



## HBOS Capital Funding No. 1 L.P.

### U.S.\$1,000,000,000 6.85 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities

having the benefit of a subordinated guarantee of

### HBOS plc

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

### Issue price: U.S.\$1,000 per Preferred Security

The U.S.\$1,000,000,000 6.85 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities (the "Preferred Securities") each with a liquidation preference of U.S.\$1,000 (the "Liquidation Preference"), comprising limited partnership interests in HBOS Capital Funding No. 1 L.P. (the "Issuer"), are proposed to be issued on 21 March 2003 (the "Closing Date"). The Preferred Securities will entitle holders to receive (subject as described herein under "Description of the Preferred Securities" and see in particular "Limitations on payment in respect of Distributions" under "Summary of the Offering" herein) non-cumulative preferential cash distributions payable quarterly in arrear on 23 March, 23 June, 23 September and 23 December in each year (each, a "Distribution Payment Date"), except that the first such distribution shall be payable on 23 June 2003 in respect of the period from (and including) the Closing Date to (but excluding) 23 June 2003, at the rate of 6.85 per cent. per annum.

The Issuer, as a Jersey limited partnership, will not be a legal entity separate from its partners. All obligations of the Issuer to make payments in respect of the Preferred Securities will be guaranteed on a limited and subordinated basis by HBOS plc ("HBOS") pursuant to a subordinated guarantee dated 21 March 2003 (the "Guarantee"), all as more fully described herein under "Subordinated Guarantee".

The Preferred Securities will be perpetual securities and not subject to any mandatory redemption provisions. The Preferred Securities will be redeemable however on 23 March 2009 or on any Distribution Payment Date thereafter in whole, but not in part, subject to satisfaction of the Redemption Conditions (as defined herein), at the option of HBOS Capital Funding (Jersey) Limited as general partner of the Issuer (the "General Partner"), at the Liquidation Preference, plus any Additional Amounts (as defined herein), plus any accrued and unpaid distributions for the then current Distribution Period (as defined herein) to but excluding the redemption date. The Preferred Securities will also be redeemable at the option of the General Partner, subject to satisfaction of the Redemption Conditions, in whole but not in part, at any time following the occurrence of a Tax Event or a Capital Disqualification Event (each as defined herein), as more fully described herein under "Description of the Preferred Securities" at the Liquidation Preference, plus any Additional Amounts plus any accrued and unpaid distributions for the then current Distribution Period to but excluding the redemption date. Under existing requirements of the Financial Services Authority (the "FSA"), neither the Issuer nor HBOS may redeem or purchase any Preferred Securities unless the FSA has given its prior written consent.

In the event of the dissolution of the Issuer, holders of Preferred Securities will be entitled to receive a liquidation preference in an amount equal to the distributions that those holders would have received in a dissolution of HBOS at that time, if they had held, instead of the Preferred Securities, non-cumulative preference shares issued directly by HBOS, having the same liquidation preference and stated distribution rate as the Preferred Securities, subject as described herein under "Description of the Preferred Securities". Upon the occurrence of a Capital Disqualification Event or a Substitution Event (as defined herein), the Preferred Securities may be substituted by Substituted Preference Shares (as defined herein) issued by HBOS, all as more fully described herein under "Description of the Preferred Securities" and "Investment Considerations".

The Preferred Securities are expected to be assigned on issue a rating of "A" by Standard & Poor's Rating Services, a division of The McGraw Hill Companies, Inc. ("Standard & Poor's"), "A1" by Moody's Investors Services, Inc. ("Moody's") and "AA-" by Fitch Ratings Ltd. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

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

Application has been made to list the Preferred Securities on the Luxembourg Stock Exchange.

The Preferred Securities will be represented on issue by a single global certificate in registered form (the "Global Certificate"). The Global Certificate will be registered in the name of Citivic Nominees Limited as nominee for, and will be deposited with, a common depository for Euroclear Bank S.A./N.V. as operator of the Euroclear system ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream, Luxembourg") on or around the Closing Date.

**JPMorgan**  
*Joint Bookrunner*

**Lehman Brothers**  
*Joint Bookrunner*

**BNP PARIBAS**

**Credit Suisse First Boston**

**Schroder Salomon Smith Barney**

**UBS Warburg**

Dated: 19 March 2003

*Each of the General Partner (in relation to itself, the Issuer and the Preferred Securities only) and HBOS confirms, after having made all reasonable enquiries, that this Offering Circular contains all information with regard to the Issuer, the General Partner, HBOS and its subsidiaries (the “HBOS Group”) 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 opinion or intention, misleading. Each of the General Partner and HBOS accepts responsibility accordingly.*

*No person has been authorised to give any information or to make any representation not contained or incorporated in this Offering Circular and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the General Partner, HBOS or the Managers (as defined under “Subscription and Sale”). Neither the delivery of this Offering Circular 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, HBOS or the HBOS 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 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, HBOS or the Managers to subscribe for or purchase any of the Preferred Securities.*

*Prospective investors should satisfy themselves that they understand all of 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.*

*The distribution of this Offering Circular and the offering of the Preferred Securities in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, HBOS and the Managers to inform themselves about, and to observe, any such restrictions.*

*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 Offering Circular is given under “Subscription and Sale” below.*

*The Jersey Financial Services Commission (the “Commission”) has given and has not withdrawn its consent under Article 8 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.*

*Nothing in this Offering Circular or anything communicated to Holders of, or investors in, the Preferred Securities (or any such potential Holders or investors) by the General Partner is intended to constitute, or should be construed as, advice on the merits of the purchase of, or subscription for, the Preferred Securities or the exercise of any rights attached thereto for the purposes of the Financial Services (Jersey) Law 1998, as amended.*

*An investment in the Preferred Securities is only suitable for financially sophisticated investors who are capable of evaluating the merits and risks of such investment and who have sufficient resources to be able to bear any losses which may result therefrom.*

*Unless otherwise specified or the context requires, references in this Offering Circular to “£” and “Sterling” are to the lawful currency of the United Kingdom of Great Britain and Northern Ireland (the “U.K.”), references to “€” and “euro” are to the currency introduced at the start of the third stage of European Economic and Monetary Union, pursuant to the Treaty establishing the European Community, as amended from time to time and references to “U.S.\$” and “U.S. dollars” are to the lawful currency of the United States of America (the “United States”).*

*Schroder is a trademark of Schroders Holdings plc and is used under licence by Salomon Brothers International Limited.*

*IN CONNECTION WITH THIS ISSUE, LEHMAN BROTHERS INTERNATIONAL (EUROPE) OR ANY AGENT ACTING ON ITS BEHALF MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE PREFERRED SECURITIES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD. HOWEVER, THERE IS NO OBLIGATION ON LEHMAN BROTHERS INTERNATIONAL (EUROPE) OR ANY AGENT ACTING ON ITS BEHALF TO DO THIS. SUCH ACTIVITY, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD.*

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### **DOCUMENTS INCORPORATED BY REFERENCE**

The audited consolidated accounts of HBOS for the two financial years ended 31 December 2002 are incorporated by reference in this Offering Circular. Copies of these accounts are available free of charge at the specified office of each of the Paying and Transfer Agents as described in “General Information” below.

## SUMMARY OF THE OFFERING

The following summary is qualified in its entirety by the more detailed information included elsewhere in this Offering Circular. Capitalised terms used but not defined in this summary shall bear the respective meanings ascribed to them under “Description of the Preferred Securities”. Prospective investors should also consider carefully, amongst other things, the factors set out under “Investment Considerations”.

**Issuer:** ..... HBOS Capital Funding No. 1 L.P., a limited partnership established for an unlimited duration in Jersey and registered under the Limited Partnerships (Jersey) Law, 1994, as amended (the “Law”). The Issuer is not a legal entity separate from its partners and has no operating history.

**General Partner:** ..... HBOS Capital Funding (Jersey) Limited, a wholly-owned subsidiary of, and fully controlled by, HBOS, incorporated in Jersey with limited liability, is the sole general partner of the Issuer and, as such, solely administers the Issuer.

**Guarantor:** ..... HBOS plc.

**Issue:** ..... U.S.\$1,000,000,000 6.85 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities, each with a liquidation preference of U.S.\$1,000 comprising limited partnership interests in the Issuer.

**Use of Proceeds:** ..... The proceeds of the issue of the Preferred Securities will be used by the General Partner, on behalf of the Issuer, after paying any expenses of the issue, to subscribe for subordinated cumulative perpetual notes issued by HBOS (the “Notes”) and will augment HBOS’s regulatory capital base.

**The Notes:** ..... The Notes will contain terms and conditions which correspond to the provisions of the Preferred Securities save that interest payable in respect of the Notes will be paid on a cumulative basis. In particular, the Notes will have an aggregate principal amount which equals the aggregate Liquidation Preference of the Preferred Securities, will bear interest at a rate which is the same as the Distribution Rate and will contain rights as to redemption which are substantially the same as those of the Preferred Securities.

The rights of Holders shall be represented solely by the Guarantee and the Preferred Securities, the terms of which provide that interests in the Notes will not be delivered or otherwise made available to Holders.

### Ranking of the Preferred

**Securities:** ..... The Preferred Securities, together with the Guarantee, are intended to provide Holders, as nearly as possible, with rights in respect of Distributions and a Liquidation Preference equivalent to those to which the Holders would be entitled if they held the most senior preference shares of HBOS. See also however “Substitution Event and Substitution” and “Investment Considerations” below.

Claims under the Preferred Securities in respect of any Liquidation Distributions will rank (i) senior to the rights of the General Partner and the Preferential Limited Partner (as defined below) and any other preferential limited partner in respect of other partnership interests issued by the Issuer and (ii) *pari passu* with claims of the holders of all other preferred securities issued by the Issuer which rank *pari passu* with the Preferred Securities.

**Subordinated Guarantee:** ..... HBOS will irrevocably guarantee on a subordinated basis and to the extent set out in the Guarantee (see “Subordinated Guarantee”) payments due on the Preferred Securities representing

(i) Distributions, (ii) Liquidation Distributions, (iii) the Optional Redemption Price and (iv) Additional Amounts.

The Guarantee will rank (a) junior to all liabilities of HBOS including subordinated liabilities (in each case other than any liability of HBOS which constitutes Tier 1 Securities or any liability which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to the Guarantee), (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with the Guarantee and (c) senior to Junior Share Capital.

The Parity Securities at the date hereof comprise the 300,000,000 9¼ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each and the 100,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each, issued by HBOS, the £600,000,000 6.461 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A issued by HBOS Capital Funding L.P. and guaranteed by HBOS, the £245,000,000 7.881 per cent. Guaranteed Non-voting Non-cumulative Preferred Securities issued by HBOS Sterling Finance (Jersey) L.P. and guaranteed by HBOS and the €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities issued by HBOS Euro Finance (Jersey) L.P. and guaranteed by HBOS.

HBOS will undertake in the Guarantee that it will not issue any preferred securities, preference shares or other Tier 1 Securities ranking senior to its obligations under the Guarantee or enter into any support agreement or give any guarantee in respect of any preferred securities, preference shares or other Tier 1 Securities if such support agreement or guarantee would rank senior to the Guarantee unless, *inter alia*, the Guarantee is changed so that it ranks *pari passu* with, and contains substantially equivalent rights of priority as to payment in respect of, any such preferred securities, preference shares, Tier 1 Securities or such other support agreement or guarantee, all as more fully described under “Subordinated Guarantee”.

**Distributions:** ..... The Preferred Securities will entitle Holders to receive (subject as described under “Description of the Preferred Securities” and below) non-cumulative preferential cash distributions payable quarterly in arrear on 23 March, 23 June, 23 September and 23 December in each year, except that the first such distribution shall be payable on 23 June 2003 in respect of the period from (and including) the Closing Date to (but excluding) 23 June 2003, at the rate of 6.85 per cent. per annum, all as more fully described under “Description of the Preferred Securities — Distributions”.

**Limitations on payments in respect of Distributions:** ..... Distributions on the Preferred Securities will be payable out of the Issuer’s own legally available resources on each Distribution Payment Date. Notwithstanding the existence of such resources legally available for distribution by the Issuer, neither the Issuer nor HBOS will pay any Distributions or make any payment in respect of Distributions (including any Additional Amounts) under the Preferred Securities or the Guarantee:

- (a) to the extent that such payment, together with the amount of any distributions or dividends paid or scheduled to be paid to holders of Parity Securities on the relevant Distribution Payment Date would exceed Adjusted Distributable Reserves

as at the Distribution Determination Date immediately preceding such Distribution Payment Date; or

- (b) even if Adjusted Distributable Reserves are sufficient, (i) to the extent that such payment in respect of the Preferred Securities and/or Parity Securities would breach or cause a breach of the U.K. banking capital adequacy requirements then applicable to HBOS on a consolidated basis, or (ii) HBOS's board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (i) above is expected to occur in the near term.

If, on any Distribution Payment Date, Distributions are not paid in full on the Preferred Securities or dividends or other distributions are not paid in full on any Parity Securities, but there are sufficient Adjusted Distributable Reserves to allow payment of part of any Distribution, then each Holder will be entitled to receive the Relevant Proportion of such Distribution, as more fully described under "Description of the Preferred Securities — Distributions".

HBOS will undertake in the Guarantee that, in the event that any Distribution is not paid in full, it will not (a) declare or pay any distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any Junior Share Capital, until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full or (b) (if permitted) repurchase or redeem Parity Securities or Junior Share Capital until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full.

To the extent that a Distribution is not paid by reason of the limitations described above, no Guaranteed Payment (as defined in the Guarantee) will be paid, or may be claimed in respect thereof.

**Withholding Tax and Additional**

**Amounts:** .....

The Issuer (or HBOS, pursuant to the Guarantee) will pay such additional amounts as may be necessary in order that the net payment received by each Holder in respect of the Preferred Securities or the Guarantee, as the case may be, after withholding for any taxes imposed by tax authorities in Jersey or the U.K., as the case may be, upon payments made by or on behalf of the Issuer or HBOS, as the case may be, will equal the amount which would have been received in the absence of any such withholding taxes, subject to the exceptions described under "Description of the Preferred Securities — Additional Amounts" and "Subordinated Guarantee".

**Optional Redemption:** .....

The Preferred Securities will be perpetual securities and not subject to any mandatory redemption provisions. They will be, however, redeemable on 23 March 2009 or on any Distribution Payment Date thereafter in whole, but not in part, at the option of the General Partner and subject to the Law and to satisfaction of the Redemption Conditions, at the Optional Redemption Price, being the Liquidation Preference per Preferred Security together with any due and accrued but unpaid Distributions calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date and any relevant Additional Amounts.

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 HBOS either has (a) Adjusted Distributable Reserves or (b) proceeds



available from an issue of Replacement Capital (as defined below) 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; and

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

**Tax Redemption:** .....

If at any time a Tax Event occurs and is continuing, the effect of which cannot be avoided by the Issuer or HBOS taking reasonable measures available to it, the Preferred Securities will be redeemable in whole, but not in part, at the option of the General Partner, subject to the Law and to satisfaction of the Redemption Conditions at the Optional Redemption Price.

As used herein, “Tax Event” means that, as a result of a change in any law or regulation of the U.K. or Jersey, or in any treaty to which the U.K. or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in the U.K. or Jersey (i) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Notes or the Preferred Securities (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 Limited Partnership Agreement in respect of the Notes and the Preferred Securities) in Jersey or the U.K., (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 U.K., (iii) payments by HBOS in respect of the Notes would be subject to deduction or to withholding tax in the U.K. or (iv) HBOS would not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes.

**Capital Disqualification Event**

**Redemption:** .....

If at any time a Capital Disqualification Event has occurred and is continuing, the Preferred Securities are redeemable at any time in whole, but not in part, at the option of the General Partner, subject to the Law and to satisfaction of the Redemption Conditions, at the Optional Redemption Price.

Alternatively, if at any time a Capital Disqualification Event has occurred and is continuing, the General Partner may, in circumstances where HBOS is not itself insolvent or in liquidation, elect to substitute Substituted Preference Shares for the Preferred Securities in the manner described under “Substitution Event and Substitution” below.

As used herein, “Capital Disqualification Event” means a change in any applicable law or regulation, or in the official interpretation or application thereof, as a result of which, for the purposes of the FSA’s capital adequacy requirements applicable to banks in the U.K. at that time, the Preferred Securities do not constitute Tier 1 Securities.

**Rights upon Liquidation:** .....

In the event of the dissolution (other than an Involuntary Dissolution) of the Issuer, Holders will be entitled to receive, subject as set out herein under “Description of the Preferred Securities — Liquidation Distributions”, for each Preferred Security a Liquidation Distribution

(being the Liquidation Preference, together with any due and accrued but unpaid Distributions calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date or, if none, the Closing Date and any relevant Additional Amounts) out of the assets of the Issuer available for distribution under the Law.

Notwithstanding the availability of sufficient assets of the Issuer to pay any Liquidation Distribution to Holders as aforesaid, if, at the time such Liquidation Distribution is to be paid, proceedings have been commenced for the voluntary or involuntary liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation, the Liquidation Distribution payable per Preferred Security shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of HBOS had the Preferred Securities and all Parity Securities been the most senior class of preference shares issued by HBOS with equivalent rights of participation in the capital of HBOS (whether or not HBOS could in fact have issued such securities at such time) and ranked (a) junior to all liabilities of HBOS including subordinated liabilities (in each case other than any liability of HBOS which constitutes Tier 1 Securities or any liability which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to the Guarantee), (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with the Guarantee and (c) senior to Junior Share Capital.

In the event of an order being made for the liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation or a declaration being made that HBOS is insolvent, the Issuer shall be dissolved and the amount per Preferred Security to which Holders will be entitled as a Liquidation Distribution will be as described above.

HBOS will undertake in the Guarantee that, so long as any of the Preferred Securities are outstanding, (a) unless HBOS itself is being wound up, HBOS will not permit, or take any action to 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) HBOS has sufficient Adjusted Distributable Reserves or (B) HBOS has proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidation Distribution (in either of cases (ii)(A) or (B) in an amount at least equal to the aggregate Liquidation Distribution) and (b) the General Partner will at all times be a directly or indirectly wholly owned subsidiary of HBOS unless, in the case of (a) or (b), otherwise approved by a simple majority of Holders by vote or in writing.

**Limitations on Liquidation**

**Payments:** .....

If, with the prior approval of the FSA (if then required), the Issuer is liquidated, dissolved or wound up in circumstances where proceedings have not been commenced for the liquidation, dissolution or winding-up of HBOS, the Liquidation Distribution shall only be payable to the extent that HBOS either has Adjusted Distributable Reserves or proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidation Distribution in either case in an amount at least equal to the aggregate Liquidation Distribution.

**Substitution Event and**

**Substitution:** .....

If either (i) HBOS’s total capital ratio calculated on a consolidated basis in accordance with applicable U.K. bank capital adequacy regulations, has fallen below the then generally applicable minimum ratio (or ratios if then applicable) required by such regulations (currently 8 per cent.); or (ii) HBOS’s board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (i) above is expected to occur in the near term; or (iii) on the Involuntary Dissolution of the Issuer (in circumstances when HBOS is not itself insolvent or in liquidation), the General Partner shall take all reasonable steps to cause the substitution of the Preferred Securities by Substituted Preference Shares, being fully-paid preference shares issued directly by HBOS having in all material commercial respects the same economic rights and benefits (including those relating to non-cumulative distributions and status) as are attached to the Preferred Securities and the Guarantee taken together, all as more fully described under “Description of the Preferred Securities — Substitution by Preference Shares”.

Under its current Articles of Association, HBOS is only authorised to issue further preference shares which rank *pari passu* with its existing issued 300,000,000 9¼ per cent. and 100,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each and in each case any further preference shares required to be issued pursuant to the terms thereof (the “Existing Preference Shares”) at a time and in circumstances where (a) the nominal amount of the preference shares proposed to be issued, taken together with the nominal amount of the Existing Preference Shares and any other preference shares ranking *pari passu* therewith (together, the “Priority Preference Shares”) at that time, does not exceed an amount equal to 25 per cent. of the Adjusted Capital and Reserves (as further described in paragraph 9 under “General Information”) of HBOS and (b) the average of the profit after taxation and before extraordinary items and dividends for the preceding three financial periods of HBOS exceeds four and a half times the aggregate annual amount of the dividends payable in the then current financial period on the whole of the issued share capital of HBOS which has priority to or ranks equally with the Priority Preference Shares including those preference shares proposed to be issued (all as more fully described herein under “Investment Considerations”). If these conditions cannot be met at the time of their issue, any preference shares issued by HBOS must rank junior to the Priority Preference Shares. Accordingly, there can be no assurance that any Substituted Preference Shares issued to Holders following a Substitution Event or a Capital Disqualification Event will not rank junior to the Priority Preference Shares and the Guarantee.

**Voting Rights:** .....

Save as specified below (and subject to Article 11 of the Law), Holders will not be entitled to receive notice of, 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 by the Issuer in full and/or HBOS has not made payments in respect thereof under the Guarantee for four consecutive Distribution Periods, Holders are entitled to elect a special representative to enforce their statutory rights. Such special representative shall vacate office if, for four consecutive Distribution Periods, Distributions are made by the Issuer in full or payments by HBOS under the Guarantee in respect thereof are made in full, all as more fully described under “Description of the Preferred Securities — Voting Rights”.

**Form of the Preferred Securities:** . . . . The Preferred Securities will be in registered form. On or about the Closing Date, a single global certificate (the “Global Certificate”) representing the Preferred Securities on issue will be deposited with Citibank, N.A. (the “Common Depositary”) as common depositary for Euroclear and Clearstream, Luxembourg. The Global Certificate will be registered in the name of Citivic Nominees Limited, as nominee for the Common Depositary. For so long as the Global Certificate is 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.

Other than in the limited circumstances referred to under “Summary of Provisions Relating to the Preferred Securities in Global Form”, definitive certificates will not be made available to Holders.

**Governing Law:** . . . . . The Limited Partnership Agreement (as defined under “HBOS Capital Funding No. 1 L.P.”) establishing HBOS Capital Funding No. 1 L.P. and the Preferred Securities are governed by, and construed in accordance with, Jersey law. However, determinations in respect of amounts of Adjusted Distributable Reserves are construed in accordance with Scots Law. The Guarantee will be governed by, and construed in accordance with, English law.

**Listing:** . . . . . Application has been made for the Preferred Securities to be listed on the Luxembourg Stock Exchange.

**Ratings:** . . . . . The Preferred Securities are expected to be assigned on issue a rating of “A” by Standard & Poor’s, “A1” by Moody’s and “AA-” by Fitch Ratings Ltd. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

## INVESTMENT CONSIDERATIONS

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

### **Risks Associated with HBOS's Financial Condition**

An investment in the Preferred Securities will, subject to the matters referred to under "Substitution" below, have substantially the same economic risks as an investment in non-cumulative perpetual preference shares issued directly by HBOS having the same liquidation preference and rate of distribution as the Preferred Securities. It is expected that the Issuer's sole source of funds to pay Distributions on the Preferred Securities will be payments which it receives under the Notes. The rights of Holders shall be represented solely by the Guarantee and the Preferred Securities, the terms of which provide that interests in the Notes will not be delivered or otherwise made available to Holders. The Preferred Securities are guaranteed on a limited and subordinated basis by HBOS pursuant to the terms of the Guarantee. Accordingly, if HBOS's financial condition were to deteriorate, the Issuer and the Holders may suffer direct and materially adverse consequences, including non-payment of Distributions on the Preferred Securities or of payments under the Guarantee.

### **Distributions Not Cumulative**

Distributions on the Preferred Securities are not cumulative. As set out in "Description of the Preferred Securities", Distributions on the Preferred Securities will be paid on each Distribution Payment Date out of interest received by the Issuer under the Notes and from other resources legally available, if any, unless HBOS has insufficient Adjusted Distributable Reserves to enable the Issuer to pay Distributions on the Preferred Securities (and in respect of any Parity Securities) or such payment would result in HBOS on a consolidated basis breaching U.K. banking capital adequacy requirements. If Distributions on the Preferred Securities for any Distribution Period are not paid, the Holders will not be entitled to receive such Distributions (or any payment under the Guarantee in respect of such Distributions) whether or not funds are, or subsequently become, available.

### **Perpetual Nature of the 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 on 23 March 2009 or on any Distribution Payment Date thereafter or following the occurrence of a Tax Event or a Capital Disqualification Event), there are limitations on its ability to do so. Therefore, Holders should be aware that they may be required to bear the financial risks of an investment in the Preferred Securities for an indefinite period of time.

### **Holding Company Structure**

HBOS is the holding company for the HBOS Group and does not carry on any operating activities nor, save for its shareholding interests in other HBOS Group companies, does it have any material assets. In servicing its obligations, HBOS will rely primarily on cashflows, chiefly dividend payments and loan repayments from its subsidiaries. The ability of such subsidiaries to make such payments will be affected by the obligations of such subsidiaries to their creditors and claims in relation to the Guarantee against the cashflows and assets of such subsidiaries will be effectively subordinated to the claims of such creditors. The ability of such subsidiaries to pay dividends will also be subject to applicable law and, in addition, may be subject to restrictions and limitations imposed in various financing agreements.

### **Substitution**

In certain circumstances (see "Description of the Preferred Securities — Substitution by Preference Shares") the Preferred Securities may be substituted by directly issued preference shares of HBOS. Although HBOS has undertaken to take all reasonable steps to create and authorise, and procure a listing for, the Substituted Preference Shares, there can be no assurance that, in the event that a Substitution Event occurs, shareholders of HBOS will approve the issue of, or that a recognised stock exchange will agree to list, the Substituted Preference Shares. In addition, under its current Articles of Association, HBOS is only authorised to issue further preference shares which rank *pari passu* with its existing issued 300,000,000 9¼ per cent. and 100,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each and in each case any further preference shares required to be issued pursuant to the terms thereof (the "Existing Preference Shares") at a time and in circumstances where (a) the nominal amount of the preference shares proposed to be issued, taken together with

the nominal amount of the Existing Preference Shares and any other preference shares ranking *pari passu* therewith (together, the “Priority Preference Shares”) at that time, does not exceed an amount equal to 25 per cent. of the Adjusted Capital and Reserves of HBOS and (b) the average of the profit after taxation and before extraordinary items and dividends for the preceding three financial periods of HBOS exceeds four and a half times the aggregate annual amount of the dividends payable in the then current financial period on the whole of the issued share capital of HBOS which has priority to or ranks equally with the Priority Preference Shares including those preference shares proposed to be issued (all as more fully described herein under “General Information — Articles of Association — Additional Preference Shares”). If these conditions cannot be met at the time of issue, any preference shares issued by HBOS must rank junior to the Priority Preference Shares. Accordingly, there can be no assurance that any Substituted Preference Shares issued to Holders following a Capital Disqualification Event or a Substitution Event will not rank junior to the Priority Preference Shares and the Guarantee. There can be no assurances that the restrictions on the issue of Priority Preference Shares contained in the Articles of Association of HBOS and described above will not be amended or removed and, further, there can be no assurances as to the capacity of HBOS to issue further Priority Preference Shares after the date hereof, either before or after the issue of Substituted Preference Shares, which may rank senior to Substituted Preference Shares issued in the circumstances described above. HBOS is not prohibited under the Guarantee from issuing Substituted Preference Shares in substitution for some of the Preferred Securities which Substituted Preference Shares rank junior to Priority Preference Shares and other Preferred Securities not so substituted and other outstanding Parity Securities. In addition, the tax treatment for holders of Substituted Preference Shares may be different from that for holders of Preferred Securities.

### **No Operating History**

The Issuer is a newly established limited partnership with no previous operating history or revenues.

### **Subordination**

The obligations of HBOS under the Guarantee will rank junior as to payments to all liabilities to creditors of HBOS (including without limitation depositors, general creditors and subordinated debt holders) and claims of holders of senior ranking securities. In the event that HBOS is wound-up, liquidated or dissolved, the assets of HBOS would be available to pay obligations under the Guarantee only after all payments have been made on such senior liabilities and claims. See also “Substitution” above.

### **No Limitation on Future Debt**

HBOS is not prohibited from issuing, guaranteeing or otherwise incurring further debt ranking *pari passu* with, or senior to, its obligations under the Guarantee.

### **Absence of prior public markets**

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

## **HBOS CAPITAL FUNDING NO. 1 L.P.**

### **Introduction**

HBOS Capital Funding No. 1 L.P. was registered in Jersey on 19 March 2003 under the Law for an unlimited duration, with HBOS Capital Funding (Jersey) Limited as the general partner (the “General Partner”), Citivic Nominees Limited as the initial limited partner (the “Initial Holder”) and Uberior Investments plc, a wholly-owned subsidiary of HBOS, as the initial preferential limited partner (the “Initial Preferential Limited Partner” and, together with the Initial Holder, the “Limited Partners”) holding the Preferential Right (as defined under “Description of the Preferred Securities”). The General Partner, the Limited Partners and HBOS have entered into a limited partnership agreement dated 19 March 2003 (the “Limited Partnership Agreement”) for the purpose of establishing the Issuer. The Issuer is not a legal entity separate from its partners and as such has no subsidiaries. The Limited Partnership Agreement does not create a trust relationship between any of the partners. Although a party to the Limited Partnership Agreement, HBOS is not a partner in the Issuer.

The General Partner, a wholly-owned subsidiary of, and fully controlled by, HBOS, is the sole General Partner of the Issuer and, as such, solely administers the Issuer. HBOS will undertake in the Guarantee to ensure that the General Partner will at all times be a directly or indirectly wholly-owned subsidiary of HBOS.

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

The General Partner and the Limited Partners also hold partnership interests in HBOS Capital Funding L.P., a separately established partnership whose assets are segregated from those of the Issuer.

### **Sole Activity**

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

### **Administration**

HBOS Capital Funding No. 1 L.P. 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 may participate in the administration of the Issuer.

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, subject to the terms of the Limited Partnership Agreement. The Limited 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, the Limited 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 have been paid to or irrevocably set aside for such Holders.

### **Capital Contributions**

In addition to the initial capital contributions by the Limited Partners 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 General Partner may accept additional Limited Partners and additional capital contributions to HBOS Capital Funding No. 1 L.P. as part of a further issue of Preferred Securities and agree the withdrawal of limited partners in accordance with the provisions of the Limited Partnership Agreement.

### **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 other than in connection with the issue of the Preferred Securities. The General Partner will undertake not to incur any indebtedness in the name of the Issuer other than the costs and expenses incidental to creating the Preferred Securities and the Issuer, performing its obligations in respect of the Limited Partnership Agreement, maintaining the listing of the Preferred Securities, the Register, the Registrar, the Paying and Transfer Agents and a listing agent in respect of the Preferred Securities, the Issuer's holding of the Notes or any securities substituted therefor and the maintenance of a custodian therefor, the exercise of the Issuer's rights in respect of the Notes or any securities substituted therefor and the administration of the Issuer.



## **USE OF PROCEEDS**

The net proceeds of the offering of the Preferred Securities, which are expected to amount to approximately U.S.\$980,000,000, will be used by the General Partner, on behalf of the Issuer, to subscribe for the Notes and will augment HBOS's regulatory capital base. The Managers will receive fees and commissions as set out under "Subscription and Sale" below. The net proceeds of the issue of the Notes will be used by HBOS to augment its regulatory capital base.

## CAPITALISATION AND INDEBTEDNESS OF HBOS

The information in the following table and the notes thereto show the audited consolidated capitalisation and indebtedness of HBOS as at the date set forth below (adjusted for the issue of the Preferred Securities) and has been extracted without material adjustment from the HBOS Group's Report & Accounts for the year ended 31 December 2002.

	<b>As at 31 December 2002</b>	<b>As at 31 December 2002 (adjusted)</b>
	<i>£ millions</i>	<i>£ millions</i>
<b>Authorised Capital</b>		
9¼% Non-Cumulative Irredeemable Preference Shares (of £1 each) . . . . .	375	375
9¾% Non-Cumulative Irredeemable Preference Shares (of £1 each) . . . . .	125	125
6.125% Non-Cumulative Redeemable Preference Shares (of £1 each) . . . . .	200	200
Sterling Preference Shares (of £1 each) . . . . .	1,000	1,000
8.117% Non-Cumulative Perpetual Preference Shares Class A (of £10 each) . . . . .	3	3
7.754% Non-Cumulative Perpetual Preference Shares Class B (of £10 each) . . . . .	1	1
Ordinary Shares (of 25p each) . . . . .	1,185	1,185
	<u>2,889</u>	<u>2,889</u>
	<u>2,889</u>	<u>2,889</u>
	<b>As at 31 December 2002</b>	<b>As at 31 December 2002 (adjusted)</b>
	<i>€ millions</i>	<i>€ millions</i>
Euro Preference Shares . . . . .	1,500	1,500
	<u>1,500</u>	<u>1,500</u>
	<u>1,500</u>	<u>1,500</u>
	<b>As at 31 December 2002</b>	<b>As at 31 December 2002 (adjusted)</b>
	<i>£ millions</i>	<i>£ millions</i>
<b>Issued Capital</b>		
9¼% Non-Cumulative Irredeemable Preference Shares (of £1 each, fully paid) . . . . .	300	300
9¾% Non-Cumulative Irredeemable Preference Shares (of £1 each, fully paid) . . . . .	100	100
Ordinary Shares (of 25p each, fully paid) . . . . .	946	946
Reserves . . . . .	12,423	12,423
Shareholders' Funds (including non-equity interests) . . . . .	13,769	13,769
Minority Interests — Equity . . . . .	436	436
Minority and Other Interests — Non Equity <sup>(1)</sup> . . . . .	1,703	2,324
	2,139	2,760
<b>Subordinated loan capital<sup>(2)</sup></b>		
Undated <sup>(3)</sup> . . . . .	3,437	3,437
Dated <sup>(4)</sup> . . . . .	5,690	5,690
<b>Total Capital Resources</b> . . . . .	<u>25,035</u>	<u>25,656</u>
<b>Other Borrowings<sup>(5)</sup></b>		
Deposits by banks . . . . .	45,637	45,637
Customer accounts . . . . .	150,221	150,221
Debt securities in issue . . . . .	80,771	80,771
Total Indebtedness . . . . .	<u>276,629</u>	<u>276,629</u>
<b>Total Capitalisation and Indebtedness<sup>(7)</sup></b> . . . . .	<u>301,664</u>	<u>302,285</u>

Notes:

- (1) The Minority and Other Interests — Non Equity was comprised as follows:

	As at 31 December 2002	As at 31 December 2002 (adjusted)
	<i>£ millions</i>	<i>£ millions</i>
U.S.\$ 1,000 million Perpetual Preferred Securities *	—	634
£600 million Perpetual Preferred Securities *	600	600
£250 million preferred securities **	250	250
£150 million preferred securities **	150	150
£245 million preferred securities *	245	245
€415 million preferred securities *	270	270
£198 million non-cumulative preference shares	198	198
Unamortised Premiums, Discounts and Issue Costs	(10)	(23)
	<u>1,703</u>	<u>2,324</u>

\* HBOS provides a subordinated guarantee in respect of each of the issues of £245,000,000 7.881% Guaranteed Non-voting Non-cumulative Preferred Securities issued by HBOS Sterling Finance (Jersey) L.P., €415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities issued by HBOS Euro Finance (Jersey) L.P., the issue of £600,000,000 6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A issued by HBOS Capital Funding L.P. and HBOS will provide a subordinated guarantee in respect of the issue of U.S.\$1,000,000,000 6.85% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities now being issued by the Issuer.

\*\* Bank of Scotland has provided a subordinated guarantee in respect of each of the issues of £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 by Bank of Scotland Capital Funding L.P. All other non-equity minority interests are unguaranteed.

- (2) All loan capital issued by the HBOS Group, as detailed in the tables below, has been issued on an unsecured basis. Unless otherwise stated, issues of loan capital are unguaranteed.

- (3) The Subordinated Undated Loan Capital was comprised as follows:

	As at 31 December 2002
	<i>£ millions</i>
€500 million Fixed to Floating Rate Undated Subordinated Notes	325
£150 million 7.286% Series A Perpetual Regulatory tier One Securities	150
£150 million 7.281% Series B Perpetual Regulatory tier One Securities	150
£300 million 7.5% Undated Subordinated Step-Up Notes	300
JPY 42.5 billion 3.50% Undated Subordinated Yen Step-up Notes	222
US\$300 million Reset Notes	186
£200 million Perpetual Notes	200
£200 million 7.375% Subordinated Guaranteed Bonds*	200
€300 million Floating Rate Subordinated Step-Up Notes	195
US\$250 million Floating Rate Primary Capital Notes	155
£150 million Instruments	150
£150 million Instruments	150
JPY 17 billion Instruments	99
£100 million Instruments	100
£100 million 12% Sterling Perpetual Subordinated Bonds	100
£100 million 8.75% Sterling Perpetual Subordinated Bonds	100
£75 million 13.625% Sterling Perpetual Subordinated Bonds	75
JPY 9 billion Instruments	47
£50 million 9.375% Sterling Perpetual Subordinated Bonds	50
£500 million 5.75% Undated Subordinated Step-up Notes	500
Unamortised Premiums, Discounts and Issue Costs	(17)
	<u>3,437</u>

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

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

	<b>As at 31 December 2002</b>
	<i>£ millions</i>
US\$300 million 8.80% Notes 2004*	186
£400 million 8.75% Subordinated Notes 2006	400
US\$150 million 8.85% Notes 2006*	93
£75 million 9.125% Subordinated Notes 2006	75
£60 million 9.00% Instruments 2006	60
€650 million 4.75% Subordinated Bonds 2009	423
US\$500 million Floating Rate Subordinated Step-up Callable Notes 2009	310
€500 million 5.50% Instruments 2009	325
£75 million Floating Rate Subordinated Notes 2009	75
US\$500 million Notes 2010*	310
£75 million Floating Rate Instruments 2010	75
US\$150 million Notes 2011*	93
€7 million Floating Rate Notes 2011	5
€750 million Subordinated Fixed Rate Notes 2012	488
US\$450 million Subordinated Floating Rate Notes 2012	279
£200 million Floating Rate Step-up Callable Subordinated Notes 2012	200
€12.8 million 6.25% Instruments 2012	8
A\$75 million Callable Notes 2012	26
€1,000 Subordinated Callable Fixed/Floating Rate Instruments 2013	651
€325 million 6.125% Notes 2013	212
£250 million 11% Subordinated Bonds 2014	250
£150 million 10.5% Subordinated Bonds 2018	150
£250 million 6.375% Instruments 2019	250
£500 million 9.375% Subordinated Bonds 2021	500
€400 million 6.45% Eurodated Floating Subordinated Guaranteed Bonds 2023**	261
Unamortised premiums, discounts and issue costs	(15)
	<u>5,690</u>

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

\*\* CMIG has provided a subordinated guarantee to CMF in relation to the issue by CMF of 6.45% Eurodated Floating Subordinated Guaranteed Bonds 2023.

- (5) Save for £603 million of the HBOS Group's debt securities in issue which are unguaranteed but secured on advances to customers and certain other assets of the HBOS Group, and £9,286 million of the HBOS Group's debt securities in issue which are unguaranteed but secured on asset backed securities of the HBOS Group, none of the other borrowings listed are secured or guaranteed. As at 31 December 2002, the HBOS Group had contingent liabilities (including guarantees) of £2,829 million. No account has been taken of intra group guarantees.
- (6) On 12 March 2003, HBOS announced its intention to issue, on or around 20 March 2003, €1,000,000,000 4.875%. Subordinated Notes due 2015.
- (7) There has been no material change in the capitalisation, indebtedness and contingent liabilities (including guarantees) of HBOS Group since 31 December 2002.

## DESCRIPTION OF THE BUSINESS OF HBOS AND THE HBOS GROUP

On 10 September 2001, The Governor & Company of the Bank of Scotland (“Bank of Scotland”) and Halifax Group plc (“Halifax Group”) merged under HBOS. HBOS is the ultimate holding company for Halifax plc, Bank of Scotland and a number of other subsidiaries principally carrying on financial services business. HBOS is a public limited company incorporated in Scotland (registered number SC218813) under the Companies Act 1985 with its head office, corporate headquarters and registered office at The Mound, Edinburgh, EH1 1YZ. Subsequent to the merger, all of Halifax Group’s innovative Tier I and Tier II capital and any guarantee obligations thereunder were transferred to HBOS on 1 July 2002.

The HBOS Group’s products and services can be categorised into the following business sectors:

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

### ***Retail Banking***

The retail operations and consumer credit businesses of Halifax Group were combined with the personal banking division of Bank of Scotland to form the Retail Banking Division of the HBOS Group employing over 40,000 people in over 1,000 branches and 10 call centres throughout the United Kingdom.

The HBOS Group has over 19 million customers and offers an extensive range of personal finance products and services including mortgages, savings, current accounts, credit cards, online services, share dealing and estate agency. In addition to Halifax and Bank of Scotland, other brands within the Retail Banking Division include Intelligent Finance, Birmingham Midshires and The Mortgage Business.

The HBOS Group is the largest mortgage provider in the United Kingdom, with residential mortgages of approximately £145 billion and the United Kingdom’s largest savings provider with savings and banking balances of over £100 billion, as at 31 December 2002.

### ***Business Banking***

The Business Banking Division provides a range of finance products and services principally to small and medium-sized enterprises (“SMEs”) through a network of branches and business centres in the United Kingdom and Ireland as well as through internet banking, mail and telephone. The HBOS Group provides a full banking service to SMEs including deposits and investments, business finance, commercial mortgages, free internet banking, merchant services and business insurance. The Business Banking Division also provides specialist services such as asset finance, cashflow finance, motor finance, vehicle management and contract hire. The Business Banking Division employs over 7,400 employees in the United Kingdom, Ireland and Australia.

The HBOS Group provides finance products and services to approximately 33 per cent. (as of September 2002) of the SME market in Scotland and is aiming to capture a significant amount of SME business in England and Wales.

### ***Corporate Banking***

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

The HBOS Group employs 1,500 staff in the Corporate Banking Division in over 20 locations in Scotland and England, with international operations in New York, Chicago, Houston, Los Angeles, Boston, Seattle, Minneapolis, Paris, Frankfurt, Amsterdam, Madrid, Singapore and Sydney.

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

### ***Insurance & Investment***

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

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

### ***Treasury***

HBOS Treasury Services plc (“Treasury Services”) provides centralised wholesale multi-currency funding, liquidity management and treasury services to HBOS and its subsidiary undertakings in the United Kingdom and the Republic of Ireland. Treasury Services manages the market risk arising from the HBOS Group’s Retail, Business and Corporate divisions. It operates in the world’s foreign exchange and money markets and also provides a range of treasury services to certain of the HBOS Group’s customers from offices in London and Glasgow. Treasury Services also trades in foreign exchange and in a limited range of derivative instruments primarily for risk management purposes. It leads the debt capital issuance and asset securitisation activities of the HBOS Group in the United Kingdom. Treasury Services has no subsidiaries.

Following the merger of Halifax Group and Bank of Scotland in 2001, substantially all of the treasury business of Halifax plc was transferred to Bank of Scotland Treasury Services PLC with effect from 1 June 2002. On 14 June 2002, Bank of Scotland Treasury Services PLC changed its name to HBOS Treasury Services plc.

### ***Management and Organisation***

The names of the HBOS Directors, all of The Mound, Edinburgh EH1 1YZ, their functions and principal outside activities are as follows:

<b>Director’s Name</b>	<b>Responsibilities</b>	<b>Principal outside activities</b>
Lord Stevenson of Coddanham	Chairman	Pearson plc
Sir Ronald Garrick	Deputy Chairman — Non-Executive	
James Crosby	Chief Executive	
Mike Ellis	Group Finance Director	
Phil Hodkinson	Chief Executive, Insurance & Investment Division	
Andy Hornby	Chief Executive, Retail Division	
Gordon McQueen	Chief Executive, Treasury Services Division	
Colin Matthew	Chief Executive, Business Banking Division	
George Mitchell	Chief Executive, Corporate Banking Division	
Charles Dunstone	Non-Executive Director	Carphone Warehouse plc
Tony Hobson	Non-Executive Director	
Brian Ivory	Non-Executive Director	
John Maclean	Non-Executive Director	
Coline McConville	Non-Executive Director	Clear Channel International Limited
Sir Bob Reid	Non-Executive Director	
Louis Sherwood	Non-Executive Director	
Philip Yea	Non-Executive Director	Investcorp International Limited

Certain details of HBOS's principal subsidiaries are as follows:

<b>Company Name</b>	<b>Activity</b>	<b>Country of Incorporation or Registration</b>	<b>Registered Office/Head Office</b>
The Governor & Company of the Bank of Scotland	Banking	Scotland	The Mound Edinburgh EH1 1YZ
Halifax plc	Banking services	England and Wales	Trinity Road Halifax HX1 2RG
Halifax Share Dealing Limited	Execution only stockbroking	England and Wales	Trinity Road Halifax HX1 2RG
HBOS Insurance & Investment Group Limited	Financial Services	England and Wales	Trinity Road Halifax HX1 2RG.

Certain details of the principal subsidiary undertakings of HBOS Insurance & Investment Group Limited are set out below:

<b>Company Name</b>	<b>Activity</b>	<b>Country of Incorporation or Registration</b>	<b>Registered Office</b>	<b>Total % held by HBOS Insurance &amp; Investment Group Ltd</b>
Halifax General Insurance Services Limited	General insurance	England and Wales	Trinity Road Halifax HX1 2RG	100%
Clerical Medical Investment Group Holdings Limited and its subsidiaries	Life assurance	England and Wales	33 Old Broad Street London EC2N 1HZ	100%
Halifax Financial Services (Holdings) Limited and its subsidiaries	Financial services	England and Wales	Trinity Road Halifax HX1 2RG	100%
St James's Place Capital plc and its subsidiaries	Financial services	England and Wales	J Rothschild House Dollar Street Cirencester GL7 2AQ	60%*

\*as at 31 December 2002

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

<b>Company Name</b>	<b>Activity</b>	<b>Country of Incorporation or Registration</b>	<b>Registered Office</b>	<b>Total % held by Bank of Scotland</b>
HBOS Treasury Services plc	Banking	England and Wales	33 Old Broad Street London EC2N 1HZ	100%
Capital Bank plc	Personal finance and banking services	England and Wales	Queens Park Road Handbridge Chester CH88 3AN	100%
Bank of Western Australia Limited	Retail and commercial banking	Australia	Bankwest Tower 108 St Georges Terrace, Perth Australia WA 6000	56.8%*

\*as at 31 December 2002



## 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 Limited Partnership Agreement, a copy of which is available for inspection as described under "General Information".*

### 1 Definitions and Interpretation

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

"30/360 Basis" means that the day-count fraction used will be the number of days in the period from (and including) the most recent Distribution Payment Date (or, if none, the Closing Date) to (but excluding) the next (or first) Distribution Payment Date or, if earlier, the relevant payment date divided by 360 (the number of days being calculated on the basis of a year of 360 days with 12 30-day months);

"Additional Amounts" means the additional amounts which may be payable in respect of the Preferred Securities as described in paragraph 6;

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

"Agency Agreement" means the agency agreement dated 21 March 2003 relating to the Preferred Securities between, *inter alios*, HBOS and the Paying and Transfer Agents;

"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 (including dealing in foreign exchange and foreign currency deposits) in the financial centre(s) specified;

"Capital Disqualification Event" means a change in any applicable law or regulation, or in the official interpretation or application thereof, as a result of which for the purposes of the FSA's capital adequacy requirements applicable to banks in the U.K., at that time the Preferred Securities do not constitute Tier 1 Securities;

"Capital Disqualification Event Redemption Date" means the date designated for optional redemption of the Preferred Securities as described under paragraph 4.4;

"Clearstream, Luxembourg" means Clearstream Banking, société anonyme or its successor;

"Closing Date" means 21 March 2003;

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

"Distribution Determination Date" means, with respect to any Distribution Payment Date, the day ten Business Days in London prior to such Distribution Payment Date;

"Distribution Payment Date" means 23 March, 23 June, 23 September and 23 December in each year, commencing on 23 June 2003;

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

"Distribution Rate" means 6.85 per cent. per annum;

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

"Existing Preference Shares" means the 300,000,000 9¼ per cent. and 100,000,000 9¾ per cent. Non-cumulative Irredeemable Preference Shares of £1 each in the capital of HBOS in issue at the date

hereof and in each case any further preference shares required to be issued pursuant to the terms of such aforementioned preference shares;

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

“General Partner” means HBOS Capital Funding (Jersey) Limited, a Jersey incorporated company being a directly or indirectly wholly owned subsidiary of HBOS;

“Guarantee” means the subordinated guarantee in respect of the Preferred Securities executed by HBOS as a deed poll and dated 21 March 2003;

“HBOS” means HBOS plc and its successors and assigns;

“HBOS Group” means HBOS together with the Subsidiaries;

“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;

“Initial Holder” means Citivic Nominees Limited;

“Initial Preferential Limited Partner” means Uberior Investments plc;

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

“Issuer” means HBOS Capital Funding No. 1 L.P.;

“Jersey” means the Island of Jersey;

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

“Junior Share Capital” means the ordinary shares of HBOS, together with any other securities or obligations which rank, or are expressed to rank, junior to the Parity Securities and to any preference shares issued in substitution for any such Parity Securities or the Preferred Securities;

“Law” means the Limited Partnerships (Jersey) Law 1994, as amended or restated from time to time;

“Limited Partnership Agreement” means an agreement dated 19 March 2003 between the General Partner, the Initial Preferential Limited Partner, HBOS and the Initial Holder establishing the Issuer, as the same may be amended from time to time;

“Liquidation Distribution” means the Liquidation Preference plus (a) any due and accrued but unpaid Distributions calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, the Closing Date) to (but excluding) the date of payment, and (b) any Additional Amounts, in each case in cash only;

“Liquidation Preference” means the liquidation preference of U.S.\$1,000 per Preferred Security;

“Notes” means the cumulative U.S.\$1,000,000,000 6.85 per cent. Undated Subordinated Notes issued by HBOS and subscribed for by the General Partner, on behalf of the Issuer, with the net proceeds of the issue of the Preferred Securities and any further Notes of HBOS of the same series issued after the Closing Date and ranking *pari passu* with the Notes, or any successor securities issued or securities substituted therefor with the prior written consent of the FSA (if then required);

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

“Optional Redemption Date” means, in the case of an optional redemption pursuant to paragraph 4.2, 23 March 2009 or any Distribution Payment Date thereafter, as specified in the relevant notice of redemption;

“Optional Redemption Price” means the Liquidation Preference plus (a) any due and accrued but unpaid Distributions calculated from (and including) the immediately preceding Distribution Payment Date (or, if none, the Closing Date) to (but excluding) the relevant Optional Redemption Date, Tax Event Redemption Date or Capital Disqualification Event Redemption Date, as the case may be and (b) any Additional Amounts payable;

“Parity Securities” means any preference shares (including the Existing Preference Shares), preferred securities (other than the Preferred Securities) or other securities either (a) issued directly by HBOS (and

ranking *pari passu* with HBOS's obligations under the Guarantee) or (b) issued by the Issuer or any other Subsidiary or entity and entitled to the benefit of the Guarantee or any other guarantee or support agreement ranking *pari passu* with the Guarantee;

"Paying and Transfer Agents" means Citibank, N.A. and Dexia Banque Internationale à Luxembourg, société anonyme or such other entities as are appointed by the General Partner on behalf of the Issuer and notified to the Holders as described under paragraph 10;

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

"Preferential Limited Partner" means the Initial Preferential Limited Partner or any other holder of the Preferential Right from time to time;

"Preferential Right" means the limited partnership interests in the Issuer held by the Preferential Limited Partner and entitling it to receive in preference to the rights of the General Partner all amounts received by the Issuer from its investment in the Notes in excess of those required to make payments in respect of the Preferred Securities by reason of the provisions of paragraphs 2, 3 or 6;

"Preferred Capital Contribution" means, in relation to the Preferred Securities, the aggregate contribution to the assets of the Issuer (being a whole multiple of U.S.\$1,000) paid in cash by the Holders;

"Preferred Securities" means the U.S.\$1,000,000,000 6.85 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities outstanding, each such security representing an interest of a Holder in the Issuer attributable to each U.S.\$1,000 of the Preferred Capital Contribution and including any further Preferred Securities of the Issuer of the same series issued after the Closing Date and ranking *pari passu* with the Preferred Securities as regards participation in the profits and assets of the Issuer and "Preferred Security" shall be construed accordingly;

"Redemption Conditions" means, with respect to any redemption, (i) that the consent of the FSA to the redemption, if then required, has been obtained and (ii) that HBOS 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;

"Register" means the register of Holders maintained outside the U.K. on behalf of the Issuer under the Law;

"Registrar" means Citibank AG or such other entity appointed by the Issuer having its office outside the U.K. and notified to the Holders as described under paragraph 10;

"Relevant Proportion" means (a), in relation to any partial payment of a Distribution on a Preferred Security, the amount of Adjusted Distributable Reserves as determined in accordance with paragraph 2.9 on the Distribution Determination Date divided by the sum of (i) the amount originally scheduled to be paid by way of Distributions on the Preferred Securities on the relevant Distribution Payment Date and (ii) the amount of any distributions or dividends originally scheduled to be payable to holders of Parity Securities on the relevant Distribution Payment Date, converted where necessary into the same currency in which Adjusted Distributable Reserves are reported by HBOS and (b), in relation to any partial payment of any Liquidation Distribution on a Preferred Security, the total amount available for any such payment and for making any corresponding payment of a liquidation distribution on any Parity Securities divided by the sum of (i) the full Liquidation Distributions before any reduction or abatement in respect of the Preferred Securities and (ii) the amount of the full liquidation distribution before any reduction or abatement in respect of any Parity Securities, converted where necessary into the same currency in which liquidation payments are made to creditors of HBOS;

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

"Restricted Person" means a person to whom Substituted Preference Shares will not be available for issue being (a) Euroclear, Clearstream, Luxembourg, First Chicago Clearing Center or any other person providing a clearance service within section 96 of the Finance Act 1986 of the U.K. or any nominee thereof or (b) a person, or nominee or agent for a person, whose business is or includes issuing depositary receipts within

section 93 of the Finance Act 1986 of the U.K. or (c) any other person the issue to whom would give rise to an equivalent charge to that described in (a) or (b) above to stamp duty reserve tax in the U.K., in each case at any time prior to the “abolition day” as defined in section 111(1) of the Finance Act 1990 of the U.K.;

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

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

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

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

“Substitution Event” means that either (i) HBOS’s total capital ratio calculated on a consolidated basis in accordance with applicable U.K. bank capital adequacy regulations, has fallen below the then generally applicable minimum ratio (or ratios, if then applicable) required by such regulations (currently 8 per cent.); or (ii) HBOS’s board of directors in its sole discretion has notified the FSA and the Issuer that it has determined 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 U.K. or Jersey, or in any treaty to which the U.K. or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in the U.K. or Jersey, (i) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Notes or the Preferred Securities (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 Limited Partnership Agreement in respect of the Notes and the Preferred Securities) in Jersey or the U.K., (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 U.K., (iii) payments by HBOS in respect of the Notes would be subject to deduction or to withholding tax in the U.K. or (iv) HBOS would not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes;

“Tax Event Redemption Date” means the date designated for optional redemption of the Preferred Securities as described under paragraph 4.3;

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

“Tier 1 Securities” means any obligation of HBOS or, as the case may be, a Subsidiary or other entity which is, or is capable of being, treated as Tier 1 Capital of HBOS on a consolidated basis;

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

“U.S. Dollars” or “U.S.\$” means the lawful currency for the time being of the United States of America.

In this description of the Preferred Securities any reference to a particular time shall, unless otherwise specified, be to that time in London.

## 2 Distributions

2.1 Subject as provided by the Law and in paragraph 2.3 and 2.9, non-cumulative distributions (“Distributions”) on the Preferred Securities will accrue from the Closing Date (or, in the case of any further Preferred Securities of the same series 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 or as otherwise provided) and shall be payable in arrear on each Distribution Payment Date.

2.2 Subject to the Law, Distributions in respect of any Distribution Period will be payable at the Distribution Rate on the amount of the Liquidation Preference calculated on a 30/360 Basis and in respect of each Distribution Period shall (subject as otherwise provided herein) be U.S.\$17.13 per Preferred Security save that in respect of the first Distribution Period the amount of the Liquidation Preference payable on the first Distribution Payment Date shall be U.S.\$17.51 per Preferred Security.

- 2.3 Distributions on the Preferred Securities will be non-cumulative and will accrue on a 30/360 Basis. Distributions on the Preferred Securities will be payable out of the Issuer's own legally available resources on each Distribution Payment Date. Notwithstanding the existence of resources legally available for distribution by the Issuer, neither the Issuer nor HBOS will pay any Distributions or make any payment in respect of Distributions (including any Additional Amounts) under the Preferred Securities or the Guarantee:
- 2.3.1 to the extent that such payment, together with the amount of any distributions or dividends paid or scheduled to be paid to holders of Parity Securities on the relevant Distribution Payment Date would exceed Adjusted Distributable Reserves as at the Distribution Determination Date immediately preceding such Distribution Payment Date; or
- 2.3.2 even if Adjusted Distributable Reserves are sufficient, (i) to the extent that such payment in respect of the Preferred Securities and/or Parity Securities would breach or cause a breach of the U.K. banking capital adequacy requirements then applicable to HBOS on a consolidated basis or (ii) HBOS's board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (i) above is expected to occur in the near term.
- 2.4 HBOS has undertaken in the Guarantee 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 distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any Junior Share Capital, until after the fourth consecutive following Distribution Payment Date on which a Distribution is paid in full (or an amount equivalent to the distributions to be paid in respect of the next four 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 Securities or Junior Share Capital until after the fourth consecutive following Distribution Payment 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 four Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).
- 2.5 If, whether by reason of the provisions of paragraph 2.3 or any equivalent article or term of a Parity Security, on any Distribution Payment Date, Distributions are not paid in full on the Preferred Securities or dividends or other distributions are not paid in full on any Parity Securities, but there are sufficient Adjusted Distributable Reserves so as to allow payment of part of any Distribution, then each Holder will be entitled to receive the Relevant Proportion of any such Distribution. 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 amounts will not cumulate for the benefit of Holders or entitle the Holders to any claim in respect thereof against the Issuer or against HBOS under the Guarantee.
- 2.6 On each Distribution Determination Date, HBOS will determine whether sufficient Adjusted Distributable Reserves exist to allow a payment of some or all of the relevant Distribution. In the event that any Distribution cannot be paid in full, HBOS will notify or procure notification to the Stock Exchange, the General Partner, the Registrar and the Paying and Transfer Agents and to Holders, in accordance with paragraph 10, 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 HBOS and in particular will have no rights to receive from the Issuer amounts paid under the Notes or otherwise amounts in excess of Distributions due and payable under the Preferred Securities. In the event that any amounts received by the Issuer 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 Preferential Limited Partner 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 paragraphs 1, 2.3.1, 2.5 and 2.6, Adjusted Distributable Reserves as at each Distribution Determination Date shall be determined by reference to whichever is the latest available at that date of the audited accounts for the previous financial year of HBOS or interim accounts for the previous half year of HBOS, adjusted in either case for any of the following events occurring since the date to which such accounts were prepared: (i) any known net losses and (ii) any further redemptions of or payments on (a) any preference shares or other obligations of HBOS that are accounted for under the then generally accepted accounting practice in

the U.K. as shareholders' funds in HBOS's accounts and (b) all securities or other obligations of an undertaking which are accounted for under the then generally accepted accounting practice in the U.K. as minority interest capital of, and with recourse (whether by way of guarantee, support agreement or otherwise) to HBOS that are similar in material respects to the Preferred Securities and the Guarantee taken together, whether or not Parity Securities, except in each case for such amounts as have been either charged to the lawful distributable reserves of HBOS 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".

### 3 Liquidation Distributions

- 3.1 Without prejudice to paragraph 8.6, in the event of the commencement of any dissolution (other than an Involuntary Dissolution) of the Issuer, the Holders will be entitled, subject as set out in paragraph 3.4, to receive the Liquidation 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 (a) before any payments due to the holder of the Preferential Right and (b) before any distribution of assets is made to the General Partner.

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

- 3.2 If the Liquidation Distribution and any other such liquidation distributions cannot be made in full by reason of the limitation described in paragraph 3.1 or any equivalent article or term of a Parity Security, but there are funds available for payment so as to allow payment of part of the Liquidation Distribution, then each Holder will be entitled to receive the Relevant Proportion of the Liquidation Distribution. After payment of all Liquidation Distributions, the Preferential Limited Partner will be entitled to any remaining assets of the Issuer representing proceeds of the Notes and the Holders will have no right or claim to any of the remaining assets of the Issuer or HBOS.
- 3.3 In the event of an order being made for the liquidation, dissolution, or winding-up of HBOS other than pursuant to a Permitted Reorganisation or HBOS is declared insolvent, the Issuer shall be dissolved (by delivery by the General Partner of a statement of dissolution in accordance with the Law) and the amount per Preferred Security to which Holders shall be entitled as a Liquidation Distribution will be as set out in paragraphs 3.1 and 3.2.
- 3.4 Subject to the Law, other than in the event referred to in paragraph 3.3, unless (i) the FSA has given its approval, if then required and (ii) HBOS 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 Liquidation Distribution (in either of cases (ii)(a) or (b) in an amount at least equal to the aggregate Liquidation Distribution), the General Partner will not permit, or take any action that would or might cause, the liquidation or dissolution of the Issuer. Notwithstanding the foregoing restriction imposed on the General Partner, if for any other reason the Issuer is liquidated, dissolved or wound up in circumstances where proceedings have not been commenced for the liquidation, dissolution or winding-up of HBOS, the Liquidation 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 HBOS) in respect of any Liquidation Distribution or part thereof not paid when it would, but for the operation of this paragraph 3.4, otherwise have become due.

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

- 4.1 The Preferred Securities have no fixed final redemption date and Holders have no rights to call for the redemption of the Preferred Securities.
- 4.2 The Preferred Securities are redeemable, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions and the Law, in whole, but not in part, on any Optional Redemption Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable). Upon the expiry of such notice, the Issuer shall be bound to redeem each of the Preferred Securities accordingly by payment of an amount equal to the Optional Redemption Price. For so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, the General Partner shall cause notice of such redemption to be given to the Luxembourg Stock Exchange.
- 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 HBOS 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 Tax Event Redemption Date (which notice shall be irrevocable), each Preferred Security being redeemable at the Optional Redemption Price. 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 HBOS stating that the Issuer is entitled to effect such redemption and an opinion of counsel to HBOS 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 each of the Preferred Securities accordingly in accordance with and subject to the Law. For so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, the General Partner shall cause notice of such redemption to be given to the Luxembourg Stock Exchange.
- 4.4 If at any time a Capital Disqualification Event has occurred and is continuing, either (i) the General Partner may (in circumstances where HBOS is itself not insolvent or in liquidation) in its absolute discretion on behalf of the Issuer elect to substitute the Substituted Preference Shares 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 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 Capital Disqualification Event Redemption Date (which notice shall be irrevocable), each Preferred Security being redeemable at the Optional Redemption Price. 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 HBOS stating that the Issuer is entitled to effect such redemption and an opinion of counsel to HBOS experienced in such matters to the effect that a Capital Disqualification Event has occurred. Upon the expiry of such notice, the Issuer shall be bound to redeem each of the Preferred Securities accordingly in accordance with and subject to the Law. For so long as the Preferred Securities are listed on the Luxembourg Stock Exchange, the General Partner shall cause notice of such redemption to be given to the Luxembourg Stock Exchange.
- 4.5 Under existing FSA requirements, neither the Issuer nor HBOS may redeem or purchase any Preferred Securities unless the FSA gives its prior written consent. The FSA may impose conditions on any such redemption or purchase.

#### **5 Substitution by Preference Shares**

- 5.1 As soon as reasonably practicable following the occurrence of a Substitution Event or the Involuntary Dissolution of the Issuer (in circumstances where HBOS is itself not insolvent or in liquidation) or following an election by the General Partner in its absolute discretion on behalf of the Issuer to substitute Substituted Preference Shares following a Capital Disqualification Event as contemplated in paragraph 4.4, the General Partner shall cause notice thereof to be given in accordance with paragraph 10 and take all reasonable steps to cause the substitution of the Preferred Securities by fully-paid preference shares issued directly by HBOS (the "Substituted Preference Shares") the terms of which provide the Holders in all material commercial respects with the same economic rights and benefits (including those relating to non-cumulative distributions and status) as are attached to the Preferred Securities and the Guarantee taken together. However, in the event that at the time of any such substitution HBOS is unable, by reason of the operation of Article 4.7 of its Articles of

Association (or any provision in its Articles of Association from time to time corresponding thereto) but not otherwise, to issue preference shares which rank as to payments of capital or income equally with the Guarantee, the Substituted Preference Shares shall comprise preference shares of HBOS which provide the Holders in all material commercial respects with the same economic rights and benefits as aforesaid save that they shall rank junior to (i) the Parity Securities issued from time to time by HBOS and (ii) the Guarantee and any other guarantee or support agreement ranking *pari passu* with the Guarantee, but senior to all Junior Share Capital in issue from time to time. Following the creation of such Substituted Preference Shares and the obtaining of all corporate authorisations for the allotment and issue of such Substituted Preference Shares, HBOS undertakes that it will allot, issue and deliver Substituted Preference Shares in satisfaction of the rights of the Holders in the circumstances and subject to the conditions described herein. HBOS undertakes that it will take all reasonable steps to procure that such Substituted Preference Shares will at the relevant time be listed on a recognised stock exchange. HBOS undertakes that as soon as practicable after a Substitution Event or the Involuntary Dissolution of the Issuer in circumstances where HBOS is itself not insolvent or in liquidation or following an election by the General Partner to substitute Substituted Preference Shares following a Capital Disqualification Event as contemplated in paragraph 4.4, it will give written notice to the Holders enclosing a substitution confirmation (the "Substitution Confirmation") which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of each Paying and Transfer Agent. To receive Substituted Preference Shares in respect of some or all of its holding of Preferred Securities, each Holder must deliver to a Paying and Transfer Agent a Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. If at the time of any substitution of the Substituted Preference Shares pursuant to the foregoing, the Preferred Securities are represented by a single certificate registered in the name of a nominee for the Common Depository (as defined in paragraph 11), the Holder may provide a list of each of the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing systems as a person with an entitlement in respect of the Preferred Securities and in whose name (or the name of the nominee for such person) the Substituted Preference Shares should be registered, subject to any such person submitting a duly completed Substitution Confirmation and appropriate references to "Holders" in this paragraph 5.1 shall be construed accordingly.

HBOS undertakes that following such substitution, each Substituted Preference Share allotted will rank for any dividend from the immediately preceding Distribution Payment Date or, if none, the Closing Date and will have no entitlement to any accrued Distributions or any other payment on the Preferred Securities. Following any partial substitution of a Holder's Preferred Securities, the relevant Paying and Transfer Agent will notify the Registrar and the General Partner who shall amend the record of the Holder's interest in the Issuer on the Register accordingly.

- 5.2 HBOS undertakes that it will pay any taxes or capital duties or stamp duties payable in the U.K. or Jersey arising on the allotment and issue of the Substituted Preference Shares. HBOS will not be obliged to pay, and each Holder delivering Preferred Securities and a duly completed Substitution Confirmation to a Paying and Transfer Agent must pay, any other taxes, stamp duty reserve taxes and capital, stamp, issue and registration duties arising on the relevant substitution. HBOS will not be obliged to pay and each Holder must pay all, if any, taxes arising by reference to any disposal or deemed disposal of a Preferred Security in connection with such substitution. Substituted Preference Shares will not be allotted to Restricted Persons.
- 5.3 The General Partner will use all reasonable endeavours to procure that certificates (if any) for Substituted Preference Shares issued on substitution will be despatched by mail free of charge (but uninsured and at the risk of the person entitled thereto) within one month after receipt of a duly completed Substitution Confirmation. Upon an Involuntary Dissolution of the Issuer occurring after a Substitution Event but prior to the relevant 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. Notwithstanding the foregoing, if Substituted Preference Shares are required to be issued, Holders will continue to be entitled to receive Distributions and/or a Liquidation Distribution in respect of the Preferred Securities until such time as notice is given by HBOS in accordance with paragraph 10 that the Substituted Preference Shares are available for issue upon substitution and thereafter Holders will have no further rights, title or interest in or to their Preferred Securities except to have them substituted in the manner described above.



## 6 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 Jersey Tax, unless the withholding or deduction of such Jersey Tax is required by law. In the event of such withholding or deduction, each Holder will be entitled to receive, as further distributions, such additional amounts (“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 behalf) with respect to any Preferred Security (i) to the extent that such Jersey Tax is imposed or levied by virtue of such Holder (or the beneficial owner) of such Preferred Security having some connection with Jersey, other than merely being a Holder (or beneficial owner) of such Preferred Security or (ii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive or (iii) who would have been able to avoid such withholding or deduction by presenting the Preferred Securities to another Paying and Transfer Agent in a Member State of the European Union, and except that the Issuer’s obligations to make any such payments are subject to the Law and to the limitations provided in paragraphs 2.3, 3.1 and 3.2.

## 7 Payments

7.1 Distributions will be payable on the relevant Distribution Payment Date (or where any Distribution Payment Date is not a Business Day in London and New York City on the next Business Day in London and New York City (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 Business Days in London and New York City prior to the relevant Distribution Payment 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, by 15.00 hours on the Optional Redemption Date, the Tax Event Redemption Date or the Capital Disqualification Event Redemption Date, as the case may be, the General Partner shall procure that the Optional Redemption Price will be paid by the Registrar or by the Paying and Transfer Agent 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 (or any part thereof) made by or on behalf of the Holders) will be extinguished and the 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 be deemed repaid.

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

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

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

provided, however, that a Holder may receive such payment by direct transfer 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 Business Day in London and New York City, 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 in respect of any Preferred Security 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 30/360 Basis, from the Optional Redemption Date, Tax Event Redemption Date or Capital Disqualification Event Redemption Date, as the case may be, to the date of actual payment of such Optional Redemption Price.

- 7.3 The Issuer will not, and HBOS has undertaken in the Guarantee that it will not and it will procure that no member of the HBOS Group will, make any payment to Holders, or procure such a payment in respect of the Preferred Securities, that could not lawfully have been made if Holders had held the most senior preference shares of HBOS (if any and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.
- 7.4 The General Partner will, and HBOS has undertaken in the Guarantee that it will procure that the General Partner will, maintain at all times whilst the Preferred Securities are outstanding (a) whilst the Preferred Securities are listed on the Luxembourg Stock Exchange, a Paying and Transfer Agent in Luxembourg, (b) a Registrar having its office outside the U.K. and (c) a Paying and Transfer Agent having a specified office in a European Union Member State (if any) that will not be obliged to withhold or deduct tax pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive.

## **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 four consecutive Distribution Periods:
- 8.2.1 Distributions and any Additional Amounts in respect of such Distributions have not been paid in full on the Preferred Securities by the Issuer; and/or
- 8.2.2 HBOS breaches any of its payment obligations under the Guarantee in respect of such Distributions or any such Additional Amounts thereon,

then the Holders of outstanding Preferred Securities, acting as a single class, will be entitled, by written notice to the General Partner at the Office given by the Holders of a majority by Liquidation Preference of such Preferred Securities or by resolution passed by the Holders of a simple majority by Liquidation Preference of such Preferred Securities present in person or by proxy at a separate general meeting of such Holders convened for the purpose, to appoint a special representative (the "Special Representative"). The Special Representative shall be authorised to represent the Holders (for this purpose as defined in the Guarantee) to enforce their statutory rights (if any) as limited partners including provision of information on the affairs of the Issuer; however, it has no rights in addition to those held by Holders and, for the avoidance of doubt, the Special Representative shall have no authority hereby to participate in the management of the Issuer or to bind the Issuer or Holders, or any of them. The Special Representative shall not, by virtue only of acting in such capacity, be admitted or authorised to act as a general partner in relation to 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 such capacity.

Not later than 30 days after such entitlement arises, if the written notice of the Holders of outstanding Preferred Securities in the circumstances described in the preceding paragraph has not been given as provided for in the preceding paragraph, the General Partner will convene a separate general meeting for the above purpose. If the General Partner fails to convene such meeting within such 30 day period, the Holders of 10 per cent. by Liquidation Preference of the Preferred Securities will be entitled to convene such meeting for the above purpose. The Limited Partnership Agreement contains provisions concerning the convening and conduct of meetings of Holders. Any Special Representative so appointed shall vacate office, if for four consecutive Distribution Periods, Distributions and any Additional Amounts in respect of such Distributions have resumed with payment in full on the Preferred Securities by the Issuer and/or HBOS has made payment of all amounts in respect of such Distributions and any Additional Amounts in respect thereof (or an amount equivalent to the Distributions to be paid in respect of the next four 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 simple majority in Liquidation Preference of the outstanding Preferred Securities or the sanction of a resolution, passed by Holders of at least a simple majority in Liquidation Preference of the Preferred Securities present or represented at a separate meeting at which the quorum shall be Holders present or represented holding at least one-third in Liquidation Preference of the outstanding Preferred Securities, shall be required in order to give effect

to any variation or abrogation of the rights, preferences and privileges of the Preferred Securities by way of amendment of the Limited Partnership Agreement or otherwise (including, without limitation, the authorisation or creation of any securities or ownership interests of the Issuer ranking, as to participation in the profits or assets of the Issuer, senior to the Preferred Securities or the approval of the exchange or substitution of the Preferred Securities and/or the Notes for obligations or securities of another entity) (unless otherwise required by applicable law). Notwithstanding the foregoing, the General Partner may, without such consent in writing or such sanction amend the Limited Partnership Agreement (including the rights, preferences and privileges of the Preferred Securities) if, as determined by the General Partner, the proposed amendment is solely of a formal, minor or technical nature or is to correct an error or cure an ambiguity, provided that the proposed amendment does not reduce the amounts payable to Holders, impose any obligation on the Holders or adversely affect their voting rights or any modification of the terms of the Preferred Securities pursuant to paragraph 8.4.

- 8.4 Notwithstanding the foregoing, provided that the four most recent Distributions have been paid in full by the Issuer (or HBOS pursuant to the Guarantee) (or an amount equivalent to the Distributions to be paid in respect of the next four Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), the General Partner may, without the consent or sanction of the Holders, take such action as is required in order to amend the Limited Partnership Agreement to allow an increase in the level of the Preferred Capital Contributions and the corresponding number of Preferred Securities.

Thereafter the Issuer may, provided that the circumstances for non-payment of Distributions in paragraph 2.3 are not subsisting, without the consent of the Holders issue any such further securities having the same terms and conditions as the Preferred Securities in all respects (or in all respects except for the first payment of Distributions on them) and so that such further issue shall be consolidated and form a single series with the Preferred Securities. References herein to the Preferred Securities include (unless the context requires otherwise) any other securities issued pursuant to this paragraph and forming a single series with the Preferred Securities.

- 8.5 Notwithstanding the foregoing, no vote of the Holders will be required for the redemption, cancellation or substitution of the Preferred Securities or withdrawal of a Holder in accordance with the Limited Partnership Agreement.
- 8.6 Subject to the Law, the Issuer may not be voluntarily dissolved by the General Partner or the holder of the Preferential Right whilst any Preferred Security is outstanding, unless the General Partner and a majority of the Holders have approved such resolution. Such approval shall not be required if the dissolution of the Issuer is proposed or initiated because of the liquidation, dissolution or winding-up of HBOS or the General Partner.
- 8.7 Any Preferred Security outstanding at such time that is owned by HBOS, or any entity of which HBOS, either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests, shall not carry a right to vote in a meeting of Holders or at any meeting called to vote for the election of a Special Representative pursuant to paragraph 8.2 and shall, for voting purposes, be treated as if it were not outstanding other than in the case of paragraph 8.6 above.
- 8.8 The General Partner will cause a notice of any meeting at which Holders are entitled to vote and any 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 Covenants of the General Partner**

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

## **10 Notices**

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

The Preferred Securities will be in registered form each in an amount equal to the Liquidation Preference. On or about the Closing Date, a single global certificate (the “Global Certificate”) representing the Preferred Securities will be deposited with Citibank, N.A. (the “Common Depository”) as common depository for Euroclear and Clearstream, Luxembourg. The Global Certificate will be registered in the name of Citivic Nominees Limited, as nominee for the Common Depository. For so long as the Preferred Securities are deposited and registered as described above, book-entry interests in the Preferred Securities will be shown on, and transfers of such interests will be effected only through, records maintained by Euroclear and Clearstream, Luxembourg.

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

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

## **12 Replacement of Certificates**

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

## **13 Prescription**

Claims against the Issuer for payment of Distributions and sums in respect of the Optional Redemption Price or Liquidation Distribution of the Preferred Securities will be prescribed in accordance with Jersey law unless made within 10 years from the date on which such payment becomes due or, if later, the date on which the Issuer makes such payment available to Holders.

## **14 Governing Law**

The Limited Partnership Agreement and the Preferred Securities shall be governed by, and construed in accordance with, Jersey law and each of the General Partner, the Initial Preferential Limited Partner, HBOS and the Initial Holder has, in the Limited Partnership Agreement, irrevocably submitted to the non-exclusive jurisdiction of the courts of Jersey to settle any disputes arising out of the Limited Partnership Agreement

and the Preferred Securities. However, determinations in respect of amounts of Adjusted Distributable Reserves shall be construed in accordance with Scots law.

The Guarantee shall be governed by English law and HBOS has, in the Guarantee, irrevocably submitted to the non-exclusive jurisdiction of the courts of England to settle any disputes arising out of the Guarantee.

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

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

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

### **Exchange**

If (a) either or both of Euroclear and Clearstream, Luxembourg is or are closed for business for a continuous period of 14 days (other than for the purposes of a public holiday) or announces an intention permanently to cease business or does in fact so cease business or (b) as a result of a change in law, transfer duties or similar taxes become payable on transfers of the Preferred Securities in Euroclear and/or Clearstream, Luxembourg, a number of Preferred Securities corresponding to its book-entry interest in the Preferred Securities represented by the Global Certificate will, subject to such reasonable requirements as the General Partner may require, be transferred to each holder of an interest in the Preferred Securities whose name is notified by the common depository to the Registrar. Each such holder will be registered as a Holder of the Preferred Securities in the Register maintained by or on behalf of the Issuer and will receive a certificate made out in its name.

### **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 Certificate 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” below, the persons shown in the records of Euroclear, Clearstream, Luxembourg or any other clearing system as the holders of the Preferred Securities evidenced by the Global Certificate (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.

### **Payment**

Each Accountholder must look solely to Euroclear or Clearstream, Luxembourg, 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 Certificate, subject to and in accordance with the respective rules and procedures of Euroclear or Clearstream, Luxembourg, 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 the Global Certificate 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 or Clearstream, Luxembourg, as the case may be.

## SUBORDINATED GUARANTEE

The following is the Guarantee substantially in the form to be executed by HBOS.

THIS DEED OF GUARANTEE (the "Guarantee"), dated 21 March 2003, is executed and delivered by HBOS plc ("HBOS") for the benefit of the Holders (as defined below).

WHEREAS:

- (i) HBOS 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 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 HBOS 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 shares of HBOS (whether or not HBOS could in fact have issued such securities)

NOW, THEREFORE HBOS 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 (as defined below) and the following terms shall, unless the context otherwise requires, have the following meanings:

"Guaranteed Payments" means (without duplication) collectively (i) all Distributions due on the Preferred Securities, (ii) any Liquidation Distribution to which Holders are entitled, (iii) the Optional 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 (or of a nominee for 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 HBOS Capital Funding No. 1 L.P.;

"Partnership Agreement" means the Limited Partnership Agreement dated 19 March 2003 establishing the Issuer as amended from time to time; and

"Preferred Securities" means the U.S.\$1,000,000,000 6.85 per cent. Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities outstanding of the Issuer, including any further Preferred Securities of the same series, 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, HBOS 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 HBOS under this Guarantee are subordinated to the claims of the Senior Creditors (as defined in clause 2.3) 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, HBOS will not, save to the extent provided in clause 2.5, be obliged to make any Guaranteed Payment if HBOS 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, HBOS 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:

- (a) to the extent that such payment, together with the amount of any distributions or dividends paid or scheduled to be paid to holders of Parity Securities on the relevant Distribution Payment Date would exceed Adjusted Distributable Reserves on the Distribution Determination Date immediately preceding such Distribution Payment Date; or
  - (b) even if Adjusted Distributable Reserves are sufficient, (i) to the extent that such payment in respect of the Preferred Securities and/or Parity Securities would breach or cause a breach of the U.K. banking capital adequacy requirements then applicable to HBOS on a consolidated basis or (ii) HBOS's board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (i) above is expected to occur in the near term.
- 2.3 Notwithstanding clause 2.1, if, at the time that the Liquidation Distribution is to be paid by HBOS under this Guarantee in respect of any Preferred Securities, proceedings have been commenced for the voluntary or involuntary liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation, payment under this Guarantee of such Liquidation Distribution shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of HBOS had the Preferred Securities and all Parity Securities been the most senior class of preference shares in HBOS with equivalent rights of participation in the capital of HBOS (whether or not HBOS could in fact have issued such securities at such time) and ranked:
- (a) junior to all liabilities of HBOS including subordinated liabilities (in each case other than any liability of HBOS which constitutes Tier 1 Securities or any liability which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to this Guarantee) (“Senior Creditors”);
  - (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with this Guarantee; and
  - (c) senior to Junior Share Capital.
- 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 U.K. or any political sub-division thereof or by any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event, HBOS will, if permitted by the FSA (to the extent such approval is required), 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) (i) 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 U.K. other than being a Holder (or beneficial owner) of a Preferred Security or (ii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive or (iii) who would have been able to avoid such withholding or deduction by presenting the Preferred Securities to another Paying and Transfer Agent in a Member State of the European Union, and except that HBOS'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 HBOS in respect of any such unpaid balance shall lapse.
- 2.6 HBOS hereby waives notice of acceptance of this Guarantee and of any liability to which it applies or may apply, presentment, demand for payment, protest, notice of non-payment, notice of dishonour, notice of redemption and all other notices and demands.



- 2.7 The obligations, covenants, agreements and duties of HBOS under this Guarantee shall in no way be affected or impaired by reason of the happening from time to time of any of the following:
- (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;
  - (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 Liquidation 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;
  - (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;
  - (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;
  - (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, HBOS 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 HBOS have been discharged in full. HBOS hereby acknowledges the right of every Holder to the production of, and the right of every Holder to obtain a copy of, this Guarantee from the Registrar.
- 2.9 A Holder may enforce this Guarantee directly against HBOS, and HBOS waives any right or remedy to require that any action be brought against the Issuer or any other person or entity before proceeding against HBOS. 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. HBOS agrees that this Guarantee shall not be discharged except by complete performance of all obligations of HBOS under this Guarantee.
- 2.10 HBOS 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 HBOS under this Guarantee. HBOS shall not (except to the extent required by mandatory provisions of law) exercise any rights which it may acquire by way of subrogation or any indemnity, reimbursement or other agreement, in all cases as a result of a payment under this Guarantee, if, at the time of any such payment, any amounts are due and unpaid under this Guarantee. If HBOS shall receive or be paid any amount with respect to the Preferred Securities in violation of the preceding sentence, HBOS agrees to pay over such amount to the Holders.
- 2.11 HBOS acknowledges that its obligations hereunder are several and independent of the obligations of the Issuer with respect to the Preferred Securities and that HBOS 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, HBOS agrees that its obligations hereunder constitute unsecured obligations of HBOS and Holders will at all times rank (a) junior to all Senior Creditors, (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with this Guarantee and (c) senior to Junior Share Capital.
- 2.13 Following a breach by HBOS of its payment obligations under this Guarantee, a Holder may petition for the winding-up of HBOS and claim in the liquidation of HBOS but no other remedy shall be available to the Holder.
- 2.14 No Holder shall following any breach by HBOS of any of its obligations under this Guarantee be entitled to exercise any right of set-off or counterclaim which may be available to it against amounts

owing by HBOS to such Holder. Notwithstanding the provisions of the foregoing sentence, if any of the said rights and claims of any Holder against HBOS is discharged by set-off, such Holder will immediately pay an amount equal to the amount of such discharge to HBOS or, in the event of its winding-up, the liquidator of HBOS and until such time as payment is made will hold a sum equal to such amount in trust for HBOS, or the liquidator of HBOS and accordingly any such discharge will be deemed not to have taken place.

- 2.15 In the event of the winding-up of HBOS if any payment or distribution of assets of HBOS 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 HBOS 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 liquidator of HBOS and in that event the receipt by the 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 HBOS undertakes that it will not issue any preferred securities or preference shares or other Tier 1 Securities ranking senior to its obligations under this Guarantee or enter into any support agreement or give any guarantee in respect of any Preferred Securities or preference shares or other Tier 1 Securities issued by any Subsidiary or other entity if such support agreement or guarantee would rank senior to this Guarantee (including, without limitation, any guarantee that would provide a priority of payment with respect to Adjusted Distributable Reserves) unless, in each case, (a) this Guarantee is changed to give the Holders such rights and entitlements as are contained in or attached to such Preferred Securities or preference shares or other securities or such other support agreement or guarantee so that this Guarantee ranks *pari passu* with, and contains substantially equivalent rights of priority as to payment on, any such preferred securities, preference shares, Tier 1 Securities or such other support agreement or guarantee and (b) the four most recent payments of Distributions on the Preferred Securities have been made in full either by the Issuer or by HBOS pursuant to this Guarantee.
- 3.2 HBOS undertakes that, in the event that any Distribution is not paid in full to Holders in accordance with the rights attaching to the Preferred Securities in accordance with the Partnership Agreement, HBOS will not (a) declare or pay any distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any Junior Share Capital, until after the fourth consecutive following Distribution Payment Date on which a Distribution is paid in full (or an amount equivalent to the distributions to be paid in respect of the next four 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 Securities or Junior Share Capital until after the fourth consecutive following Distribution Payment 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 four Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).
- 3.3 HBOS undertakes that, so long as any of the Preferred Securities is outstanding (a) unless HBOS is itself being 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) HBOS has sufficient Adjusted Distributable Reserves or (B) HBOS has proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidation Distribution (in either of cases (ii)(A) or (B) in an amount at least equal to the aggregate Liquidation Distribution) and (b) the General Partner will at all times be a directly or indirectly wholly owned subsidiary of HBOS, unless in the case of (a) or (b), otherwise approved by a simple majority of the Holders by vote or in writing.
- 3.4 HBOS undertakes that it will not and it will procure that no member of the HBOS Group will, make any payment to Holders, or procure such a payment in respect of the Preferred Securities, that could not lawfully have been made if Holders had held the most senior preference shares of HBOS (if any, and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.

- 3.5 HBOS undertakes to take all reasonable steps to ensure that, with effect from the date of its annual general meeting in 2003 it will at all times have a sufficient number of authorised but unissued Substituted Preference Shares 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. Following the creation of such Substituted Preference Shares and obtaining such corporate authorisations as aforesaid, HBOS further undertakes that (a) it will allot, issue and deliver Substituted Preference Shares in satisfaction of the rights of the Holders in the circumstances and subject to the conditions described in the Limited Partnership Agreement, (b) it will take all reasonable steps to procure that such Substituted Preference Shares 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 U.K. or Jersey arising on the allotment and issue of such Substituted Preference Shares. HBOS undertakes that as soon as practicable after a Substitution Event or the Involuntary Dissolution of the Issuer in circumstances where HBOS is itself not insolvent or in liquidation, or following an election by the General Partner to substitute Substituted Preference Shares following a Capital Disqualification Event as contemplated in the Partnership Agreement it will give written notice to the Holders enclosing a Substitution Confirmation which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of each Paying and Transfer Agent. HBOS undertakes that following such substitution, each Substituted Preference Share allotted will rank for any dividend from the immediately preceding Distribution Payment Date or, if none, the Closing Date and will have no entitlement to any accrued Distributions or any other payment on the Preferred Securities.
- 3.6 HBOS will procure that the General Partner will maintain at all times whilst the Preferred Securities are outstanding (a) whilst the Preferred Securities are listed on the Luxembourg Stock Exchange, a Paying and Transfer Agent in Luxembourg, (b) a Registrar having its office outside the U.K. and (c) a Paying and Transfer Agent having a specified office in a European Union Member State (if available) that will not be obliged to withhold or deduct tax pursuant to any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive.

#### **4 Termination**

With respect to the Preferred Securities, this Guarantee shall terminate and be of no further force and effect upon payment of the Optional Redemption Price on, or purchase and cancellation of, all Preferred Securities or full payment of the Liquidation Distribution or upon the issue and allotment of the Substituted Preference Shares, 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 or if the Substituted Preference Shares have not been validly issued and allotted.

#### **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 HBOS and shall inure to the benefit of the Holders. HBOS shall not transfer its obligations hereunder without the prior approval of the Holders of not less than a simple majority in Liquidation Preference of the outstanding Preferred Securities (excluding any Preferred Securities held by HBOS or any entity of which HBOS, either directly or indirectly, owns 20 per cent. or more of the voting shares or similar ownership interests), which approval shall be obtained in accordance with procedures contained in Part A of Schedule 3 to the Limited Partnership Agreement and applicable law of Jersey.
- 5.2 Except for those changes (a) required by clause 3.1 hereof; or (b) which do not adversely affect the rights of Holders (in any of which cases no agreement will be required), this Guarantee shall be changed only by agreement in writing signed by HBOS with the prior approval of the Holders of not less than a simple majority in Liquidation Preference of the outstanding Preferred Securities (excluding any Preferred Securities held by HBOS or any entity of which HBOS, either directly or indirectly, owns 20 per cent. or more of the voting shares or other similar ownership interests), which approval shall be obtained in accordance with the procedures contained in Part A of Schedule 3 to the Limited Partnership Agreement and applicable law of Jersey.

- 5.3 Any notice, request or other communication required or permitted to be given hereunder to HBOS shall be given in writing by delivering the same against receipt therefor or be addressed to HBOS, as follows, to:

HBOS plc  
The Mound  
Edinburgh  
EH1 1YZ

Attention: Company Secretary  
Telephone: 0131 442 7777  
Facsimile: 0131 243 5516

The address of HBOS may be changed at any time and from time to time and shall be the most recent such address furnished in writing by HBOS to the registrar for the Preferred Securities.

Any notice, request or other communication required or permitted to be given hereunder to the Holders shall be given by HBOS in the same manner as notices sent on behalf of HBOS Capital Funding No. 1 L.P. 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 HBOS will furnish any Holder, upon request of such Holder, with a copy of its annual report, and any interim reports made generally available by HBOS to holders of the ordinary shares of HBOS.

## **6 Governing Law**

This Guarantee shall be governed by, and construed in accordance with, English law and HBOS irrevocably submits to the non-exclusive jurisdiction of the courts of England to settle any disputes arising out of this Guarantee. HBOS irrevocably agrees that service of process in England may be made upon it at HBOS Treasury Services plc, 33 Old Broad Street, London EC2N 1HZ (Attention: Legal and Regulatory Risk).

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

Executed as a deed by  
HBOS plc

Acting by

Director

Director/Secretary

## 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 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 absolute beneficial owners of their Preferred Securities and may not apply to certain classes of persons such as the Managers. 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 HBOS Capital Funding No. 1 L.P. is a Jersey limited partnership and not a legal entity separate from its partners.

### 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.

### U.K. Taxation

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

##### *Classification of HBOS Capital Funding No. 1 L.P.*

HBOS has been advised that the Issuer should be classified as a partnership (and not as a unit trust scheme or offshore fund) for U.K. tax purposes. Accordingly, Holders who are U.K. resident, or in the case of individuals, ordinarily resident in the U.K. for tax purposes should, broadly, be subject to U.K. taxation as if they are partners in the Issuer and 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 an "offshore fund". 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. investors who are in any doubt as to their tax position in respect of the Preferred Securities (or on exchange of Preferred Securities for Substituted Preference Shares) are strongly recommended to take independent professional advice.

##### *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. Corporate Investors*

###### *(a) For accounting periods commencing before 1 October 2002*

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. Under this Statement of Practice U.K. corporate holders should be treated, broadly speaking, as being entitled for the purposes of the "loan relationship" rules in the Finance Act 1996 to their appropriate share of the debits and credits arising in respect of the Issuer's ownership of the Notes, other than such debits and credits arising to the Issuer in respect of foreign exchange gains and losses relative to the Issuer's functional currency for U.K. tax purposes (US dollars), which will instead be treated as apportioned to such holders for the purposes of the "foreign exchange gains and losses" rules in the

Finance Act 1993. Such holders would also be liable to tax as income under the same rules on profits arising to them on transfer or redemption of their Preferred Securities. 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 or offshore fund, then holders within the charge to corporation tax would be treated as if their holding in the Issuer were itself a loan relationship in respect of which they were obliged to use an authorised mark to market basis of accounting.

*(b) For accounting periods of holders commencing on or after 1 October 2002*

On the basis that the Issuer is treated for U.K. tax purposes as a partnership, U.K. tax-resident corporate holders of Preferred Securities should be treated as being entitled to, for the purposes of the “loan relationship” rules in the Finance Act 1996, an appropriate share of the total debits and credits (including those in respect of foreign exchange gains and losses) arising in respect of the Issuer’s ownership of Notes. Such holders would also be liable to tax as income under the same rules on profits arising to them on transfer or redemption of their Preferred Securities. U.K. resident corporate holders are required to use an authorised accruals basis of accounting in determining the debits and credits to be so brought into account, except where such a holder accounts on an authorised mark to market basis of accounting in relation, for the purposes of the loan relationship regime, to its interest in the Issuer and the use of a mark to market basis of accounting is not otherwise prohibited.

If the Issuer were classified as a unit trust or offshore fund the position for holders within the charge to corporation tax would be unchanged from that obtaining in accounting periods of such holders commencing before 1 October 2002.

***U.K. Investment Trusts***

*(a) For accounting periods of such holders commencing before 1 October 2002*

The U.K. tax position for such holders in such periods is the same as for other holders within the charge to corporation tax in such periods, except that no debits and credits in respect of foreign exchange gains and losses should be apportioned to such investors for the purposes of the foreign exchange gains and losses rules in the Finance Act 1993.

*(b) For accounting periods of such holders commencing on or after 1 October 2002*

The U.K. tax position for such holders in such periods is the same as for other holders within the charge to corporation tax in such periods, except that no debits and credits will be apportioned to such holders for the purposes of the U.K. loan relationship provisions to the extent they are carried to or sustained by a capital reserve in accordance with the Statement of Recommended Accounting practice relating to Investment Trusts issued by the Association of Investment Trust Companies in December 1995, as it or any subsequent Statement of Recommended Accounting practice replacing it is modified, revised or amended from time to time.

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

*(a) For accounting period commencing before 1 October 2002*

Whether the Issuer is classified as a partnership, unit trust scheme or offshore fund, U.K. 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 HBOS) 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.

*(b) For accounting periods of holders commencing on or after 1 October 2002*

The U.K. tax position for such holders in such periods is the same as for holders within the charge to corporation tax in such periods, except that no debits and credits will be apportioned to such holders for the purposes of the U.K. loan relationship provisions to the extent they fall to be dealt with under either (a) the heading “net gains/losses on investments during the period” or (b) the heading “other

gains/losses” in either case in the statement of total return for the accounting period in accordance with the Statement of Recommended Accounting practice relating to Authorised Unit Trust Schemes issued by the Investment Management Regulatory Organisation Limited in January 1997, as it or any subsequent Statement of Recommended Accounting practice replacing it is modified, revised or amended from time to time.

### ***U.K. Individuals***

If the Issuer is classified as a partnership, an individual resident in the U.K. 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 Notes held by the Issuer. The Notes are not qualifying corporate bonds and accordingly, a disposal of Preferred Securities by a holder resident or ordinarily resident for tax purposes in the U.K. or who carries on a trade, profession or vocation in the U.K. through a branch or agency to which the Preferred Security is attributable may give rise to a chargeable gain or allowable loss for the purposes of taxation of capital gains. In calculating any gain or loss on disposal of a Preferred Security, sterling values are compared at acquisition and transfer. Accordingly, a taxable profit can arise even where the foreign currency amount received on a disposal is less than or the same as the amount paid for the Preferred Security. 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.

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

Payments of Distributions on Preferred Securities may be made without withholding for or on account of UK taxation.

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

No UK stamp duty will be chargeable in respect of the issue of the Preferred Securities to a Holder. Transfers of the Preferred Securities within a clearing system should not be chargeable to UK stamp duty unless such transfer is effected by means of a written instrument.

No liability to SDRT should arise in respect of the issue or subsequent transfer of the Preferred Securities.

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

On 21 January 2003, the European Commission published revised proposals for a draft directive to ensure effective taxation of savings income in the form of interest payments within the European Community. Subject to a number of important conditions being met, it is proposed that Member States will be required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State, subject to Belgium, Luxembourg and Austria instead operating a withholding system for a transitional period in relation to such payments. The Directive is not yet final and may be subject to further amendment and/or clarification.

## SUBSCRIPTION AND SALE

Pursuant to a Subscription Agreement (the "Subscription Agreement") dated 19 March 2003, J.P. Morgan Securities Ltd., Lehman Brothers International (Europe), BNP Paribas, Credit Suisse First Boston (Europe) Limited, Salomon Brothers International Limited and UBS Limited (the "Managers") have jointly and severally agreed to subscribe for the Preferred Securities at a price of U.S.\$1,000 per Preferred Security. The Managers will receive a combined management and underwriting commission of U.S.\$5 per Preferred Security and a selling commission of U.S.\$15 per Preferred Security. In addition, the Managers shall be reimbursed for certain of their expenses in connection with the issue of the Preferred Securities. The Managers are entitled to terminate the Subscription Agreement in certain circumstances before the issue of the Preferred Securities.

### United Kingdom.

Each Manager has represented, warranted and agreed that:

- (a) it has not offered or sold and, prior to the expiry of six months from the Closing Date, will not offer or sell, any Preferred Securities to persons in the U.K. 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 U.K. within the meaning of the Public Offers of Securities Regulations 1995;
- (b) it has complied and will comply with all applicable provisions of the Financial Services and Markets Act 2000 (the "FSMA") with respect to anything done by it in relation to the Preferred Securities in, from or otherwise involving the U.K.;
- (c) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of such Preferred Securities in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or HBOS;
- (d) it has only offered or sold and will only offer or sell Preferred Securities to (a) investment professionals falling within article 14(5) of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "Promotion of CIS Order") and article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the "Financial Promotion Order"), who have professional experience of participating in unregulated schemes and of matters relating to investments, or (b) persons falling within article 22(2) of the Promotion of CIS Order and article 49(2) of the Financial Promotion Order; and
- (e) it has in place and will have in place proper systems and procedures to prevent any person other than those persons described in (c) above from participating in the Preferred Securities.

### United States

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

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Preferred Securities, (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, within the United States or to, or for the account or benefit of, U.S. persons and it will have sent to each dealer to which it sells any Preferred Security during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Preferred Securities within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of the Preferred Securities within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

### Singapore

Each Manager has acknowledged that this Offering Circular has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, each Manager has severally represented and agreed that it will not offer or sell the Preferred Securities, nor will it make the Preferred Securities the subject of an invitation for



subscription or purchase, nor will it circulate or distribute this Offering Circular or any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Preferred Securities, whether directly or indirectly, to the public or any member of the public in Singapore other than (a) to an institutional investor or other person specified in Section 274 of the Securities and Futures Act 2001 of Singapore (the “Singapore Securities and Futures Act”), (b) to a sophisticated investor, and in accordance with the conditions specified in Section 275 of the Singapore Securities and Futures Act or (c) otherwise pursuant to, and in accordance with the conditions of, any other applicable provisions of the Singapore Securities and Futures Act.

### **Hong Kong**

Each Manager has represented and agreed that, unless it is a person permitted to do so under the securities laws of Hong Kong, it has not issued, or had in its possession for the purposes of issue, and will not issue, or have in its possession for the purposes of issue, any advertisement, invitation or document relating to the Preferred Securities other than with respect to Preferred Securities intended to be disposed of to persons outside Hong Kong or to be disposed of in Hong Kong only to persons whose business involves the acquisition, disposal or holding of securities, whether as principal or agent.

### **General**

No action has been or will be taken by the General Partner, the Issuer, HBOS or any of the Managers that would permit a public offering of the Preferred Securities, or the possession or distribution of this Offering Circular, or any amendment or supplement thereto, or any other offering material relating to the Preferred Securities, in any country or jurisdiction where action for that purpose is required. Accordingly, the Preferred Securities may not be offered or sold, directly or indirectly, and neither this Offering Circular nor any other offering material may be distributed or published, in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

## 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 the Preferred Securities will be expressed in U.S. dollars as a percentage of the liquidation preference of U.S.\$1,000 per Preferred Security. The Preferred Securities will be considered as debt securities for the purpose of the Luxembourg Stock Exchange Rules and Regulations. At the date hereof, it is not intended to list the Preferred Securities on any other stock exchange.

In connection with the application to list the Preferred Securities on the Luxembourg Stock Exchange, a legal notice relating to their issue will be filed, together with copies of the Limited Partnership Agreement, with the Chief Registrar of the District Court in Luxembourg ("*Greffier en Chef du Tribunal d'Arrondissement de et à 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 Limited Partnership Agreement to establish HBOS Capital Funding No. 1 L.P. has been duly authorised by a resolution of the Board of Directors of the General Partner passed on 18 March 2003.

The entering into of the Limited Partnership Agreement and the Guarantee and the issue of the Notes by HBOS was authorised by a resolution of a duly authorised committee of the Board of Directors of HBOS passed on 13 March 2003.

All consents, approvals, authorisations or other orders of all regulatory authorities required by HBOS Capital Funding No. 1 L.P. and/or HBOS under the laws of Jersey and the U.K. have been given for the issue of the Preferred Securities and for HBOS Capital Funding No. 1 L.P., the General Partner and HBOS, as the case may be, to undertake and perform their respective obligations as appropriate under the Limited Partnership Agreement, the Subscription Agreement, the Agency Agreement, the Preferred Securities, the Notes and the Guarantee.

### 3 Clearing

The Preferred Securities have been accepted for clearance through Euroclear and Clearstream, Luxembourg, with a common code of 16548316. The International Securities Identification Number for the Preferred Securities is XS0165483164.

### 4 No Material Change

Save as described or incorporated by reference herein, there has been no significant change in the financial or trading position of HBOS or the HBOS Group since 31 December 2002 or of the Issuer since the date of its establishment and no material adverse change in the financial position or prospects of HBOS or the HBOS Group since 31 December 2002 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 (c) and (d) for collection (free of charge) from) the offices of the Paying and Transfer Agents and at the registered offices of the Issuer and HBOS during normal business hours for so long as the Preferred Securities are outstanding:

- (a) the Limited Partnership Agreement;
- (b) the Memorandum and Articles of Association of HBOS;
- (c) the accounts incorporated herein by reference (see "Documents Incorporated by Reference");
- (d) the consents and authorisations referred to in paragraph 2 above;
- (e) the Guarantee;

- (f) the Agency Agreement; and
- (g) 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 semi-annual interim financial statements of HBOS, and the most recently published non-consolidated audited annual accounts of the Issuer, will be available at the offices of the Paying and Transfer Agents. HBOS does not intend to publish non-consolidated annual financial statements or non-consolidated interim financial statements. The first accounts of the Issuer are expected to be prepared for the period ending on 31 December 2003. Thereafter, the Issuer intends to publish annual accounts. The Issuer does not intend to publish any interim accounts.

## **6 Litigation**

Neither the Issuer nor HBOS nor any member of the HBOS Group is involved in any litigation or arbitration proceedings relating to claims or amounts that are material in the context of the issue of the Preferred Securities nor so far as the Issuer or HBOS is aware is any such litigation or arbitration pending or threatened which may have a significant effect on the financial position of the Issuer, HBOS or the HBOS Group.

## **7 Auditors**

The auditor of HBOS is KPMG Audit Plc, registered auditors. The financial information set out in this Offering Circular does not constitute statutory accounts within the meaning of section 240(5) of the Companies Act 1985. The audited consolidated accounts of HBOS for the two years ended 31 December 2002, the audited consolidated accounts of Halifax Group for the year ended 31 December 2000 and the audited consolidated accounts of Bank of Scotland for the year ended 28 February 2001 were audited by KPMG Audit Plc. KPMG Audit Plc made reports under section 235 of the Companies Act 1985 on the accounts of HBOS for the two years ended 31 December 2002, the accounts of Halifax Group for the year ended 31 December 2000 and the accounts of Bank of Scotland for the year ended 28 February 2001 which were unqualified and did not include a statement under section 237(2) or (3) of the Companies Act 1985 and which were delivered to the Registrar of Companies in Scotland (in the case of HBOS) and to the Registrar of Companies in England & Wales (in the case of Halifax Group).

No accounts of the Issuer have yet been audited. KPMG, registered auditors, has been appointed as auditor of the Issuer in Jersey.

## **8 Notices**

Notices to the holders of Preferred Securities, including notices for meetings of holders of the Preferred Securities and payments of distributions or other amounts in relation to the Preferred Securities will be mailed to the holder of record and 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*). 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.

## **9 Articles of Association — Additional Preference Shares**

The Articles of Association of HBOS restrict the circumstances in which HBOS can issue preference shares (“Additional Preference Shares”) which rank *pari passu* with the Existing Preference Shares and other Priority Preference Shares (each as defined herein under “Summary of the Offering”) (see also “Investment Considerations — Substitution”). Article 4.7 provides that no such Additional Preference Shares may be issued unless (i) at the time of such proposed issue the Auditors (as defined therein) have reported that immediately following such issue the aggregate nominal amount of the Additional Preference Shares to be issued, when added to the aggregate nominal amount of the Priority Preference Shares for the time being in issue, will not exceed an amount equal to 25 per cent. of the Adjusted Capital and Reserves; and (ii) the average of the profit after taxation and before extraordinary items and dividends on an annualised basis for the most recent three accounting reference periods of HBOS to have ended prior to the date of such issue for each such period exceeds four and one half times the aggregate annual amount of the dividends (exclusive of

any imputed tax credit available to shareholders) payable in the then current accounting reference period on the whole of the issued share capital of HBOS which has priority to or ranks equally with the Priority Preference Shares (including any such share capital then being issued). For these purposes, the “Adjusted Capital and Reserves” means the aggregate from time to time of the amount paid up or credited as paid up on the issued share capital of HBOS and the amount standing to the credit of reserve accounts, including any share premium account and revaluation reserve and any credit balance on the profit and loss account all as shown in the balance sheet from the then latest accounts but after: (i) deducting from the aggregate any debit balance on the profit and loss account subsisting at the date of the accounts; (ii) deducting any amount referable to goodwill (arising other than on consolidation) or any other intangible asset; (iii) deducting an amount equal to any distribution (other than distributions to any member of the HBOS Group) out of the profits accrued prior to the date of the accounts; (iv) excluding any sums set aside for future taxation; (v) excluding any amounts attributable to outside interests in subsidiaries; (vi) making such adjustments as may be appropriate to reflect any variation in the amount of the paid up share capital or share premium account since the date of the accounts; and (vii) making such adjustments as may be appropriate to reflect the issue of the Additional Preference Shares then to be issued.

## SUMMARY FINANCIAL INFORMATION

The following tables provide summary audited consolidated financial information for HBOS. Such information has been derived without material adjustment from the audited consolidated accounts of HBOS for the year ended 31 December 2002.

### Consolidated Profit and Loss Account

	For the year ended 31 December 2002 <i>(£ millions)</i>	For the year ended 31 December 2001 <i>(£ millions)</i>
Net interest income .....	4,770	4,155
Non-interest income .....	2,776	2,379
Net operating income .....	7,546	6,534
Operating expenses .....	(3,762)	(3,505)
General insurance claims .....	(79)	(68)
Provisions for bad and doubtful debts .....	(832)	(608)
Amounts written off fixed asset investments .....	(24)	(21)
Operating profit .....	2,849	2,332
Before exceptional items .....	3,002	2,479
Exceptional items .....	(153)	(147)
Share of operating profits of associated undertakings and joint ventures ..	35	36
Profit on disposal of business .....	25	
Merger costs — exceptional .....		(76)
Profit on ordinary activities before taxation .....	2,909	2,292
Before exceptional items .....	3,062	2,515
Exceptional items .....	(153)	(223)
Tax on profit on ordinary activities .....	(835)	(663)
Profit on ordinary activities after taxation .....	2,074	1,629
Before exceptional items .....	2,186	1,811
Exceptional items .....	(112)	(182)
Minority interests (equity and non-equity) .....	(158)	(161)
Profit attributable to shareholders .....	1,916	1,468
Dividends		
Ordinary .....	1,140	993
Preference .....	37	37
Retained Profit .....	739	438
Underlying earnings per share .....	56.1p	47.7p
Basic earnings per share .....	50.6p	40.5p
Diluted earnings per share .....	50.2p	40.1p

## Consolidated Balance Sheet

	As at 31 December 2002		As at December 2001	
	<u>(£ millions)</u>	<u>(£ millions)</u>	<u>(£ millions)</u>	<u>(£ millions)</u>
<b>Total assets</b> . . . . .		<b>355,080</b>		<b>312,071</b>
<b>Liabilities</b>				
Other borrowings . . . . .		276,629		240,493
Other liabilities . . . . .		16,085		12,546
Dated subordinated liabilities . . . . .		5,690		4,966
Undated subordinated liabilities . . . . .		3,437		2,957
<b>Capital and Reserves</b>				
Preference share capital . . . . .	400		400	
Ordinary share capital . . . . .	946		892	
Share premium account . . . . .	1,292		27	
Other reserves . . . . .	496		492	
Profit and loss account . . . . .	<u>10,635</u>		<u>9,602</u>	
Shareholders' Funds . . . . .		13,769		11,413
Minority interests (equity and non-equity) . . . . .		2,139		2,095
Long-term assurance liabilities attributable to policyholders . . . . .		<u>37,331</u>		<u>37,601</u>
<b>Total liabilities</b>		<b>355,080</b>		<b>312,071</b>

**REGISTERED OFFICE OF THE ISSUER**

22 Grenville Street  
St Helier  
Jersey  
JE4 8PX  
Channel Islands

**REGISTERED OFFICE OF HBOS plc**

The Mound  
Edinburgh  
EH1 1YZ  
United Kingdom

**PAYING AND TRANSFER AGENTS**

**Citibank, N.A.**  
5 Carmelite Street  
London  
EC4Y 0PA  
United Kingdom

**Dexia Banque Internationale à Luxembourg,  
société anonyme**  
69 route d'Esch  
L-1470 Luxembourg

**REGISTRAR**

**Citibank AG**  
Neue Mainzer Strasse 75  
D-60311 Frankfurt am Main  
Germany

**LEGAL ADVISERS**

*To the General Partner  
and HBOS as to English law*

**Linklaters**  
One Silk Street  
London  
EC2Y 8HQ  
United Kingdom

*To the General Partner  
and HBOS as to Scots law*

**Tods Murray WS**  
66 Queen Street  
Edinburgh  
EH2 4NE  
United Kingdom

*To the General Partner  
and HBOS as to Jersey law*

**Mourant du Feu & Jeune**  
22 Grenville Street  
St Helier  
Jersey  
JE4 8PX  
Channel Islands

*To the Managers as to English law*

**Allen & Overy**  
One New Change  
London  
EC4M 9QQ  
United Kingdom

**AUDITORS**

*To the Issuer*

**KPMG**  
45 Esplanade  
St Helier  
Jersey  
JE4 8WQ  
Channel Islands

*To HBOS*

**KPMG Audit Plc**  
Saltire Court  
20 Castle Terrace  
Edinburgh  
EH1 2EG  
United Kingdom

**LISTING AGENT**

**Dexia Banque Internationale à Luxembourg, société anonyme**  
69 route d'Esch  
L-2953 Luxembourg

