanley & Co. International Limited, on behalf of the Managers (“Morgan Stanley”), may engage in transactions that stabilise, maintain or otherwise affect the price of the Preferred Securities. Specifically, Morgan Stanley may overallocate the offering, creating a syndicate short position. Morgan Stanley may bid for and purchase Preferred Securities in the open market to cover such syndicate short position or to stabilise the price of the Preferred Securities. These activities may stabilise or maintain the market price of the Preferred Securities at levels which might not otherwise prevail. Morgan Stanley is not required to engage in these activities, and may end any such activities at any time. Any such stabilising shall be in compliance with applicable laws, regulation and rules.

## GENERAL INFORMATION

### 1. Listing

Application has been made to list the Preferred Securities on the Luxembourg Stock Exchange. The quotation on the Luxembourg Stock Exchange of each class of the Preferred Securities will be expressed in sterling as a percentage of the liquidation preference of £1,000 per Preferred Security. For listing purposes, the Preferred Securities will be considered as debt securities. At the date hereof it is not intended to list the Preferred Securities on any other stock exchange.

As required by Luxembourg law, a *notice légale* in connection with the application for listing of the Preferred Securities on the Luxembourg Stock Exchange will be filed, together with copies of the Partnership Agreement, with the Registrar of the District Court in Luxembourg prior to the listing of the Preferred Securities, and copies thereof may be obtained on request, against payment of the customary charges.

The Luxembourg listing agent will serve as intermediary between the Luxembourg Stock Exchange and persons connected with the issuance and listing of the Preferred Securities for so long as the Preferred Securities remain listed on the Luxembourg Stock Exchange.

### 2. Authorisations

The execution of the Partnership Agreement and the creation of the Preferred Securities has been duly authorised by a resolution of the Board of Directors of the General Partner passed on March 9, 2000.

The execution of the Partnership Agreement and the entering into of the Guarantee by Bank of Scotland has been duly authorised by a resolution of a committee of the Board of Directors of Bank of Scotland passed on March 6, 2000.

All consents, approvals, authorisations or other orders of all regulatory authorities required by the Issuer and/or the Bank under the laws of Jersey and the United Kingdom have been given for the creation of the Preferred Securities and for the Issuer and Bank of Scotland, as the case may be, to undertake and perform their respective obligations under each of the Partnership Agreement, the Subscription Agreement, the Agency Agreement, the Preferred Securities and the Guarantee.

### 3. Clearing

The Preferred Securities have been accepted for clearance through Euroclear and Clearstream, Luxembourg.

The following security codes have been assigned:

	Class A		Class B	
	Regulation S	Restricted	Regulation S	Restricted
ISIN:	XS0109138536	XS0109138882	XS0109139344	XS0109139427
Common Code:	010913853	010913888	010913934	010913942

### 4. No material change

Save as described in the interim financial statements of the Group or elsewhere herein, there has been no significant change in the financial or trading position of the Bank or the Group since February 28, 1999 (the date to which the last audited financial statements of the Group were prepared) or of the Issuer since the date of its establishment and no material adverse change in the financial position or prospects of the Bank or the Group since February 28, 1999 or of the Issuer since the date of its establishment.

### 5. Documents for inspection

Copies of the following documents will be available for inspection at (and, in the case of 5(c) and (d) for collection (free of charge) from) the offices of the Luxembourg listing agent, Kredietbank S.A.

Luxembourgeoise, shown on the back page of this Offering Circular during normal business hours for so long as the Preferred Securities are in issue and at the registered office of the Issuer and the head office of the Bank:

- (a) the Certificate of Limited Partnership in respect of the Issuer;
- (b) the Partnership Agreement;
- (c) the Bank of Scotland Acts 1695 to 1970 and the Regulations for the Management and Administration of the Bank;
- (d) the audited consolidated accounts and the annual reports of Bank of Scotland for the financial years ended February 28, 1998 and 1999 and the unaudited interim report of Bank of Scotland for the six months ended August 31, 1999;
- (e) the consents and authorisations referred to in paragraph 2 above;
- (f) the Guarantee;
- (g) the Agency Agreement; and
- (h) the Subscription Agreement.

For so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, the most recently published consolidated audited annual financial statements and consolidated unaudited half-yearly interim financial statements of the Bank, and the most recently published audited annual accounts of the Issuer, will also be available at the offices of Kredietbank S.A. Luxembourgeoise in Luxembourg, currently as shown on the back page of this Offering Circular. The Bank does not publish non-consolidated half-yearly financial statements. The first annual accounts of the Issuer are expected to be prepared for the period commencing on the date of its incorporation and ending on February 28, 2001. The Issuer does not intend to publish interim financial statements.

## **6. Litigation**

There are no legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Bank is aware) which may have or have had during the year prior to the date hereof a significant effect on the financial position of the Issuer, the Bank or the Group.

## **7. Auditors**

The current auditors of the Bank are KPMG Audit plc, registered auditors. The Bank's then auditors, Ernst & Young, registered auditors, made reports under Section 235 of the Companies Act 1985 (the "Companies Act") on the statutory accounts of the Bank for the three years ended February 28, 1999 which were not qualified (within the meaning of Section 262 of the Companies Act) and did not contain a statement made under Section 237(2) or Section 237(3) of the Companies Act. KPMG Audit plc have given their consent to the inclusion in this Offering Circular of their report in the form and context in which it is included. No accounts of the Issuer have yet been audited. KPMG have been appointed as auditors of the Issuer in Jersey.

## **8. Notices**

Notices to the holders of Preferred Securities, including notices for meetings of holders of the Preferred Securities, will be published, for so long as the Preferred Securities are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, in a leading Luxembourg daily newspaper (which is expected to be the *Luxemburger Wort*).

## **SUMMARY OF MATERIAL DIFFERENCES BETWEEN U.K. GAAP AND U.S. GAAP**

### **Differences Between U.K. and U.S. Generally Accepted Accounting Principles**

The Bank prepares its consolidated financial statements in accordance with the Companies Act 1985, as applicable to banking groups, and U.K. GAAP. Such principles may vary from U.S. GAAP. Set out below are the principal accounting and disclosure differences between U.K. GAAP and U.S. GAAP. The Bank has not quantified the effect of differences between U.K. GAAP and U.S. GAAP, nor prepared consolidated financial statements under U.S. GAAP, nor undertaken a reconciliation of U.K. GAAP and U.S. GAAP financial statements. Had the Bank undertaken any such quantification or preparation or reconciliation, other potentially significant accounting and disclosure differences may have come to its attention which are not identified below. Accordingly, the Bank does not provide any assurance that the differences identified below represent all the principal differences between U.K. GAAP and U.S. GAAP.

### **Property**

The Group's freehold and long-leasehold properties are revalued regularly and the net revaluation surplus is carried directly to a non-distributable reserve. These properties are not depreciated.

Under U.S. GAAP property revaluations are not permitted except in respect of asset impairment, and depreciation is required to be computed on all properties based on historical cost. Any realised surplus or deficit is reflected in income on disposal of property.

### **Deferred Taxation**

Recognition is given to deferred taxation arising from timing differences to the extent that, and at the estimated rates at which, future taxation is expected to become payable.

Under U.S. GAAP, a deferred tax asset or provision is recognised in full for all temporary differences using the liability method. A valuation allowance is raised against any deferred tax asset where it is more likely than not that the asset, or part thereof, will not be realised.

### **Pension Costs**

Pension fund liabilities are assessed by independent professionally qualified actuaries, normally at triennial valuations and at intervening dates if considered necessary. In accordance with the requirements of Statement of Standard Accounting Practice No 24 ("SSAP 24"), pension costs are charged against profits using actuarial valuation methods intended to spread the pension cost evenly over the average service periods of the current employees in the schemes. Under this standard the actuarial cost for the year of providing pensions for applicable persons employed by the Group during the year is charged against profits. SSAP 24 permits this charge to be reduced by offsetting any actuarial surpluses within the relevant pension schemes.

U.S. GAAP requires that the projected benefit obligation is matched against the market value of the plan's assets and other unrecognised actuarial gains and losses in determining the pension cost for the year. Certain variations from regular cost are allocated in equal amounts over the average remaining service lives of employees.

### **Proposed Final Dividend**

The Bank records the proposed final dividend, which is declared after the last day of February each year, in the period to which it relates.

Under U.S. GAAP, dividends are recorded in the period in which they are declared.

### **Equipment Leased to Customers**

The Group credits leasing income, including related government grants and leasing earnings equalisation provisions, and income from instalment credit agreements, to profit by spreading interest and charges over the period of repayment in proportion to the net cash investment, taking into account tax payments and receipts

associated with the lease. Leases are classified as finance leases when the substance of the agreement is that of a finance transaction and the lessee substantially assumes all of the risks and benefits relating to the asset. All other leases are classified as operating leases. Operating leased assets are depreciated over their useful lives such that, for each asset, rentals less depreciation are recognised at a constant periodic rate of return on the net cash invested in the leased asset.

Under U.S. GAAP, income from equipment leased to customers is recognised by amortising the unearned income, residual asset value and investment tax credits over the life of the lease, using a method which results in a level rate of return on investment. No account is taken of the tax flows generated by the lease. Leases are classified as capital leases when any of the criteria under Statement of Financial Accounting Standards No. 13 “Accounting for Leases” are met. Operating leased assets are depreciated such that the depreciation charge is at least equal to that which would have arisen on a straight line basis.

### **Goodwill**

In accordance with U.K. GAAP prevailing at that time, goodwill arising on acquisitions prior to March 1, 1998 was written off to reserves in the year in which it arose. These amounts will continue to be charged to the profit and loss account on a subsequent disposal of the business to which they relate.

To reflect current U.K. GAAP, goodwill arising on acquisitions after March 1, 1998 is capitalised and included within Intangible Fixed Assets. Goodwill is amortised by equal instalments over its estimated useful life as stated. Impairment charges are included within operating profit.

Under U.S. GAAP, goodwill is capitalised and amortised through the profit and loss account on a straight line basis over its estimated useful life, usually not exceeding 25 years. Goodwill is written off to the profit and loss account when it is considered to have no recoverable value.

### **Debt Securities and Equity Shares**

The Group includes debt securities (and other fixed interest securities) held for dealing at market value and includes gains or losses within interest receivable in the profit and loss account. Debt securities (and other fixed interest securities) held for continuing use are included at cost less amounts written off and adjusted for the amortisation of premiums or discounts arising on purchase of investments redeemable at fixed dates. Such premiums or discounts are taken to revenue evenly over the period to redemption and gains or losses on realisation of such securities are taken to revenue as “Profit on sale of investment securities” as they arise. Equity shares are stated at cost less amounts written off.

U.S. GAAP require disclosure of debt securities and equity shares within one of three categories: (i) held to maturity; (ii) available for sale; and (iii) trading. Held to maturity securities are measured at amortised cost and include those securities where a positive intent and ability to hold the securities to maturity exists. Trading securities are those securities bought principally with a view to selling them in the near term and are measured at fair value with unrealised holding gains and losses included in earnings. Available for sale securities are those not classified as either held to maturity or trading securities and include those securities where there is an absence of intent and ability to hold them to maturity. Such securities are measured at fair value with unrealised holding gains and losses excluded from earnings and reported (net of applicable taxes and minority interests) in a separate component of other comprehensive income within stockholders funds.

### **Provision for Doubtful Debts**

The Group establishes specific provisions against loans and advances when, as a result of a detailed appraisal of the portfolio, it is considered that recovery is doubtful. The amount of specific provision reflects the Bank’s assessment of the likely loss. General provisions are raised to cover the losses which are judged to be present in the loan portfolio but have not been specifically identified as such.

Statement of Financial Accounting Standard (“SFAS”) No. 114 “Accounting by Creditors for Impairment of a Loan”, as amended by SFAS No. 118 “Accounting by Creditors for Impairment of a Loan — Income Recognition and Disclosures” specifies how allowances for credit losses for certain loans should be determined.



A loan is impaired when it is probable that the creditor will be unable to collect all amounts in accordance with the contractual terms of the loan agreement. Impaired loans are determined based on the present value of expected future cash flows discounted at the loans' effective interest rates or at the loans' observable market values or the fair values of collateral if the loans are collateral dependent.

### **Acceptances**

Acceptances outstanding and the matching customers' liabilities are not reflected in the consolidated balance sheet, but are disclosed as memorandum items below the consolidated balance sheet.

Under U.S. GAAP, acceptances outstanding and the matching customers' liabilities are reflected in the consolidated balance sheet.

### **Loan Origination Fees**

Certain loan origination fees, in respect of services provided, are recognised in the profit and loss account on the basis of work done. Fees receivable in respect of bearing risk are recognised over the period of the advance or risk exposure. Mortgage incentive costs are charged to the profit and loss account as they are incurred.

Under U.S. GAAP, certain loan origination costs and loan origination fees, to the extent they are not offset by related direct costs, are deferred and amortised through the profit and loss account over the life of the loan.

### **Stock Based Compensation**

Equity based instruments, such as share options, issued under compensation plans are accounted for within the share capital and share premium accounts on the balance sheet when exercised.

U.S. GAAP encourages companies to account for equity based instruments issued under compensation plans at their fair value, measured at the date at which the instruments are granted. U.S. GAAP also permits the intrinsic value-based method of accounting under which the compensation cost, being the excess, if any, of the quoted market price of the stock at grant date over the exercise price, must be recognised in the profit and loss account over the vesting period. On the balance sheet this is offset by a corresponding adjustment to share premium.

### **Fair Value of Financial Instruments**

Under U.K. GAAP, the Bank is not required to provide disclosure of the fair values of its financial instruments for the three years ended February 28, 1999, although certain disclosures are made regarding the market value of debt and equity securities and the replacement cost of off-balance sheet contracts.

Under U.S. GAAP, Statement of Financial Account Standards No. 107 "Disclosures about Fair Values of Financial Instruments" requires disclosure of the estimated fair values of certain financial instruments, both on-balance sheet and off-balance sheet, where it is practicable to do so.

### **Foreign Exchange**

Under U.K. GAAP, foreign currency earnings of overseas entities may be translated using period-end exchange rates.

Under U.S. GAAP, foreign currency earnings must be translated using the average exchange rate prevailing for each period.

### **Software Development Costs**

In accordance with U.K. GAAP, the Bank recognises the costs of developing and obtaining computer software for internal use within the profit and loss account as incurred.

Within the United States, Statement of Position ("SOP") 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" requires internal and external costs to develop internal use



computer software to be capitalised from the application development stage through to the point at which the project is substantially complete. Capitalised amounts are amortised over the software's estimated useful life. The SOP is effective for fiscal years beginning after December 15, 1998 and retroactive application is not permitted.

### **Profit and Loss Presentation**

Under U.K. GAAP, the following amounts are shown separately in the profit and loss account: "Provision for contingent liabilities and commitments", "Amounts written off fixed asset investments" and "Profit on sale of investment securities and tangible fixed assets".

Under U.S. GAAP, "Provisions for contingent liabilities and commitments" are classified as "Operating expenses", "Amounts written off fixed asset investments" are classified as "Other operating expenses" and "Profit on sale of investment securities and tangible fixed assets" are classified as "Other operating income".

### **Cash Flow Presentation**

Under U.K. GAAP, "Cash Flow" represents increases or decreases in "Cash". "Cash" comprises cash in hand and repayable on demand overdrafts.

Under U.S. GAAP, "Cash" represents increases or decreases in cash or cash equivalents which include short term, highly liquid investments with original maturities less than 90 days, and excludes overdrafts.

Under U.K. GAAP, the principal headings of a Cash Flow statement are "Net cash flow from operating activities", "Dividends received from joint ventures", "Dividends received from associated undertakings", "Returns on investment and servicing of finance", "Taxation", "Capital expenditure and financial investment", "Acquisitions and disposals" and "Financing".

Under U.S. GAAP, cash flows are disclosed under the following headings: "Cash flow from operating activities", "Investing activities" and "Financing activities".

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**REGISTERED OFFICE OF  
THE ISSUER**

22 Grenville Street  
St Helier, Jersey JE4 8PX

**HEAD OFFICE OF  
BANK OF SCOTLAND**

The Mound  
Edinburgh EH1 1YZ

**REGISTRAR**

**Citibank Channel Islands Limited**  
38 Esplanade  
St Helier, Jersey JE4 8QB

**PAYING AND TRANSFER AGENT**

**Banque Internationale à Luxembourg S.A.**  
69, Route d'Esch  
L-1470 Luxembourg

**CALCULATION AGENT, PAYING AND TRANSFER AGENT**

**Citibank, N.A.**  
5 Carmelite Street  
London EC4Y 0PA

**LEGAL ADVISERS**

*To the Issuer  
and Bank of Scotland  
as to English law*

**Herbert Smith**  
Exchange House  
Primrose Street  
London EC2A 2HS

*To the Issuer  
and Bank of Scotland  
as to Scots law*

**Tods Murray WS**  
66 Queen Street  
Edinburgh EH2 4NE

*To the Issuer  
and Bank of Scotland  
as to Jersey law*

**Mourant du Feu & Jeune**  
22 Grenville Street  
St. Helier, Jersey JE4 8PX

*To the Issuer  
and Bank of Scotland  
as to U.S. law*

**Milbank, Tweed,  
Hadley & McCloy**  
Dashwood House  
69 Old Broad Street  
London EC2M 1QS

*To the Managers as to English law*

**Allen & Overy**  
One New Change  
London EC4M 9QQ

*To the Managers as to U.S. law*

**Cleary, Gottlieb, Steen & Hamilton**  
City Place House  
55 Basinghall Street  
London EC2V 5EH

**AUDITORS**

*To the Issuer*

**KPMG**  
45 Esplanade  
St Helier, Jersey JE4 8WQ

*To Bank of Scotland*

**KPMG Audit Plc**  
Saltire Court  
20 Castle Terrace  
Edinburgh EH1 2EG

**LISTING AGENT**

**Kredietbank S.A. Luxembourgeoise**  
43 Boulevard Royal  
L-2955 Luxembourg

