



# HBOS Capital Funding No. 4 L.P.

**£750,000,000 Fixed-to-Floating Rate 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: 100 per cent.**

The fixed-to-floating rate non-voting non-cumulative perpetual preferred securities (the "Preferred Securities") each with a liquidation preference of 100 per cent. of the nominal amount of the denomination in which it is issued (the "Liquidation Preference"), comprising limited partnership interests in HBOS Capital Funding No. 4 L.P. (the "Issuer"), are proposed to be issued on 19 March 2008 (the "Closing Date"). The Preferred Securities will entitle investors, subject to certain conditions described herein, to receive non-cumulative distributions ("Distributions") semi-annually in arrear on 19 March and 19 September in each year until 19 March 2018 (the "First Optional Redemption Date"), and thereafter quarterly in arrear on 19 March, 19 June, 19 September and 19 December in each year (each, a "Distribution Payment Date"). Distributions shall accrue from (and including) the Closing Date to (but excluding) the "First Optional Redemption Date", at a fixed rate per annum of 9.54 per cent., and from (and including) the First Optional Redemption Date, at a floating rate per annum equal to the sum of 6.75 per cent. and the three-month Sterling LIBOR (as defined herein) for the relevant Distribution Period (as defined herein). The first Distribution will, if payable, be paid on 19 September 2008. In respect of each Distribution Payment Date falling on or prior to the First Optional Redemption Date, the amount of each Distribution payable in respect of each £50,000 of Preferred Securities shall be £2,385 and in respect of each £1,000 of Preferred Securities shall be £47.70. See "*Description of the Preferred Securities – Distributions*".

The Issuer, as a Jersey limited partnership, is not 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 to be dated the Closing Date (the "Guarantee"), all as more fully described herein under "*Subordinated Guarantee*".

The Preferred Securities will be perpetual and not subject to any mandatory redemption provisions. The Preferred Securities may be redeemed, however, on the First Optional Redemption Date or 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 accrued and unpaid Distribution for the then current Distribution Period to but excluding the redemption date, plus any relevant Additional Amounts (as defined herein) (the "Optional Redemption Price"). The Preferred Securities may also be redeemed 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, an Accounting Event or a Regulatory Event, at the Tax Event Redemption Price, Accounting Event Redemption Price or the Regulatory Event Redemption Price (each as defined herein), respectively, and as more fully described herein under "*Description of the Preferred Securities*". Under the existing requirements of the Financial Services Authority (the "FSA"), neither the Issuer nor HBOS may redeem or purchase any Preferred Securities unless notice has been given to, and no objection has been received from, the FSA and, in certain circumstances, the FSA has given its prior written consent.

The Preferred Securities may, at the option of the General Partner, at any time be substituted by Qualifying Tier 1 Instruments (as defined herein) issued, directly or indirectly, by HBOS (being an "Optional Substitution"). In addition, upon the occurrence of a Mandatory Substitution Event (as defined herein), the General Partner shall take all reasonable steps to cause the Preferred Securities to be substituted by Qualifying Tier 1 Instruments (being a "Mandatory Substitution") in the form of preference shares issued by HBOS (unless other forms of legal instrument are then permitted by the FSA to be issued in substitution, in which case the General Partner may in its absolute discretion elect to effect the relevant substitution with such forms of instrument which are Qualifying Tier 1 Instruments). Where Qualifying Tier 1 Instruments in the form of preference shares are to be issued by HBOS upon a Mandatory Substitution, the terms of the Preferred Securities permit the General Partner in certain circumstances to procure the issue to holders of Preferred Securities (the "Holders"), of economically equivalent Repackaged Instruments (as defined herein) by an entity which is not a member of the HBOS Group (as defined herein) which are secured with first ranking priority on such preference shares of HBOS. See "*Description of the Preferred Securities*" and "*Risk Factors*".

In the event of the dissolution of the Issuer, Holders will be entitled to receive a liquidation distribution 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 held by them, subject as described herein under "*Description of the Preferred Securities*".

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. ("Fitch"). 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.

Application has been made to the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "FSMA") (the "UK Listing Authority") for the Preferred Securities to be admitted to the official list of the UK Listing Authority (the "Official List") and to the London Stock Exchange plc (the "London Stock Exchange") for the Preferred Securities to be admitted to trading on the London Stock Exchange – Regulated Market (the "Market"). References in this Prospectus to Preferred Securities being "listed" (and all related references) shall mean that such Preferred Securities have been admitted to trading on the Market and have been admitted to the Official List. The Market is a regulated market for the purposes of Directive 2004/39/EC of the European Parliament and of the Council on Markets in Financial Instruments of 21 April 2004.

The Preferred Securities will be represented by a single global certificate in registered form (the "Global Certificate") and issued in the denomination of £50,000 and integral multiples of £1,000 thereabove. The Preferred Securities will be registered in the name of a nominee of, and deposited with, a common depositary for Euroclear Bank SA/NV ("Euroclear") and Clearstream Banking, société anonyme, Luxembourg ("Clearstream, Luxembourg"). Preferred Securities issued in definitive certificated form will only be available in certain limited circumstances and will not be issued with a denomination above £99,000. See "*Summary of Provisions relating to the Preferred Securities in Global Form*".

See "*Risk Factors*" for a discussion of certain factors that should be considered by prospective investors.

## MANAGERS

BNP PARIBAS

The Royal Bank of Scotland

UBS Investment Bank

This Prospectus comprises a prospectus for the purposes of Article 5.3 of Directive 2003/71/EC (the “Prospectus Directive”) and for the purpose of giving information with regard to the Issuer, HBOS and the Preferred Securities which, according to the particular nature of the Issuer, HBOS and the Preferred Securities, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer or HBOS and of the rights attaching to the Preferred Securities.

Each of the Issuer, the General Partner and HBOS (the “Responsible Persons”) accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of each of the Responsible Persons (each having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Prospectus is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see “*Documents Incorporated by Reference*” below).

No person is authorised to give any information or to make any representation not contained in this Prospectus and any information or representation not so contained must not be relied upon as having been authorised by or on behalf of the Issuer, the General Partner, HBOS or the Managers. The delivery of this Prospectus at any time does not imply that the information contained in it is correct as at any time subsequent to its date. Neither the delivery of this Prospectus nor any sale made in connection herewith shall, under any circumstances, create any implication that there has been no change in the affairs of the Issuer or HBOS since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that there has been no adverse change in the financial position of the Issuer or HBOS since the date hereof or the date upon which this Prospectus has been most recently amended or supplemented or that any other information supplied in connection with the Preferred Securities is correct as of any time subsequent to the date on which it is supplied or, if different, the date indicated in the document containing the same.

To the fullest extent permitted by law, the Managers accept no responsibility whatsoever for the contents of this Prospectus or for any other statement made or purported to be made by a Manager or on its behalf in connection with the Issuer or HBOS or the issue and offering of the Preferred Securities. Each Manager accordingly disclaims all and any liability, whether arising in tort or contract or otherwise (save as referred to above), which it might otherwise have in respect of this Prospectus or any such statement.

The distribution of this Prospectus and the offering and delivery of the Preferred Securities in certain jurisdictions may be restricted by law. Persons into whose possession the Prospectus comes are required by the General Partner, the Issuer, HBOS and the Managers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of Preferred Securities and on the distribution of this Prospectus and other offering material relating to the Preferred Securities, investors should see “*Subscription and Sale*”. In particular, Preferred Securities have not been and will not be registered under the United States Securities Act of 1933 (as amended). Subject to certain exceptions, Preferred Securities may not be offered, sold or delivered within the United States or to U.S. persons.

This Prospectus may not be used for the purpose of an offer or solicitation by anyone in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

This Prospectus does not constitute an offer or an invitation by or on behalf of the Issuer, HBOS or the Managers to subscribe for or purchase any Preferred Securities and should not be considered as a recommendation by the General Partner, the Issuer, HBOS or the Managers that any recipient of this Prospectus should subscribe for or purchase any Preferred Securities. Each recipient shall be taken to have made its own investigation and appraisal of the financial condition of the General Partner, the Issuer and HBOS. Prospective investors should have regard to the factors described under the section headed “*Risk*

*Factors*” in this Prospectus. This Prospectus does not describe all of the risks of an investment in the Preferred Securities.

The Jersey Financial Services Commission (the “Commission”) has given and has not withdrawn its consent under Article 10 of the Control of Borrowing (Jersey) Order 1958 to the creation by the Issuer of the Preferred Securities. The Commission is protected by the Control of Borrowing (Jersey) Law 1947, as amended, against liability arising from the discharge of its functions under that Law. Potential investors should be aware that, in giving its consent, the Jersey Financial Services Commission does not take any responsibility for the financial soundness of the Issuer or for the correctness of any statements made, or opinions expressed, with regard to it.

Capitalised terms used in this Prospectus and not separately defined shall have the meanings ascribed to them in the “*Description of the Preferred Securities*” below.

Unless otherwise stated, all references in the Prospectus to “€”, “Euro” or “EUR” are to the single currency which was introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended, references to “US dollars”, “U.S.\$”, “\$” or “¢” are to US currency, references to “pounds sterling”, “Sterling”, “£”, “pence” or “p” are to UK currency.

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**IN CONNECTION WITH THE ISSUE OF THE PREFERRED SECURITIES, UBS LIMITED (THE “STABILISING MANAGER”) (OR ANY PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) MAY OVER-ALLOT PREFERRED SECURITIES 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. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE PREFERRED SECURITIES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE PREFERRED SECURITIES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE PREFERRED SECURITIES. ANY STABILISATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE RELEVANT STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF ANY STABILISING MANAGER) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.**

## **Documents Incorporated by Reference**

This Prospectus should be read and construed in conjunction with the audited consolidated annual financial statements of HBOS for the financial years ended 31 December 2006 and 31 December 2007 together in each case with the audit report thereon. These documents shall be deemed to be incorporated in, and form part of this Prospectus, save that any statement contained in a document which is deemed to be incorporated by reference herein shall be deemed to be modified or superseded for the purpose of this Prospectus to the extent that a statement contained herein modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

Copies of documents incorporated by reference in this Prospectus may be obtained at the offices of Tods Murray LLP, Edinburgh Quay, 133 Fountainbridge, Edinburgh EH3 9AG, and are, in addition, available free of charge on or through HBOS’ internet website at [www.hbosplc.com](http://www.hbosplc.com) and on or through the website of the Regulatory News Service operated by the London Stock Exchange at [www.londonstockexchange.com/en-gb/pricesnews/marketnews.htm](http://www.londonstockexchange.com/en-gb/pricesnews/marketnews.htm).

## Overview of the Offering

*This overview must be read as an introduction to this Prospectus. Any decision to invest in the Preferred Securities should be based on a consideration of this Prospectus as a whole, including the documents incorporated by reference, by any investor. Words and expressions defined in “Description of the Preferred Securities” or elsewhere in this Prospectus have the same meaning in this overview.*

- Issuer:** ..... HBOS Capital Funding No. 4 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.
- HBOS:** ..... HBOS plc (“HBOS”) is a public limited company and was incorporated and registered in Scotland on 3 May 2001 under the Companies Act 1985. HBOS is the holding company of the HBOS group, comprising of HBOS and its subsidiaries and subsidiary undertakings (as defined in the Companies Acts) and which includes Bank of Scotland plc as a wholly-owned subsidiary of HBOS (the “HBOS Group”), a diversified financial services group conducting banking, insurance-broking, financial services and finance-related activities for personal and medium and large size corporate customers throughout the UK and internationally.
- 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 and administrator of the Issuer.
- Issue:** ..... £750,000,000 fixed-to-floating rate non-voting non-cumulative perpetual preferred securities (the “Preferred Securities”), each with a liquidation preference of 100 per cent. of the nominal amount of the denomination in which it is issued (the “Liquidation Preference”) comprising limited partnership interests in the Issuer.
- Use of Net Proceeds:** ..... The net proceeds of the issue of the Preferred Securities will be used by the General Partner, on behalf of the Issuer, to subscribe for perpetual subordinated notes (the “Notes”) to be issued by HBOS to augment HBOS’ regulatory capital base.
- Ranking of the Preferred Securities:** The Preferred Securities and Guarantee are intended to provide the Holders, as nearly as possible, with rights in respect of Distributions (as defined below) and the Liquidation Preference equivalent to those to which the Holders would be entitled if they were holders of HBOS’ most senior preference shares.
- Claims under the Preferred Securities in respect of any Liquidation Distributions will rank senior to the rights of the General Partner and any limited partner of the Issuer.
- Risk Factors:** ..... Factors which prospective investors should consider when making an investment decision with respect to the Preferred Securities include the following: HBOS’ business is affected by borrower credit quality, general economic conditions and macro-economic factors including changes in interest rates and capital requirements that could limit its operations and operational risks; payment of Distributions is

discretionary and non-cumulative and may not be made if payments on Parity Securities (as defined below) are not made; although *pari passu* ranking, the terms of the Parity Securities may differ from the Preferred Securities in important respects; the Preferred Securities have no fixed maturity date and are subordinated; HBOS may issue or guarantee *pari passu* ranking securities without limitation; HBOS may for regulatory capital reasons be required to substitute the Preferred Securities with Qualifying Tier 1 Instruments in the form of HBOS preference shares which may in certain circumstances due to provisions of HBOS' Articles of Association be junior preference shares (ranking below the Preferred Securities); UK stamp duty or SDRT may be payable by Holders upon the transfer of Qualifying Tier 1 Instruments in the form of preference shares issued upon a Mandatory Substitution Event if the Holder elects for such preference shares to be held outside of a clearing system; the terms of the Preferred Securities may be amended by a specified majority of Holders; investors may face exposure to fluctuations in exchange rates and interest rates; Preferred Securities may not be suitable investments for all investors; and credit ratings may not reflect all risks.

**Guarantee:** ..... HBOS will irrevocably guarantee on a subordinated basis and to the extent set out in the Guarantee payments due on the Preferred Securities.

The Guarantee will rank (1) junior to all HBOS' liabilities 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 (2) or (3) and any other liability expressed to rank *pari passu* with or junior to the Guarantee), (2) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with HBOS' obligations under the Guarantee and (3) senior to Junior Share Capital.

HBOS will undertake in the Guarantee not to 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 to rank *pari passu* with, and contain substantially equivalent rights of priority as to payment in respect of such preferred securities, preference shares of other Tier 1 Securities or such guarantee.

**Distributions:** ..... The Preferred Securities will entitle Holders to a return (being a "Distribution") at a rate of 9.54 per cent. per annum payable semi-annually in arrear from (and including) 19 March 2008 (the "Closing Date") to (but excluding) 19 March 2018 (the "First Optional Redemption Date"), and thereafter at a rate, reset and payable quarterly in arrear on 19 March, 19 June, 19 September and 19 December of each year (subject to adjustment for days which are not Business Days), of 6.75 per cent. per annum above the then prevailing offered rate for three-month Sterling LIBOR, subject in each case to "*Limitations on Distributions*".



**Limitations on Distributions:** . . . . . Each Distribution will be payable at the General Partner’s sole discretion from the Issuer’s own legally available resources on each Distribution Payment Date.

Distributions will not be cumulative. If the Issuer does not pay Distributions in full and HBOS is not required to pay under the Guarantee, the Holders will have no claim in respect thereof.

**Distribution and Capital Stopper:** . . . . . If any Distribution is not paid in full, HBOS will not (1) declare or pay any distribution or dividend and, where applicable will procure that no distribution or dividend is declared or paid on any Parity Securities (meaning any preference shares, other preferred securities, other securities, limited partnership interests or obligations issued by HBOS and ranking *pari passu* with the Preferred Securities or 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 of HBOS ranking *pari passu* with the Guarantee) where the dividend or distribution in all forms is at the discretion of the directors or equivalent person(s) of the relevant entity), or on any Junior Share Capital (meaning the ordinary shares of HBOS, together with any preference shares, other securities, limited partnership interests or obligations which rank, or are expressed to rank, junior to Parity Securities and the Preferred Securities (except for any series of perpetual preference shares which are issued in satisfaction of an obligation existing on 27 April 2004 (“Excluded Preference Shares”)), or if permitted (2) repurchase or redeem such Parity Securities or Junior Share Capital (except for Excluded Preference Shares), in either case until after the second consecutive following Distribution Payment Date on which Distributions then due in respect of the Preferred Securities are paid in full (or an amount equivalent to the Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to Holders), in the case of a Distribution Period ending on or before the First Optional Redemption Date, or until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount at least equal to the expected Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders and, if upon determination of the amount of each of such Distribution there is a shortfall in the amounts so paid or set aside with reference to the amounts so determined, an amount at least equal to such shortfall shall be paid or irrevocably set aside in the same manner), in the case of a Distribution Period ending after the First Optional Redemption Date.

**Withholding Tax and Additional Amounts:** . . . . . The Issuer (or HBOS, under 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 after any withholding or deduction for any taxes imposed by tax authorities in Jersey (in respect of the Preferred Securities) or the UK (in respect of the Guarantee) upon payments made by or on behalf of the Issuer or HBOS will equal the amount which would



have been received in the absence of any such withholding or deduction, subject to certain exceptions.

**Redemption:** ..... The Preferred Securities will be perpetual and not subject to any mandatory redemption provisions. The Preferred Securities may be redeemed at the General Partner’s option as further set out below, including following the occurrence of a Tax Event, an Accounting Event or a Regulatory Event, but in all cases such redemption is subject to the Redemption Conditions.

**Optional redemption:** ..... The Preferred Securities may be redeemed on the First Optional Redemption Date or any Distribution Payment Date thereafter in whole, but not in part, at the General Partner’s option subject to the Redemption Conditions, at the Optional Redemption Price.

“Optional Redemption Price” means the Liquidation Preference per Preferred Security plus any due and accrued but unpaid Distribution calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date (or if none, the Closing Date) plus any relevant Additional Amounts.

“Redemption Conditions” means (1) the Issuer has notified, and received no objection from, the FSA of its intention to make such redemption at least one month (or such other period, longer or shorter, as the FSA may then require or accept) before the date scheduled for redemption and, if such optional redemption is scheduled to occur before the First Optional Redemption Date or if otherwise required, has obtained the consent of the FSA in the form of a waiver of the restriction on redemption and (2) that HBOS is, at the date of the Issuer notifying the FSA, and will be immediately following the redemption, in compliance with Applicable Regulatory Capital Requirements (except to the extent that the FSA no longer so requires).

“Applicable Regulatory Capital Requirements” means any requirements contained in Capital Regulations for the maintenance of capital from time to time applicable to HBOS on a solo and/or consolidated basis, including transitional rules and waivers.

“Capital Regulations” means at any time the regulations, requirements, guidelines and policies relating to capital adequacy then in effect of the FSA or other relevant regulator.

**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, the Preferred Securities may be redeemed in whole, but not in part, at the General Partner’s option subject to the Redemption Conditions, at the Tax Event Redemption Price.

“Tax Event” means (1) a Change in Law Withholding Tax Event, (2) a Change in Law Tax Event or (3) that, other than as a result of a Change in Law Withholding Tax Event or a Change in Law Tax Event and only after the First Optional Redemption Date unless a FSA waiver is obtained, (A) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or Notes (except, in the case of the General

Partner only, for any such tax that would arise as a result of (a) actual 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 Preferred Securities) in Jersey or the UK or (B) HBOS (or the relevant UK tax resident member of the HBOS Group) would not obtain relief for the purposes of UK corporation tax for any payment of interest in respect of the Notes or payment under the Guarantee (other than payments representing a Liquidation Preference in respect of any Preferred Securities).

“Change in Law Withholding Tax Event” means that, as a result of a change in any law or regulation of the UK or Jersey, or in any treaty to which the UK or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant court or authority entitled to do so (expressly or implicitly), on or after the Closing Date, (1) payments to Holders would be subject to deduction or to withholding tax or would give rise to any obligations of the Issuer or HBOS to account for any tax in Jersey or the UK, or (2) payments by HBOS (or the relevant UK tax resident member of the HBOS Group) in respect of the Notes would be subject to deduction or to withholding tax in the UK.

“Change in Law Tax Event” means that as a result of a change in any law or regulation of the UK or Jersey, or in any treaty to which the UK or Jersey is a party or in the official interpretation or application of any law, regulation or treaty by any relevant court or authority entitled to do so (expressly or implicitly), on or after the Closing Date, (1) 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 UK or (2) HBOS (or the relevant UK tax resident member of the HBOS Group) would not obtain relief for the purposes of UK corporation tax for any payment of interest in respect of the Notes.

“Tax Event Redemption Price” means (1) in relation to any redemption of a Preferred Security pursuant to a Tax Event, other than a Change in Law Withholding Tax Event or a Change in Law Tax Event, prior to the First Optional Redemption Date, the higher of the Optional Redemption Price and the Make Whole Amount, and (2) in relation to any other redemption of a Preferred Security pursuant to a Tax Event (including, for the avoidance of doubt, at any time pursuant to a Change in Law Withholding Tax Event or a Change in Law Tax Event), the Optional Redemption Price.

**Accounting Event Call** . . . . .

If at any time an Accounting Event occurs and is continuing, the Preferred Securities may be redeemed in whole, but not in part, at the option of the General Partner, subject to the Redemption Conditions at the Accounting Event Redemption Price.

“Accounting Event” means that as a result of a change in accounting principles, the obligations under the Preferred Securities must be recorded as a “financial liability” in the next following annual consolidated financial statements of HBOS prepared in accordance with IFRS or any other accounting standards that HBOS may adopt in the future for the preparation of its annual consolidated financial statements in accordance with company law then in effect in the United Kingdom.

“Accounting Event Redemption Price” means (i) in relation to any redemption of a Preferred Security prior to the First Optional Redemption Date, the higher of the Optional Redemption Price and the Make Whole Amount, and (ii) in relation to any redemption of a Preferred Security after the First Optional Redemption Date, the Optional Redemption Price.

**Regulatory Event Call:** . . . . .

If at any time a Regulatory Event occurs and is continuing, the Preferred Securities may be redeemed in whole, but not in part, at the General Partner’s option subject to the Redemption Conditions, at the Regulatory Event Redemption Price.

“Regulatory Event” means the FSA has determined that the Preferred Securities can no longer qualify as Tier 1 Capital.

“Regulatory Event Redemption Price” means (1) in relation to any redemption of a Preferred Security prior to the First Optional Redemption Date, the higher of the Optional Redemption Price and the Make Whole Amount, and (2) in relation to any redemption of a Preferred Security after the First Optional Redemption Date, the Optional Redemption Price.

**Make Whole Amount:** . . . . .

As used in the respective definitions of Tax Event Redemption Price, Accounting Event Redemption Price and Regulatory Event Redemption Price, “Make Whole Amount” means, in respect of each Preferred Security, the price, expressed as a percentage (rounded to four decimal places, 0.00005 being rounded upwards), at which the gross redemption yield (as calculated on the basis set out by the United Kingdom Debt Management Office in the paper Formulae for Calculating Gilt Prices for Yields page 4, Section One: Price Yield Formulae “Conventional Gilts: Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date” (published 8/6/1998 as amended or updated from time to time) on such Preferred Security, if it were to be purchased at such price on the third Business Day prior to the date fixed for redemption, would be equal to the gross redemption yield on such Business Day of £1,000 in principal amount of the Reference Bond plus 1.50 per cent. on the basis of the middle market price of the Reference Bond prevailing at 11.00 a.m. (London time) on such Business Day as determined by an independent investment bank of international repute appointed by the General Partner for such purpose, together with any due and accrued but unpaid Distribution on such Preferred Security calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date (or if none, the Closing Date), plus any Additional Amounts.

“Reference Bond” means such UK government bond with a maturity date as near as possible to the First Optional Redemption

Date as the Calculation Agent may, with the advice of the Reference Market Makers and in consultation with the Issuer, determine to be appropriate.

**Qualifying Tier 1 Instruments**

**Substitution:** .....

The Preferred Securities may be substituted by Qualifying Tier 1 Instruments upon the occurrence of a Mandatory Substitution Event (as defined below) (“Mandatory Substitution”), or following the exercise by the General Partner of its option to make such substitution (“Optional Substitution”), each as further set out below:

**Mandatory Substitution:** If either (A) (i) HBOS’s total capital ratio, calculated on a consolidated basis in accordance with the Applicable Regulatory Capital Requirements, has fallen below the then generally applicable minimum ratio (or ratios if then applicable) required by such requirements; 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 (B) upon the Involuntary Dissolution of the Issuer (in circumstances when HBOS is not itself insolvent or in liquidation) (each event set out in (A) and (B) being a “Mandatory Substitution Event”), the General Partner shall take all reasonable steps to cause the substitution of the Preferred Securities in whole, but not in part, with Qualifying Tier 1 Instruments in the form of preference shares issued by HBOS (save where some other form of legal instrument is then permitted by the FSA to be substituted, in which case the General Partner may in its absolute discretion elect to substitute Preferred Securities with such other form of legal instrument which is a Qualifying Tier 1 Instrument) in an equivalent nominal amount at any time without the requirement for the approval of the Holders. Upon any Mandatory Substitution Event, it is the current intention of HBOS to discuss with the FSA whether forms of legal instrument other than preference shares may be issued in substitution of the Preferred Securities.

**Optional Substitution:** Subject to the Issuer having given one month’s prior notice (or such other period, longer or shorter, as the FSA may then require or accept) (and having received no objection from) to the FSA, the General Partner may substitute the Preferred Securities in whole, but not in part, with Qualifying Tier 1 Instruments in an equivalent nominal amount at any time without the requirement for approval of the Holders.

“Qualifying Tier 1 Instruments” means instruments including debt, shares or interests in limited partnerships or otherwise, issued directly or indirectly by HBOS that:

- (a) have terms not materially less favourable to a Holder of the Preferred Securities (as reasonably determined by HBOS, and provided that a certification to such effect of two Directors and an opinion to such effect of an Independent Investment Bank is delivered to HBOS before the issue of the relevant instruments and is so stated in the certificate) provided that they shall (1) include a ranking at least equal to that of the Guarantee, (2) have the same dividend or distribution rate or rate of return and distribution or dividend payment dates from time to time applying to the Preferred Securities, (3) have

the same redemption dates as the Preferred Securities, (4) comply with the requirements of the FSA in relation to Tier 1 Capital as in effect on the Closing Date, (5) if not issued by HBOS, have the benefit of a guarantee by HBOS on substantially similar terms as the Guarantee and (6) preserve any existing rights under the Preferred Securities and the Guarantee to any accrued but unpaid Distribution in respect of the period from (and including) the Distribution Payment Date last preceding the Substitution Date to (but excluding) the Substitution Date; and

- (b) are listed on the London Stock Exchange, the Luxembourg Stock Exchange or such other stock exchange as is a Recognised Stock Exchange.

In the event that Qualifying Tier 1 Instruments in the form of preference shares are issued by HBOS, such preference shares shall be subject to redemption at the option of HBOS (and subject to the Redemption Conditions) following the occurrence of a Change in Law Withholding Tax Event on the same terms as applicable to the Preferred Securities, notwithstanding that the relevant preference shares may have been issued by HBOS after the occurrence of a Change in Law Withholding Tax Event.

Following the occurrence of a Mandatory Substitution Event, in circumstances where (1) the relevant Qualifying Tier 1 Instruments are required by the FSA to be in the form of preference shares issued by HBOS and (2) HBOS is unable by reason of the provisions 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 Qualifying Tier 1 Instruments in the form of preference shares which are *pari passu* ranking with the Preferred Securities, HBOS shall be permitted to issue preference shares which rank junior to but are otherwise economically equivalent to the Preferred Securities.

The General Partner's obligations to cause the substitution of Preferred Securities with Qualifying Tier 1 Instruments in the case of a Mandatory Substitution only shall be satisfied, in circumstances where such Qualifying Tier 1 Instruments are to be in the form of preference shares issued by HBOS only, if perpetual non-cumulative instruments ("Repackaged Instruments") are issued by an entity which is not a member of the HBOS Group and delivered to the Holders which (1) are secured with first ranking priority on such preference shares, (2) entitle Holders to rights and benefits which are economically equivalent to such preference shares including with regard to the timing and amount of any payments due on such preference shares, any dates of redemption and any rights of waiver and subordination and (3) are listed on the London Stock Exchange, the Luxembourg Stock Exchange or such other stock exchange as is a Recognised Stock Exchange; provided that:

- (i) if at the time of such substitution, such preference shares issued by HBOS are rated by one or more Rating Agency, each such Rating Agency shall assign the same rating (or, if the Rating Agencies have revised their criteria for rating transactions of a similar nature to the Repackaged

Instruments after the Closing Date, an equivalent rating (being an “Equivalent Rating”)) to such Repackaged Instruments as it has assigned to such preference shares; or

- (ii) if at the time of such substitution, such preference shares issued by HBOS are not rated by any Rating Agency, at least one Rating Agency shall have confirmed to the General Partner that it will assign at least the same rating or, where applicable, Equivalent Rating, to such Repackaged Instruments as that which would have been assigned to the preference shares had they been rated at such time.

“Rating Agency” as referred to above means any of Standard & Poor’s Rating Services (a division of the McGraw Hill Companies, Inc.), Moody’s Investor Services, Inc. and Fitch Ratings Ltd.

**Variation instead of Redemption: . .**

If a Tax Event, Accounting Event or Regulatory Event occurs and is continuing, instead of redeeming the Preferred Securities the General Partner may vary the terms thereof so they constitute Qualifying Tier 1 Instruments but not so as to materially prejudice the interests of the Holders, provided that the Issuer shall have notified the FSA of its intention to make such variation at least one month prior to the date upon which such variation is intended to become effective.

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

In the event of the dissolution (other than an Involuntary Dissolution) of the Issuer, the Holders will be entitled to receive for each Preferred Security, a Liquidation Distribution (being the Liquidation Preference, together with any due and accrued but unpaid Distribution calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date or, if none, the Closing Date), plus any relevant Additional Amounts, out of the assets of the Issuer legally available for distribution under the Law.

Notwithstanding the availability of sufficient assets of the Issuer to pay any Liquidation Distribution to the Holders as aforesaid, if, at the time such Liquidation Distribution is to be paid, proceedings have been commenced for the administration, 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 HBOS’ assets 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 (1) junior to all HBOS’ liabilities 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 (2) or (3) below and any other liability expressed to rank *pari passu* with or junior to the Guarantee), (2) *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 (3) 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 the Holders will be entitled as a Liquidation Distribution will be as set out above.

HBOS will undertake in the Guarantee that, so long as any of the Preferred Securities is outstanding, (1) unless HBOS is being wound-up, HBOS will not permit, or take any action to cause, the General Partner's or Issuer's liquidation, dissolution or winding-up and (2) the General Partner will at all times be a directly or indirectly wholly-owned subsidiary of HBOS unless, in the case of (1) or (2) otherwise approved by a simple majority of the Holders by vote or in writing.

**Limitations on  
Liquidation Payments: . . . . .**

Subject to the Law, the General Partner will not permit, or take any action that would or might cause, the liquidation or dissolution of the Issuer except following an order being made for the liquidation, dissolution, or winding-up of HBOS (other than pursuant to a Permitted Reorganisation) or HBOS being declared insolvent whereupon in either case the Issuer shall be dissolved. In addition, if any Limited Partner takes any action or procures that any action be taken in order that 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 (1) Adjusted Distributable Reserves or (2) proceeds available from an issue of Qualifying Tier 1 Instruments that has been made for the purpose of funding the Liquidation Distribution (in either of cases (1) or (2) in an amount at least equal to the aggregate Liquidation Distribution).

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

The Holders will not generally 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 and any Additional Amounts in respect of such Distributions have not been duly paid by the Issuer in full and/or HBOS has not made payments in respect thereof under the Guarantee for two consecutive Distribution Periods, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for four consecutive Distribution Periods, the Holders are entitled to elect a Special Representative to enforce their statutory rights. Such Special Representative shall vacate office if for any two consecutive Distribution Periods, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for any 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 (or an amount equivalent to the Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).

**Governing Law: . . . . .**

The Limited Partnership Agreement (establishing HBOS Capital Funding No. 4 L.P.) and the Preferred Securities are governed by and construed in accordance with Jersey law. Determinations in respect of amounts of Adjusted Distributable Reserves are construed in

accordance with the laws of Scotland. The Guarantee and the Notes will be governed by, and construed in accordance with, English law.

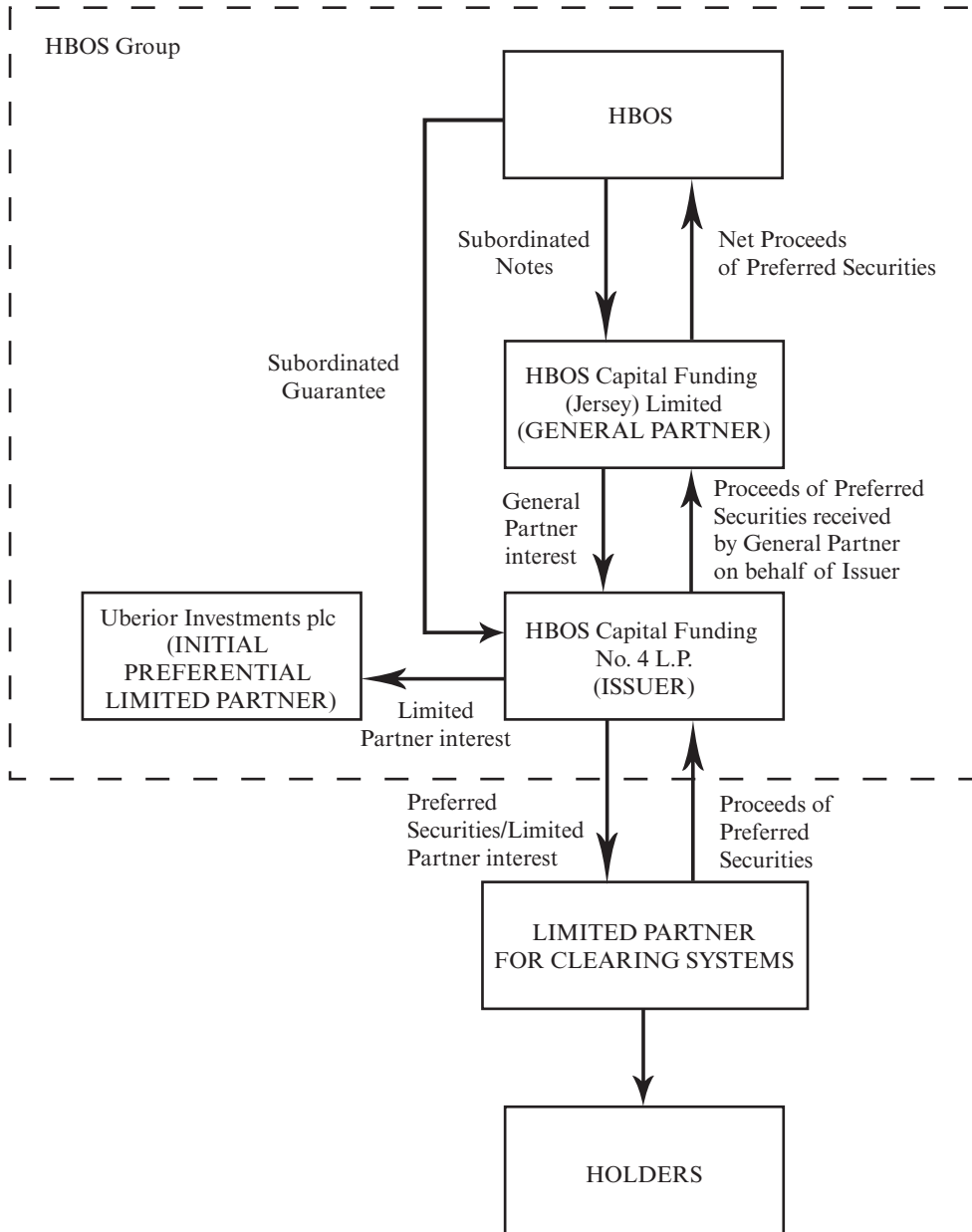
**Listing:** ..... An application has been made for the Preferred Securities to be listed on the Official List of the UK Listing Authority and to trading on the London Stock Exchange – Regulated Market.

**Denomination:** ..... The Preferred Securities will be issued in the denominations of £50,000 and integral multiples of £1,000 thereabove, up to and including £99,000. No definitive certificates will be issued with a denomination above £99,000.

**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. A credit rating is not a recommendation to buy, or sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

## Structure Diagram of the Offering

The following diagram shows the structure of the offering as at the Closing Date. Capitalised terms used but not defined are as defined in “*Description of the Preferred Securities*”.



## Risk Factors

*Prospective investors should consider carefully the following information in conjunction with the other information contained in this Prospectus before investing in the Preferred Securities. Each of the risks highlighted below could have a material adverse effect on HBOS' business, operations, financial condition or prospects, which, in turn, could have a material adverse effect on the amount of principal and interest which investors will receive in respect of the Preferred Securities. In addition, each of the risks highlighted below could adversely affect the trading price of the Preferred Securities or the rights of investors under the Preferred Securities and, as a result, investors could lose some or all of their investment.*

*The Issuer and HBOS believe that the factors described below represent the principal risks inherent in investing in the Preferred Securities. Neither the Issuer nor HBOS represents that the statements below regarding the risks of holding any Preferred Securities are exhaustive. Prospective investors should note that the risks described below are not the only risks faced by HBOS. HBOS has described only those risks relating to their operations that they consider to be material. There may be additional risks that HBOS currently considers not to be material or of which it is not currently aware, and any of these risks could have the effects set forth above. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision as these risk factors cannot be deemed complete.*

**The purchase of Preferred Securities involves substantial risks and is suitable only for investors who have the knowledge and experience in financial and business matters necessary to enable them to evaluate the risks and the merits of an investment in the Preferred Securities. Before making an investment decision, prospective purchasers of Preferred Securities should ensure that they understand the nature of the Preferred Securities and the extent of their exposure to risks and that they consider carefully, in the light of their own financial circumstances, financial condition and investment objectives, all the information set forth herein.**

**Each prospective purchaser of the Preferred Securities must determine, based on its own independent review and such professional advice as it deems appropriate under the circumstances, that its acquisition of the Preferred Securities (a) is fully consistent with its (or if it is acquiring the Preferred Securities in a fiduciary capacity, the beneficiary's/beneficiaries') financial needs, objectives and condition; (b) complies and is fully consistent with all investment policies, guidelines and restrictions applicable to it (whether acquiring the Preferred Securities as principal or in a fiduciary capacity); and (c) is a fit, proper and suitable investment for it (or if it is acquiring the Preferred Securities in a fiduciary capacity, for the beneficiary/beneficiaries), notwithstanding the clear and substantial risks inherent in investing in or holding the Preferred Securities.**

### **Risks Relating to HBOS and its Business**

***The financial performance of HBOS and its subsidiaries (the "HBOS Group") is affected by borrower credit quality and general economic conditions, in particular in the UK***

Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of its businesses. Adverse changes in the credit quality of its borrowers and counterparties or a general deterioration in the UK or global economic conditions, or arising from systemic risks in the financial systems, could affect the recoverability and value of its assets and require an increase in its impairment provision for bad and doubtful debts and other provisions.

***Changes in interest rates, foreign exchange rates, equity prices, house prices and other market factors affect HBOS Group's business***

The most significant market risks the HBOS Group faces are interest rate, foreign exchange and bond, equity and house price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs. Changes in currency rates affect the value of assets and liabilities denominated in foreign currencies and affect earnings reported by the HBOS Group's non-UK subsidiaries, and may affect income from foreign exchange dealing. The performance of financial markets may cause changes in the value of the HBOS Group's investment and trading portfolios. The HBOS Group has implemented risk management methods to mitigate and control these and other market risks to

which it is exposed. However, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on its financial performance and business operations.

***HBOS is subject to capital requirements that could limit its operations***

HBOS is subject to capital adequacy guidelines adopted by the FSA for a bank or a bank holding company, which provide for a minimum ratio of total capital to risk-adjusted assets both on a consolidated basis and on a solo-consolidated basis expressed as a percentage. At least half of the total capital must be maintained in the form of Tier 1 capital. HBOS has received FSA approval to use the “Advanced Internal Ratings Based Approach” (in respect of credit risk) and Advanced Measurement Approach (in respect of operational risk) for capital determination purposes with effect from 1 January 2008. Failure by HBOS to maintain its ratios may result in administrative actions or sanctions against it, which may impact its ability to fulfil its obligations under the Preferred Securities.

***Operational risks are inherent in the HBOS Group’s businesses***

HBOS Group’s businesses are dependent on the ability to process a very large number of transactions efficiently and accurately. Operational risk and losses can result from fraud, errors by employees, failure to document transactions properly or to obtain proper internal authorisation, failure to comply with regulatory requirements and conduct of business rules, equipment failures, natural disasters or the failure of external systems (for example, those of the HBOS Group’s suppliers or counterparties). Although the HBOS Group has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures and to staff training, it is only possible to be reasonably, but not absolutely, certain that such procedures will be effective in controlling each of the operational risks.

**Risks Relating to the Preferred Securities**

***Preferred Securities may not be a suitable investment for all investors***

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

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the relevant Preferred Securities, the merits and risks of investing in the Preferred Securities and the information contained or incorporated by reference in this Prospectus;
- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Preferred Securities and the impact such investment will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Preferred Securities;
- (iv) understand thoroughly the terms of the Preferred Securities;
- (v) recognise that it may not be possible to make any transfer of the Preferred Securities for a substantial period of time, if at all; and
- (vi) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

***Distributions on the Preferred Securities are subject to payment and other restrictions and are non-cumulative***

Distributions on the Preferred Securities will only be payable at the sole discretion of the General Partner. Distributions will only be paid when so determined by the General Partner and applicable law so permit, and if sufficient resources exist. The payment of any such Distribution is also subject to compliance with the then-existing capital adequacy requirements of the FSA. Distributions on the Preferred Securities are non-cumulative. 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.

***If HBOS does not make payments on its Parity Securities, distributions may not be permitted to be made in respect of the Preferred Securities***

HBOS has previously, directly or indirectly, issued preference shares and other securities and limited partnership interests having similar economic rights and benefits as the Preferred Securities and Guarantee taken together, each being Parity Securities (as defined in “Description of the Preferred Securities” below). If the relevant issuer does not pay in full dividends or distributions (as applicable) on such Parity Securities, Distributions will not be permitted to be made in respect of the Preferred Securities until such other dividends or distributions have been paid or provided for, in either such case, for the periods specified in their terms.

***HBOS preference shares do, and the terms of other shares or other securities or other limited partnership interests which are expressed to rank pari passu with the Preferred Securities and which HBOS has issued or guaranteed or may issue or guarantee in the future may, differ and may receive different treatment from the Preferred Securities in certain important respects***

Although the Preferred Securities will rank, as regards participation in the profit and assets of HBOS upon a winding-up or a liquidation, equally among themselves and with HBOS preference shares and with any other shares or other securities or limited partnership interests (such as preferred securities which are expressed to rank equally with, and may be required to be converted into, preference shares) which HBOS has issued or guaranteed or may issue or guarantee which are expressed to rank equally with them, and in priority to any other share capital of HBOS and any other securities which are expressed to rank junior to the Preferred Securities, investors should note that the terms of HBOS preference shares and certain other shares or other securities or limited partnership interests which HBOS has issued or guaranteed do, and the terms of other shares or other securities or limited partnership interests which HBOS may issue or guarantee in the future may, differ from the terms of the Preferred Securities in certain important respects. In particular, the terms under which a dividend or other distribution may or must be paid to holders of HBOS preference shares or to holders of such other shares or securities or limited partnership interests, may result in such holders receiving in part or in full the dividends or other distributions, including payments in kind, due for payment on HBOS preference shares or such other shares or securities or limited partnership interests, where the holders of the Preferred Securities have not or do not receive payment or accrued but unpaid Distributions. Furthermore, because preferred securities are in legal form of a different nature to preference shares, there can be no assurances given to holders of preferred securities that were preference shares to be issued in substitution for the preferred securities that as holders of such preference shares, they would be treated in all circumstances on the same basis as if they had still been holders of preferred securities.

***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 the First Optional Redemption Date or on any Distribution Payment Date thereafter or at any time following the occurrence of a Change in Law Withholding Tax Event, a Change in Law Tax Event, a Regulatory Event or an Accounting 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.

***Subordination***

The obligations of the Issuer under the Preferred Securities and 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 (whether currently existing or incurred in the future, there being no limit on HBOS in so incurring).



### ***HBOS free to issue more preferred securities***

Unlike the restrictions on the issue of further preference shares contained in its Articles of Association, there are no limits on the issue or guarantee by HBOS of further preferred securities or limited partnership interests ranking *pari passu* with the Preferred Securities. Such further preferred securities would rank equally with the Preferred Securities in a winding-up and so could dilute the recovery made by holders of the Preferred Securities.

### ***An active market for the Preferred Securities may fail to develop***

The Issuer will apply to list the Preferred Securities on the Official List and to have them admitted to trading on the Market. Notwithstanding such listing, there can be no assurance that an active trading market for the Preferred Securities will develop and, if such a market were to develop, neither the initial purchasers nor any other person are required to maintain such a market. The liquidity and the market prices for the Preferred Securities can be expected to vary with changes in market and economic conditions generally and in the Issuer's financial condition and prospects in particular, as well as in response to other factors that generally influence the market prices of securities.

### ***Preference shares of HBOS issued on substitution may have to be issued as junior ranking preference shares***

If (i) the aggregate nominal amount of the preference shares of HBOS to be issued upon the occurrence of a Mandatory Substitution Event (in circumstances where the FSA does not permit other forms of legal instrument to be issued in substitution) and any preference shares issued upon the occurrence of an analogous event at substantially the same time together with the aggregate nominal amount of HBOS' Priority Preference Shares (as defined in the Articles of Association of HBOS), would exceed an amount equal to 25 per cent. of HBOS' Adjusted Capital and Reserves (as defined in the Articles of Association of HBOS) or (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 issue of the preference shares so issued, for each such period does not exceed 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 substitute preference shares then being issued), then HBOS may not issue preference shares ranking equally with Parity Securities but instead may issue substitute preference shares ranking immediately below the Parity Securities.

### ***Certain preference shares issued in substitution would not be subject to the same restrictions on dividends and redemption***

The terms of certain securities issued before 27 April 2004 require, on the occurrence of similar specified circumstances, HBOS to issue preference shares in substitution for such securities. The holders of such securities are entitled to substitute preference shares ranking equally with the other HBOS preference shares. The restrictions on the issue of preference shares set out above also apply to these securities. However, although preference shares ranking junior to the Parity Securities may have to be issued, in order to give the holders of such securities the same economic rights and benefits upon substitution as the other HBOS preference shares, except in ranking, the restriction on dividends and redemption described herein shall not apply to such junior-ranking substitute preference shares to the extent described therein.

### ***Stamp duty or SDRT may be payable by Holders upon the transfer of Qualifying Tier 1 Instruments in the form of preference shares of HBOS issued upon a Mandatory Substitution Event if the Holder elects for such preference shares to be held outside of a clearing system, which will not be borne by the Issuer or HBOS***

Where, following a Mandatory Substitution Event, Qualifying Tier 1 Instruments in the form of preference shares of HBOS have been issued (and where the General Partner has not procured the issue of Repackaged Instruments), Holders can elect for such preference shares to be issued either (i) in registered certificated form held outside of a clearing system; or (ii) into a clearing system which has not made an election under section 97A of the Finance Act 1986 that applies to the preference shares. If Holders elect for the preference shares to be issued in registered certificated form, then subsequent transfers of such

preference shares will, under current law, give rise to a stamp duty or SDRT charge for the purchaser at the rate of 0.5 per cent. of the consideration paid for the transfer. However, if Holders elect for the preference shares to be issued into a clearing system then the subsequent transfer of such preference shares will not, under current law, give rise to a stamp duty or SDRT charge.

#### ***Stamp duty or SDRT arising in relation to the transfer of Repackaged Instruments***

Where the General Partner procures the issue of Repackaged Instruments following a Mandatory Substitution Event, HBOS will ensure that the issuer of such Repackaged Instruments will pay any UK stamp duty or SDRT arising on the issue thereof. Under current law, it is expected that no stamp duty or SDRT liability should arise in relation to any transfer of the Repackaged Instruments. However, to the extent that any such liability does arise (whether as a result of a change in law or otherwise), it will not be borne by the Issuer or HBOS.

#### ***Modification and waivers***

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

The terms of the Preferred Securities also contain provisions which allow the General Partner, in certain circumstances, to vary the terms of the Preferred Securities so they constitute Qualifying Tier 1 Instruments but not so as to materially prejudice the interests of the Holders. The Issuer must notify the FSA one month prior to the date upon which such variation is intended to become effective but the Holders are not required to consent to such variation.

#### ***Minimum denomination***

It is possible that the Preferred Securities may be traded in amounts in excess of £50,000 that are not integral multiples of £50,000. In such a case a Holder who, as a result of trading such amounts, holds a principal amount of less than £50,000 may not receive a definitive certificate in respect of such holding (should definitive certificates be printed) and would need to purchase a principal amount of Preferred Securities such that its holding amounts to £50,000 or an integral multiple of £1,000 in excess thereof.

#### ***EU Savings Directive***

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland).

If a payment were to be made or collected through a Member State or relevant non-EU country or territory which has opted for a withholding system and an amount of, or in respect of tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Preferred Security as a result of the imposition of such withholding tax. The General Partner will be required (on behalf of the Issuer) to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive.

#### ***Exchange rate risks***

The Issuer will make payments on the Preferred Securities and HBOS will make any payments under the Guarantee in Sterling. This presents certain risks relating to currency conversions if an investor's

financial activities are denominated principally in a currency or currency unit (the “Investor’s Currency”) other than Sterling. These include the risk that exchange rates may significantly change (including changes due to devaluation of Sterling or revaluation of the Investor’s Currency). An appreciation in the value of the Investor’s Currency relative to Sterling would decrease (a) the Investor’s Currency-equivalent yield on the Preferred Securities and (b) the Investor’s Currency-equivalent market value of the Preferred Securities.

***Interest rate risks***

Distributions on the Preferred Securities will be payable at a fixed rate until the First Optional Redemption Date. Investment in fixed rate instruments involves the risk that subsequent changes in market interest rates may adversely affect the value of the fixed rate instruments.

***Credit ratings may not reflect all risks***

The Preferred Securities are expected to be rated by Standard & Poor’s, Moody’s and Fitch. A 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 assigning rating organisation. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Preferred Securities.

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

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

**THE CONSIDERATIONS SET OUT ABOVE ARE NOT INTENDED TO BE A COMPREHENSIVE LIST OF ALL CONSIDERATIONS RELEVANT TO A DECISION TO PURCHASE OR HOLD ANY OF THE PREFERRED SECURITIES.**

## 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:

“Accounting Event” means that as a result of a change in accounting principles, the obligations under the Preferred Securities must be recorded as “financial liability” in the next following annual consolidated financial statements of HBOS prepared in accordance with IFRS or any other accounting standards that HBOS may adopt in the future for the preparation of its annual consolidated financial statements in accordance with company law then in effect in the UK;

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

“Accounting Event Redemption Price” means (i) in relation to any redemption of a Preferred Security prior to the First Optional Redemption Date, the higher of the Optional Redemption Price and the Make Whole Amount, and (ii) in relation to any redemption of a Preferred Security after the First Optional Redemption Date, the Optional Redemption Price;

“Accrual Period” means the relevant period for which a Distribution is to be calculated (from and including the first such day to but excluding the last);

“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, (1) the lawful distributable reserves of HBOS at such time less (2) 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 in accordance with IFRS at the Closing Date as shareholders’ funds in HBOS’ accounts and (b) all securities or other obligations of an undertaking which are accounted for in accordance with IFRS at the Closing Date 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 where in the case of (2)(a) or (b) any amounts in respect of such redemptions and/or payments (as the case may be) since the Closing Date have been either charged to the lawful distributable reserves of HBOS or funded at that time by an issue of Qualifying Tier 1 Instruments;

“Agency Agreement” means the paying and transfer agency agreement dated the Closing Date relating to the Preferred Securities between, *inter alios*, the Issuer, HBOS and the Principal Paying and Transfer Agent;

“Applicable Regulatory Capital Requirements” means any requirements contained in Capital Regulations for the maintenance of capital from time to time applicable to HBOS on a solo and/or consolidated basis, including transitional rules and waivers;

“Business Day” means a day other than a Saturday or Sunday on which banks and foreign exchange markets are open for business in (i) the relevant place of presentation (if applicable in the context in which the term is used) and (ii) London;

“Calculation Agent” means Citibank, N.A., London Branch or such other entity as is appointed by the General Partner on behalf of the Issuer and notified to the Holders as described under paragraph 10;

“Capital Regulations” means at any time the regulations, requirements, guidelines and policies relating to capital adequacy then in effect of the FSA or other relevant regulator;

“Change in Law Tax Event” means that as a result of a change in any law or regulation of the UK or Jersey, or in any treaty to which the UK or Jersey is a party or in the official interpretation or application of any law, regulation or treaty by any relevant court or authority entitled to do so (expressly or implicitly), on or after the Closing Date, (i) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or the Notes (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) actual 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 UK or (ii) HBOS (or the relevant UK tax resident member of the HBOS Group which issues the Notes) would not obtain relief for the purposes of UK corporation tax for any payment of interest in respect of the Notes;

“Change in Law Withholding Tax Event” means that, as a result of a change in any law or regulation of the UK or Jersey, or in any treaty to which the UK or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant court or authority entitled to do so (expressly or implicitly), on or after the Closing Date, (i) payments to Holders would be subject to deduction for or on account of tax or to withholding tax or would give rise to any obligation of the Issuer or HBOS to account for any tax in Jersey or the UK or (ii) payments by HBOS (or the relevant UK tax resident member of the HBOS Group which issues the Notes) in respect of the Notes would be subject to deduction or to withholding tax in the UK;

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

“Closing Date” means 19 March 2008;

“Companies Acts” means the Companies Acts as defined in Section 2 of the Companies Act 2006, save that where any provision of such Act is not in force at the relevant time, such reference shall be construed accordingly as referring to the Companies Act 1985 (as amended);

“Day Count Fraction” means, prior to the First Optional Redemption Date, a fraction calculated on the following basis:

- (a) if the Accrual Period is equal to or shorter than the Distribution Period during which it falls, the number of days in the Accrual Period divided by the number of days in such Distribution Period multiplied by 0.5; and
- (b) if the Accrual Period is longer than one Distribution Period, the sum of:
  - (i) the number of days in such Accrual Period falling in the Distribution Period in which it begins divided by the number of days in such Distribution Period multiplied by 0.5; and
  - (ii) the number of days in such Accrual Period falling in the next Distribution Period divided by the number of days in such Distribution Period multiplied by 0.5,

and, on or after the First Optional Redemption Date, the actual number of days in the relevant Distribution Period divided by 365 (or, if any portion of the Distribution Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Distribution Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Distribution Period falling in a non-leap year divided by 365);

“Distributions” means the non-cumulative distributions in respect of the Preferred Securities as described under paragraph 2 and “Distribution” shall be construed accordingly;

“Distribution Determination Date” means, with respect to any Distribution Payment Date, the tenth Business Day prior to such Distribution Payment Date;

“Distribution Payment Date” means 19 March and 19 September in each year, commencing on 19 September 2008 and ending on the First Optional Redemption Date and thereafter 19 March, 19 June, 19 September and 19 December in each year provided that where a Distribution Payment Date falling after the First Optional Redemption Date is not a Business Day, it shall be postponed to the next day which is a Business Day;

“Distribution Period” means the period from (and including) the Closing Date to (but excluding) 19 September 2008 and each period thereafter from (and including) one Distribution Payment Date to (but excluding) the next following Distribution Payment Date;

“Distribution Rate” means, in respect of the Preferred Securities, (i) for each Distribution Period until the First Optional Redemption Date, 9.54 per cent. per annum and (ii) for each Distribution Period thereafter a floating rate per annum equal to the sum of 6.75 per cent. and the three-month Sterling LIBOR for such Distribution Period;

“Euroclear” means Euroclear Bank SA/NV or its successor;

“Excluded Preference Shares” means any Junior Share Capital issued in satisfaction of an obligation existing on 27 April 2004;

“First Optional Redemption Date” means 19 March 2018;

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

“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 the Closing Date;

“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;

“IFRS” means the then applicable International Financial Reporting Standards;

“Independent Investment Bank” means the independent investment bank or financial institution of international repute selected and appointed by the Issuer (acting through the General Partner) at the Issuer’s expense for the purposes of performing one or more of the functions expressed to be performed by it in connection with the Preferred Securities as set out herein;

“Initial Holder” means Citivic Nominees Limited;

“Initial Preferential Limited Partner” means Uberior Investment plc;

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



“Issuer” means HBOS Capital Funding No. 4 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 preference shares, other securities, limited partnership interests or obligations which rank, or are expressed to rank, junior to the Parity Securities and 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 on or before the Closing Date 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 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, in each case in cash only;

“Liquidation Preference” means, in respect of each Preferred Security, 100 per cent. of the nominal amount of the denomination in which it is issued;

“Make Whole Amount” in respect of each Preferred Security means the price, expressed as a percentage (rounded to four decimal places, 0.00005 being rounded upwards), at which the gross redemption yield (as calculated on the basis set out by the United Kingdom Debt Management Office in the paper Formulae for Calculating Gilt Prices for Yields page 4, Section One: Price Yield Formulae “Conventional Gilts: Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date” (published 8/6/1998 as amended or updated from time to time) on such Preferred Security, if it were to be purchased at such price on the third Business Day prior to the date fixed for redemption, would be equal to the gross redemption yield on such Business Day of £1,000 in principal amount of the Reference Bond plus 1.50 per cent. on the basis of the middle market price of the Reference Bond prevailing at 11.00 a.m. (London time) on such Business Day as determined by an Independent Investment Bank appointed by the General Partner for such purpose, together with any due and accrued but unpaid Distribution on such Preferred Security calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date (or if none, the Closing Date), plus any Additional Amounts.

“Mandatory Substitution Event” means that either (A)(i) HBOS’ total capital ratio, calculated on a consolidated basis in accordance with the Applicable Regulatory Capital Requirements, has fallen below the then generally applicable minimum ratio (or ratios, if then applicable) required by such requirements; or (ii) HBOS’ 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 (B) an Involuntary Dissolution has occurred in circumstances where HBOS is itself not insolvent or in liquidation;

“Notes” means (i) the £750,000,000 undated subordinated fixed-to-floating rate 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 such Notes or (ii) any Replacement Debt;

“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, the First Optional Redemption Date and each Distribution Payment Date thereafter, as specified in the relevant notice of redemption;

“Optional Redemption Price” means the Liquidation Preference per Preferred Security plus any due and accrued but unpaid Distribution calculated to (but excluding) the date of payment from (and including) the immediately preceding Distribution Payment Date (or, if none, the Closing Date) plus any relevant Additional Amounts;

“Parity Securities” means any preference shares, preferred securities (other than the Preferred Securities), other securities, limited partnership interests or obligations either (a) issued directly by HBOS and ranking *pari passu* with HBOS’ 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 of HBOS ranking *pari passu* with the Guarantee or with which HBOS’ obligations under the Guarantee rank *pari passu*;

“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 paragraph 2, 3 or 6;

“Preferred Securities” means the £750,000,000 fixed-to-floating rate non-voting non-cumulative perpetual preferred securities outstanding, each such Preferred Security representing a limited partnership interest of a Holder in the Issuer attributable to the nominal amount of the Preferred Securities held by it, 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;

“Principal Paying and Transfer Agent” means Citibank, N.A., London Branch 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;

“Qualifying Tier 1 Instruments” means instruments whether debt, shares, interests in limited partnerships or otherwise, issued directly or indirectly or guaranteed by HBOS that:

- (a) have terms not materially less favourable to a Holder of the Preferred Securities (as reasonably determined by HBOS, and provided that a certification to such effect of two Directors and an opinion to such effect of an Independent Investment Bank shall have been delivered to HBOS prior to the issue of the relevant instruments and is so stated in the certificate) provided that they shall (1) include a ranking at least equal to that of the Guarantee, (2) have the same dividend or distribution rate or rate of return and distribution or distribution payment dates as the Preferred Securities (save that where they are in the form of preference shares issued by HBOS in circumstances where the directors of HBOS are otherwise permitted to declare and pay dividends or distributions on such preference shares, Holders shall only be entitled to receive such dividends or distributions on such preference shares if (and to the extent) such dividends or distributions are declared by the directors of HBOS at their discretion), (3) have the same redemption dates as the Preferred Securities, (4) comply with the requirements of the FSA in relation to Tier 1 Capital as in effect on the Closing Date, (5) if not issued by HBOS,

then have the benefit of a guarantee by HBOS on substantially similar terms to the Guarantee and (6) preserve any existing rights under the Preferred Securities and the Guarantee to any accrued Distribution which has not been paid in respect of the period from (and including) the Distribution Payment Date last preceding the Substitution Date to (but excluding) the Substitution Date; and

- (b) are listed on the London Stock Exchange, the Luxembourg Stock Exchange or such other stock exchange as is a Recognised Stock Exchange;

“Rating Agency” means any of Standard & Poor’s Rating Services (a division of the McGraw Hill Companies, Inc.), Moody’s Investor Services, Inc. and Fitch Ratings Ltd;

“Recognised Stock Exchange” means (a) any market of a recognised investment exchange which is for the time being designated as a recognised stock exchange for the purposes of s.1005 of the Income Tax Act 2007 by an order made by the Commissioners for Her Majesty’s Revenue and Customs, and (b) any market outside the UK which is for the time being so designated;

“Redemption Conditions” means (i) that the Issuer has notified, and received no objection from, the FSA of its intention to make such optional redemption at least one month (or such other period, longer or shorter, as the FSA may then require or accept) prior to the date scheduled for redemption and, if such optional redemption is scheduled to occur prior to the First Optional Redemption Date or if otherwise required, has obtained the consent of the FSA in the form of a waiver of the restriction on redemption and (ii) that HBOS is at the date that such notice is given to the FSA by the Issuer, and will be immediately following such redemption, in compliance with its Applicable Regulatory Capital Requirements (except to the extent that the FSA no longer requires);

“Redemption Price” means the Optional Redemption Price, the Tax Event Redemption Price, the Accounting Event Redemption Price or the Regulatory Event Redemption Price (as applicable);

“Reference Bond” means such UK government bond with a maturity date as near as possible to the First Optional Redemption Date as the Calculation Agent may, with the advice of the Reference Market Makers and in consultation with the Issuer, determine to be appropriate;

“Reference Market Makers” means such independent investment banks as may be appointed as such by the Calculation Agent in consultation with the Issuer;

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

“Registrar” means Citigroup Global Markets Deutschland AG & Co. KGaA or such other entity appointed by the Issuer having its office outside the UK and notified to the Holders as described under paragraph 10;

“Regulatory Event” means the FSA has determined that the Preferred Securities can no longer qualify as Tier 1 Capital either at that time or at some point in the future;

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

“Regulatory Event Redemption Price” means (i) in relation to any redemption of a Preferred Security prior to the First Optional Redemption Date, the higher of the Optional Redemption Price and the Make Whole Amount, and (ii) in relation to any redemption of a Preferred Security after the First Optional Redemption Date, the Optional Redemption Price;

“Relevant Proportion” means, in relation to any partial payment of any Liquidation Distribution on a Preferred Security, the total amount available for all such payments 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, in each case converted where necessary into the same currency in which liquidation payments are made to creditors of HBOS;

“Repackaged Instrument” means any perpetual non-cumulative instrument issued by an entity which is not a member of the HBOS Group which complies with the requirements in paragraph 5.3 and “Repackaged Instruments” shall be construed accordingly;

“Replacement Debt” means any debt securities issued by a UK tax resident member of the HBOS Group (which, if not issued by HBOS, are guaranteed by HBOS) with terms substantially equivalent to the Notes described in (i) of the definition thereof (including those relating to interest rate provisions which will be equal to the then current Distribution Rate provisions of the Preferred Securities);

“SDRT” has the meaning ascribed to it in paragraph 5.5;

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

“Sterling” or “£” means the lawful currency of the UK;

“Stock Exchange” means the London Stock Exchange plc or such other Recognised Stock Exchange approved by the General Partner on which the Preferred Securities (or any Qualifying Tier 1 Instruments) may be listed from time to time;

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

“Substitution Confirmation” has the meaning ascribed to it in paragraph 5.4;

“Substitution Date” has the meaning ascribed to it in paragraph 5.1;

“Tax Event” means (i) a Change in Law Withholding Tax Event, (ii) a Change in Law Tax Event or (iii) that, other than as a result of a Change in Law Withholding Tax Event or a Change in Law Tax Event and only after the First Optional Redemption Date unless a FSA waiver is obtained, (A) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or Notes (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) actual 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 Preferred Securities) in Jersey or the UK or (B) HBOS (or the relevant UK tax resident member of the HBOS Group) would not obtain relief for the purposes of UK corporation tax for any payment of interest in respect of the Notes or payment under the Guarantee (other than payments representing a Liquidation Preference in respect of any Preferred Securities);

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

“Tax Event Redemption Price” means (i) in relation to any redemption of a Preferred Security pursuant to a Tax Event, other than a Change in Law Withholding Tax Event or a Change in Law Tax Event, prior to the First Optional Redemption Date, the higher of the Optional Redemption Price and the Make Whole Amount, and (ii) in relation to any other redemption of a Preferred Security pursuant to a Tax Event (including, for the avoidance of doubt, at any time pursuant to a Change in Law Withholding Tax Event or a Change in Law Tax Event), the Optional Redemption Price;

“three-month Sterling LIBOR”, in respect of any Distribution Period falling after the First Optional Redemption Date, means the offered rate (expressed as a rate per annum) for three-month Sterling deposits as displayed on Reuters Screen LIBOR01 for such deposits (or such other page or pages as may replace it for the purpose of displaying such information) as of 11:00 a.m., London time, on the first day of the relevant Distribution Period; provided that, if, at such time, no such rate appears or the relevant Reuters Screen page is unavailable, it shall mean the rate calculated by the Calculation Agent as the arithmetic mean of at least two offered quotations obtained by the Calculation Agent after requesting the principal London office of each of four major reference banks, in the London interbank market, to provide the Calculation Agent with its offered quotation for deposits for three months in Sterling commencing on the first day of the relevant Distribution Period to prime banks in the London interbank market at approximately 11:00 a.m., London time, on the first day of the relevant Distribution Period; provided further that if fewer than two such offered quotations are provided as requested, it shall mean the rate calculated by the Calculation Agent as the arithmetic mean of the Sterling lending rates which leading banks in London selected by the Calculation Agent are quoting, on the first day of the relevant Distribution Period, to leading London banks for a period of three months, except that, if the banks so selected by the Calculation Agent are not quoting as mentioned above, the rate shall be the rate in effect for the last preceding Distribution Period;

“Tier 1 Capital” has the meaning ascribed to it in the FSA’s “General Prudential Sourcebook” 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; and

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

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, a non-cumulative return on the Preferred Securities shall 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 distributions (“Distributions”) in respect thereof shall be payable in arrear on each Distribution Payment Date.

2.2 Subject as provided by the Law and in paragraph 2.3, Distributions in respect of any Distribution Period will be payable at the applicable Distribution Rate on the Liquidation Preference of the Preferred Security. In respect of each Distribution Payment Date falling upon or prior to the First Optional Redemption Date, the amount of each Distribution payable in respect of each £50,000 of Preferred Securities shall be £2,385 and in respect of each £1,000 of Preferred Securities shall be £47.70. In respect of each Distribution Period falling after the First Optional Redemption Date, the Calculation Agent will at or as soon as practicable after each time at which the Distribution Rate is to be determined, determine the Distribution for the relevant Distribution Period. Each such determination will be notified to the Issuer, HBOS, the Registrar, the Holders and the Stock Exchange before the commencement of the Distribution Period in accordance with paragraph 10 hereof.

2.3 Distributions on the Preferred Securities will be payable at the sole discretion of the General Partner out of the Issuer’s own legally available resources on each Distribution Payment Date and in accordance with the terms of the Limited Partnership Agreement.

Distributions on the Preferred Securities will not be cumulative. If the General Partner decides not to pay Distributions on the Preferred Securities or HBOS does not pay corresponding



amounts under the Guarantee, the Holders of the Preferred Securities will have no claim in respect of such non-payment.

- 2.4 HBOS has undertaken 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 Parity Securities (where the dividend or distribution in all forms is at the discretion of the directors or equivalent person(s)) or on any Junior Share Capital (except for any Excluded Preference Shares) or (b) (if permitted) repurchase or redeem such Parity Securities or Junior Share Capital (except for any Excluded Preference Shares), in the case of both (a) and (b) until after the second consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount equivalent to the Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), in the case of a Distribution Period ending on or before the First Optional Redemption Date, or until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount at least equal to the expected Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders and, if upon determination of the amount of each of such Distribution there is a shortfall in the amounts so paid or set aside with reference to the amounts so determined, an amount at least equal to such shortfall shall be paid or irrevocably set aside in the same manner), in the case of a Distribution Period ending after the First Optional Redemption Date.
- 2.5 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.
- 2.6 The liability of a Holder to contribute to the debts or obligations of the Issuer (if any) shall (subject to the Law) be limited to, and shall be satisfied by, the amount of that Holder's capital contribution.

### **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, in which case the provisions set out in 5.2 shall apply) 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 and the terms of the Limited Partnership Agreement. Such entitlement will arise (a) before any payments due to the Preferential Limited Partner 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 administration, 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 the second paragraph of 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 Preferred Securities 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, the General Partner will not permit, or take any action that would or might cause, the liquidation or dissolution of the Issuer. In addition, if any Limited Partner takes any action or procures that any action be taken in order that 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 (a) Adjusted Distributable Reserves or (b) proceeds available from an issue of Qualifying Tier 1 Instruments that has been made for the purpose of funding the Liquidation Distribution (in either of cases (a) or (b) in an amount at least equal to the aggregate Liquidation Distribution).

#### **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 may be redeemed, 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 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.
- 4.3 If at any time a Tax Event or an Accounting 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 days' notice to the Holders specifying the Tax Event Redemption Date or the Accounting Event Redemption Date, as applicable (which notice shall be irrevocable), each Preferred Security being redeemable at the Tax Event Redemption Price or the Accounting Event Redemption Price, as applicable.

Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar (i) a copy of a certificate signed by two Directors of HBOS stating that the Issuer is entitled to effect such redemption and (ii) in the case of a Tax Event,

an opinion of counsel to HBOS experienced in such matters, or in the case of an Accounting Event, an opinion of the statutory auditor of HBOS, to the effect, respectively, that:

- (i) a Tax Event has occurred (and specifying which of clauses (i) to (iii) as set out in the definition of “Tax Event” is applicable and in the case of a Change in Law Withholding Tax Event or a Change in Law Tax Event further specifying which of clauses (i) or (ii) in the definition of “Change in Law Withholding Tax Event” or “Change in Law Tax Event”, as the case may be, is applicable, and, in the case of an event within clause (iii) in the definition of “Tax Event”, further specifying which of clauses (A) and (B) is applicable); or
- (ii) an Accounting 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.

- 4.4 If at any time a Regulatory Event occurs and is continuing, 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 days’ notice to the Holders specifying the Regulatory Event Redemption Date (which notice shall be irrevocable), each Preferred Security being redeemable at the Regulatory Event 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.

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.

- 4.5 Under existing FSA requirements, the Issuer may not redeem, and neither the Issuer nor HBOS may purchase, any Preferred Securities unless the Issuer has notified, and received no objection from, the FSA of its intention to make such optional redemption at least one month (or such other period, longer or shorter, as the FSA may then require or accept) prior to the date scheduled for redemption and, if such optional redemption is scheduled to occur prior to the First Optional Redemption Date or if otherwise required, has obtained the consent of the FSA in the form of a waiver of the restriction on redemption. The FSA may impose conditions on any redemption or purchase.
- 4.6 For so long as the Preferred Securities are admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange – Regulated Market, the General Partner shall cause notice of any redemption to be given to the London Stock Exchange.

## **5 Optional Substitution and Mandatory Substitution by Qualifying Tier 1 Instruments**

- 5.1 Optional Substitution: Subject to the Issuer having given at least one month’s prior notice to, and having received no objection from, the FSA (or such other period, longer or shorter, as the FSA may require or accept), the General Partner may, at any time, by giving not less than 30 days notice to Holders in accordance with paragraph 10 (such notice specifying the relevant date upon which substitution shall take effect (the “Substitution Date”)), elect that the Preferred Securities be substituted in whole by an equivalent nominal amount of Qualifying Tier 1 Instruments (being an “Optional Substitution”).

Notwithstanding the provisions of this sub-paragraph 5.1, if on the Substitution Date the relevant Qualifying Tier 1 Instruments do not comply with the criteria for Tier 1 Capital in effect on that date (but do comply with the corresponding criteria in effect as at the Closing

Date), HBOS has undertaken to procure that the issuer thereof shall not be permitted to redeem such Qualifying Tier 1 Instruments on terms analogous to a Regulatory Event solely as a consequence of such non-compliance.

- 5.2 **Mandatory Substitution:** As soon as reasonably practicable following the occurrence of a Mandatory Substitution Event, the General Partner shall cause notice thereof to be given in accordance with paragraph 10 (such notice specifying the Substitution Date) and take all reasonable steps to cause the substitution of the Preferred Securities in whole by an equivalent nominal amount of Qualifying Tier 1 Instruments in the form of preference shares issued by HBOS (save where some other form of legal instrument is then permitted by the FSA to be substituted, in which case the General Partner may elect in its absolute discretion to substitute Preferred Securities with such other form of legal instrument which is a Qualifying Tier 1 Instrument) (being a “Mandatory Substitution”). In the event that at the time of any such substitution (i) the relevant Qualifying Tier 1 Instruments are required by the FSA to be in the form of preference shares issued by HBOS and (ii) HBOS is unable solely 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) to issue a sufficient number of preference shares which are *pari passu* ranking with the Preferred Securities in order to effect the substitution of all outstanding Preferred Securities, HBOS shall, to the extent required by Article 4.7 of its Articles of Association (or any provision in its Articles of Association from time to time corresponding thereto), issue preference shares which are economically equivalent to the Preferred Securities 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, with each Holder receiving an amount of such junior-ranking preference shares which is proportioned to their holding of Preferred Securities as at the Substitution Date.

Any Qualifying Tier 1 Instruments which when issued are in the form of preference shares issued by HBOS will also be subject to Article 5.17 of the Articles of Association of HBOS (or any provision from time to time corresponding thereto), which contains restrictions on the ability of HBOS to declare or set aside any sum for the payment of any dividends or distributions on preference shares in certain circumstances where dividends or distributions are not paid in full (or a sum has not been set aside therefor) on other series of preference or other shares which rank *pari passu* with, or senior to, such preference shares.

- 5.3 Notwithstanding any provision of sub-paragraph 5.2 above, the Issuer’s obligations to substitute the Preferred Securities for Qualifying Tier 1 Instruments which are to be in the form of preference shares issued by HBOS under sub-paragraph 5.2 shall be satisfied if Repackaged Instruments are issued and delivered to the Holders which (1) are secured with first ranking priority on such preference shares, (2) entitle Holders to rights and benefits which are economically equivalent to such preference shares including with regard to the timing and amount of any payments due on such preference shares, any dates of redemption and any rights of waiver and subordination and (3) are listed on a Recognised Stock Exchange; provided that:
- (i) if at the time of such substitution such preference shares issued by HBOS are rated by one or more Rating Agency, each such Rating Agency shall assign the same rating (or, if the Rating Agencies have revised their criteria for rating transactions of a similar nature to the Repackaged Instruments after the Closing Date, an equivalent rating (being an “Equivalent Rating”)) to such Repackaged Instruments as it has assigned to the preference shares of HBOS; or
  - (ii) if at the time of such substitution such preference shares issued by HBOS are not rated by any Rating Agency, at least one Rating Agency shall have confirmed to the General Partner that it will assign at least the same rating or, where applicable, Equivalent

Rating, to such Repackaged Instruments as that which would have been assigned to the preference shares had they been rated at such time.

Where the General Partner has procured the issue of Repackaged Instruments in accordance with this sub-paragraph 5.3, HBOS will ensure that the issuer of such Repackaged Instruments will pay any UK stamp duty or SDRT arising on the issue thereof.

- 5.4 Following the creation of such Qualifying Tier 1 Instruments, and the obtaining of all corporate authorisations and any applicable regulatory approvals required for the issue and allotment of any Qualifying Tier 1 Instruments (as applicable), HBOS has undertaken that it will, or it will procure the relevant person to issue, allot and deliver (as applicable) to the Holders, Qualifying Tier 1 Instruments, or any Repackaged Instruments issued pursuant to sub-paragraph 5.3 above, in satisfaction of the rights of the Holders in the circumstances and subject to the conditions described herein. HBOS has undertaken to take all reasonable steps to procure that such Qualifying Tier 1 Instruments or any Repackaged Instruments (as applicable) will at the relevant time be listed on a Recognised Stock Exchange. HBOS has undertaken that in the case of either a Mandatory Substitution Event or an Optional Substitution being notified to Holders in accordance with sub-paragraphs 5.1 and 5.2 above, respectively, it will (not later than the time of such notification to Holders) give written notice to the Holders enclosing a substitution confirmation (the “Substitution Confirmation”) which each Holder will be required to complete to the extent set out below. The form of such Substitution Confirmation shall also be made available at the offices of the Principal Paying and Transfer Agent.

Where the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depositary for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, are to be represented by a single certificate registered in the name of such nominee or, where applicable, by a single bearer instrument deposited with such common depositary, HBOS has undertaken to procure that on the Substitution Date, each Holder shall receive Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, in an equivalent nominal amount to its holding of Preferred Securities.

Where the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depositary for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, are to be represented in definitive form, the Holder shall provide a list (the “Beneficial Owner List”) of each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or any other clearing systems as a person with an entitlement in respect of the Preferred Securities, together with the address of each such person for delivery purposes as set out below. The Beneficial Owner List shall, in the case of Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, in definitive registered form, specify in whose name (or the name of the nominee for such person) such instruments should be registered and their address for the purposes set out herein. In such case HBOS has undertaken to use reasonable endeavours to procure that certificates (if any) for Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, in an equivalent nominal amount to each such person’s entitlement in respect of Preferred Securities will be dispatched to the persons identified in the Beneficial Owner List (at the corresponding address), by mail free of charge (but uninsured and at the risk of the person entitled thereto, including as to the accuracy of the address presented in the Beneficial Owner List) within one month after the Substitution Date. In the case of Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, in definitive bearer form, the Beneficial Owner List shall specify the person entitled to surrender their certificate in respect of the Preferred Securities and receive in exchange therefor a definitive bearer instrument representing such Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be. For such purposes HBOS shall specify a bank in London or such other major recognised financial centre as the designated place of exchange and the definitive bearer instruments shall be available for exchange as soon as reasonably practicable.

Where the Preferred Securities are represented in definitive registered form, to receive Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, which are in either definitive registered or definitive bearer form, in respect of its holding of Preferred Securities each Holder must deliver to the Principal Paying and Transfer Agent a completed Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner.

Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations.

HBOS has undertaken in the Guarantee that following such substitution, each Qualifying Tier 1 Instrument or Repackaged Instrument, as the case may be, issued, allotted and delivered (as applicable) will rank for any distribution 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.

Prior to the publication of any notice of substitution pursuant to the foregoing provisions, HBOS must first deliver to the Registrar a certificate, signed by two Directors, certifying that the securities to be offered in substitution for the Preferred Securities are, and an Independent Investment Bank appointed by HBOS for the purpose of making such an assessment agrees that they are Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be.

- 5.5 In circumstances where Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS are issued upon a Mandatory Substitution Event (and the General Partner has not procured the issue of Repackaged Instruments in accordance with sub-paragraph 5.3 above), then HBOS will confer upon Holders the option for such preference shares to be issued either (A) in registered certificated form, in which case HBOS will pay any UK stamp duty or stamp duty reserve tax (“SDRT”) arising on the issue of such preference shares (but not any stamp duty or SDRT that would arise on a subsequent transfer of such preference shares), or (B) into a clearing system (or to a nominee for such a person) which has not made an election under section 97A of the Finance Act 1986 that applies to the preference shares, in which case HBOS will pay the UK stamp duty or SDRT that arises on the issue of such preference shares into the clearing system.

In circumstances where Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS are issued other than upon a Mandatory Substitution Event, then HBOS will (A) issue such preference shares and deliver them to a depositary (or a nominee or agent for such depositary) of a clearing system (or to a nominee for such a person) which has not made an election under section 97A of the Finance Act 1986 that applies to the preference shares, and (B) pay any UK stamp duty or SDRT arising on the issue of such preference shares.

In the case of Qualifying Tier 1 Instruments not being in the form of preference shares issued by HBOS, HBOS will pay or procure that the issuer of the relevant Qualifying Tier 1 Instruments will pay any UK stamp duty or SDRT arising on issue thereof.

Notwithstanding the provisions of sub-paragraph 4.3 above, in the event that Qualifying Tier 1 Instruments in the form of preference shares are issued by HBOS, such preference shares may be redeemed at HBOS’ option (subject to the Redemption Conditions) following the occurrence of a Change in Law Withholding Event (the provisions of which shall apply equally to such preference shares as they do to Preferred Securities), with such preference shares being deemed to have been issued on the Closing Date for these purposes only.

- 5.6 Upon notice of substitution being given to Holders in accordance with sub-paragraph 5.1 or 5.2 above, but prior to the Substitution Date, 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, save that Holders will continue to be entitled to receive Distributions and/or a Liquidation Distribution in respect of the Preferred Securities until the Substitution Date 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.

*Note: If (A) in the case of Preferred Securities which are in definitive registered form, a Holder fails to complete and deliver a Substitution Confirmation in accordance with sub-paragraph 5.4 prior to the Substitution Date or (B) in the case of Preferred Securities which are represented by a single certificate registered in the name of a nominee of a common depositary for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, are to be represented in definitive form and the name and/or address of any person with an entitlement in respect of Preferred Securities (or any nominee thereof) has not been provided in the Beneficial Owner List, the Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, shall be issued to and held on trust by a nominee for such Holder, in the case of (A), or person with an entitlement to Preferred Securities, in the case of (B), which shall in all cases include all sums received thereunder, pending delivery of a completed Substitution Confirmation in accordance with sub-paragraph 5.4, in the case of (A), or pending the provision of the appropriate details for registration, delivery and/or exchange as applicable, in the case of (B).*

*Thereafter, in the case of Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, in definitive registered form, the relevant nominee will arrange for such instrument to be registered in the name of such Holder or person (or its nominee, as appropriate) with an entitlement to Preferred Securities and to effect delivery of a certificate (if any) to the address provided for such purposes. In the case of Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, in definitive bearer form, the relevant nominee will arrange for such instruments to be available for exchange at a bank in London or such other major recognised financial centre. Any person claiming an entitlement to receive Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, shall agree to reimburse the nominee for all reasonably incurred costs and expenses in connection herewith. Claims in respect of any entitlement to receive Qualifying Tier 1 Instruments or Repackaged Instruments, as the case may be, shall be prescribed in accordance with English law unless made within 10 years from the Substitution Date.*

## **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 European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive, 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 on the next Business Day (without interest in respect of such delay)) to the Holders of record as they appear on the Register on the relevant record date, which will be five Business Days prior to the relevant Distribution Payment Date.

If the General Partner gives a notice of redemption in respect of the Preferred Securities pursuant to (i) paragraph 4.2, 4.3 or 4.4, then, by 11:00 a.m. on the Optional Redemption Date, the Tax Event Redemption Date, the Accounting Event Redemption Price or the Regulatory Event Redemption Date, as the case may be, the General Partner shall procure that the applicable Redemption Price will be paid by the Registrar or by the Principal 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 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 capital contribution will, on payment of the applicable 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 applicable 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 the Principal 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, 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 applicable 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, according to the Day Count Fraction, from the Optional Redemption Date, the Tax Event Redemption Date, the Accounting Event Redemption Date or the Regulatory Event Redemption Date, as the case may be, to the date of actual payment of such applicable 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 admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange – Regulated Market, a Principal Paying and Transfer Agent in London, (b) a Registrar having its office outside the UK and (c) a paying agent in an EU member state that will not be obliged to withhold or deduct tax pursuant to European

Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000.

## **8 Voting Rights**

- 8.1 Except as described below and provided for in the Law, Holders will not be entitled to receive notice of or attend or vote at any meeting of partners in the Issuer or participate in the management of the Issuer.
- 8.2 If for two consecutive Distribution Periods, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for any 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.

Any Special Representative so appointed shall vacate office, if for any two consecutive Distribution Periods, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for any 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 under the Guarantee 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 such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).

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.

- 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 Preferred Securities for obligations or securities of another entity) (unless otherwise required by applicable law or provided in the Limited Partnership Agreement as set out herein). 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, 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.

Notwithstanding the above, if any of the events specified in Tax Event, Accounting Event or Regulatory Event or occurs and is continuing, instead of redeeming the Preferred Securities, the General Partner may vary the terms thereof so they constitute Qualifying Tier 1 Instruments but not so as to materially prejudice the interests of the Holders, provided that the Issuer shall have notified the FSA of its intention to make such variation one month prior to the date upon which such variation is intended to become effective.

Prior to the publication of any notice of variation pursuant to the foregoing provisions, HBOS must first deliver to the Registrar a certificate, signed by two Directors, certifying that the Preferred Securities to be varied are still, and an Independent Investment Bank appointed by HBOS for the purpose of making such an assessment agrees that they are still, Qualifying Tier 1 Instruments.

- 8.4 Notwithstanding the foregoing, provided that the two most recent Distributions in the case of Distributions to be paid in respect of Distribution Periods ending on or before the First Optional Redemption Date, or the four most recent Distributions to be paid in respect of Distribution Periods thereafter, 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 two Distribution Periods, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for the next four Distribution Periods, have 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 capital contributions and the corresponding number of Preferred Securities.

Thereafter the Issuer may, provided that the two most recent Distributions, in the case of Distributions to be paid in respect of Distribution Periods ending on or before the First Optional Redemption Date, or the four most recent Distributions to be paid in respect of Distribution Periods thereafter, 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 two Distribution Periods, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for the next four Distribution Periods, have been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), 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 Principal Paying and Transfer Agent 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 admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange – Regulated Market and the rules of the London Stock Exchange so require, published in a leading London daily newspaper which is expected to be the *Financial Times*. Any mailed notice shall be deemed to have been given one clear day after the date on which it was posted and any notice published in a newspaper shall be deemed to have been given on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

## **11 Transfers and Form**

- 11.1 The Preferred Securities will be in registered form each in the denominations of £50,000 per Preferred Security and integral multiples of £1,000 thereabove.
- 11.2 If definitive certificates are made available in respect of Preferred Securities they will be available from the Registrar and from the Principal Paying and Transfer Agent at its specified offices, and will be posted to the relevant Holders at the address shown in the Register or, as applicable, in the relevant Note of transfer within three Business Days of issue, by uninsured

post at the risk of such Holders. Transfers of Preferred Securities if represented by definitive certificates may be effected by presentation of the relevant certificate (with the transfer certificate relating thereto duly completed on behalf of the transferor and the transferee) at the specified office of the Registrar or the Principal Paying and Transfer Agent. Where a Holder transfers only some of the Preferred Securities represented by any such certificate he shall be entitled to a certificate for the balance without charge. In either case the Register shall only issue a certificate with respect to holdings in excess of £50,000. Holders will not be required to bear the costs and expenses of effecting any registration of transfer as provided above, except for any costs or expenses of delivery other than by regular uninsured mail and except that the Issuer may require the payment of a sum sufficient to cover any stamp or other duty, or other tax or other governmental charge that may be imposed in relation to the registration.

## **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 Principal Paying and Transfer Agent.

## **13 Prescription**

Claims against the Issuer for payment of Distributions and sums in respect of the applicable 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 a 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 the Closing Date. Upon the registration of the Preferred Securities in the name of a nominee of Euroclear and Clearstream, Luxembourg and delivery of the Global Certificates to the common depository for Euroclear and Clearstream, Luxembourg, it will credit each subscriber with such number of Preferred Securities equal to the number thereof for which it has subscribed and paid.

So long as the Preferred Securities are represented by a Global Certificate and the relevant clearing system(s) so permit, the Preferred Securities will be tradeable only in the minimum authorised denomination of £50,000 and higher integral multiples of £1,000, notwithstanding that no definitive certificates will be issued with a denomination above £99,000.

### Accountholders

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

### Exchange

The Global Certificate will be exchangeable in whole but not in part (free of charge to the Holder) for definitive certificates if either Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so and no alternative clearing system satisfactory to the Registrar is available.

Thereupon the General Partner may give notice to the Holders of its intention to exchange the Global Certificate for definitive certificates on or after the Exchange Date (as defined below).

On or after the Exchange Date, the Holder of the Global Certificate may surrender the Global Certificate to or to the order of the Registrar. In exchange for the Global Certificate, the Registrar will deliver, or procure the delivery of, definitive certificates printed in accordance with any applicable legal and stock exchange requirements and in or substantially in the form set out in the Limited Partnership Agreement. On exchange of the Global Certificate, the General Partner will procure that it is cancelled and, if the Holder of the Global Certificate so requests, returned to that Holder together with any relevant definitive certificates.

For these purposes, Exchange Date means a day specified in the notice requiring exchange falling not less than 10 days after that on which such notice is given and being a day on which banks are open for general business in the place in which the specified office of the Registrar is located.



**Payments**

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

**Settlement**

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

## Subordinated Guarantee

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

THIS DEED OF GUARANTEE (the “Guarantee”), dated 19 March 2008 (the “Closing Date”), 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 Limited 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, Tax Event Redemption Price, Accounting Event Redemption Price or Regulatory Event Redemption Price (as applicable) and (iv) any relevant Additional Amounts;

“Guarantor Additional Amounts” has the meaning ascribed to it in clause 2.3;

“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 depositary (or of a nominee for a common depositary) for Euroclear and Clearstream, Luxembourg, in which case it shall mean each person 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 and Clearstream, Luxembourg as to the number of Preferred Securities standing to the account of any person shall be conclusive and binding for all purposes), the right to which shall be vested in the name of the person appearing as the relevant limited partner in the Register;

“Issuer” means HBOS Capital Funding No. 4 L.P.;

“Limited Partnership Agreement” means the Limited Partnership Agreement dated on or before the Closing Date establishing the Issuer as amended from time to time;

“Preferred Securities” means the £750,000,000 fixed-to-floating rate non-voting non-cumulative perpetual preferred securities comprising limited partnership interests in 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; and

“Senior Creditors” has the meaning ascribed to it in clause 2.2.

## 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 have not 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 2.2) 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, 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 administration, 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 Preferred 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.
- 2.3 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 UK 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 of a Preferred Security (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 such Preferred Security having some connection with the UK, 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 European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive or (iii) which would not have been payable or due but for the failure to comply with any statutory requirements or make, or procure that any third party makes, a declaration of non-residence or similar claim for exemption from such withholding or deduction or (iv) where the relevant Preferred Security is presented for payment more than 30 days after the Relevant Date, except to the extent that the Holder thereof would have been entitled to such Guarantor Additional Amounts on presenting the same for payment on the last day of such period of 30 days, and except that HBOS’ obligation to pay any Guarantor

Additional Amounts is subject to the exceptions relating to Guaranteed Payments set out in clause 2.2.

In this clause 2.3, “Relevant Date” means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received by the Principal Paying and Transfer Agent on or prior to such due date, the date on which, the full amount having been so received, notice to that effect shall have been given to the Holders. Any reference in this Guarantee to any Guaranteed Payment shall be deemed to include any additional amounts which may be payable by HBOS under this clause 2.3, or under any undertaking given by HBOS in addition to or in substitution for this clause 2.3.

- 2.4 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.
- 2.5 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 applicable 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.

- 2.6 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.
- 2.7 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 2.8, 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.

- 2.8 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.
- 2.9 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 2.5.
- 2.10 Subject to applicable law, HBOS agrees that its obligations hereunder constitute unsecured obligations of HBOS and the 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.
- 2.11 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.
- 2.12 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.
- 2.13 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) payments of Distributions on the Preferred Securities in respect of the most recent Distribution Period, if on or before the First Optional Redemption Date, or payments of Distributions on the Preferred Securities in respect of the four most recent Distribution Periods, if after the First Optional Redemption Date, 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 Limited 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 Parity Securities (where the dividend or distribution in all forms is at the discretion of the directors or equivalent person(s)) and any Junior Share Capital (except for any Excluded Preference Shares), or (b) (if permitted) repurchase or redeem such Parity Securities or Junior Share Capital (except for Excluded Preference Shares), in each case (a) or (b) until after the second consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount equivalent to the Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), in the case of a Distribution Period ending on or before the First Optional Redemption Date, or until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount at least equal to the expected Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders and, if upon determination of the amount of each of such Distribution there is a shortfall in the amounts so paid or set aside with reference to the amounts so determined, an amount at least equal to such shortfall shall be paid or irrevocably set aside in the same manner), in the case of a Distribution Period ending after the First Optional Redemption Date.
- 3.3 HBOS undertakes that, so long as any of the Preferred Securities are 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 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 (a) it will at all times have a sufficient number of authorised but unissued preference shares to permit the substitution thereof for all outstanding Preferred Securities and (b) all corporate authorisations will have been taken for the issue and allotment of such preference shares free from pre-emptive rights.

Following the creation of such preference shares and obtaining such corporate authorisations as aforesaid, HBOS further undertakes that where the Preferred Securities are to be substituted with Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS, (a) it will issue and allot to Holders such preference shares (or, where any Repackaged Instruments are to be issued to Holders in accordance with the Limited Partnership Agreement, procure the issue, allotment and delivery to Holders (as applicable) of such Repackaged Instruments by the issuer thereof) 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 preference shares or, where



applicable, Repackaged Instruments will at the relevant time be listed on a Recognised Stock Exchange and (c) in circumstances where Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS are issued upon a Mandatory Substitution Event (and the General Partner has not procured the issue of Repackaged Instruments in accordance with the Limited Partnership Agreement), then HBOS will confer upon Holders the option for such preference shares to be issued either (A) in registered certificated form, in which case HBOS will pay any UK stamp duty or SDRT arising on the issue of such preference shares (but not any stamp duty or SDRT that would arise on a subsequent transfer of such preference shares), or (B) into a clearing system (or to a nominee for such a person) which has not made an election under section 97A of the Finance Act 1986 that applies to the preference shares, in which case HBOS will pay the UK stamp duty or SDRT that arises on the issue of such preference shares into the clearing system.

In circumstances where Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS are issued other than upon a Mandatory Substitution Event, then HBOS will (A) issue such preference shares and deliver them to a depository (or a nominee or agent for such depository) of a clearing system (or to a nominee for such a person) which has not made an election under section 97A of the Finance Act 1986 that applies to the preference shares, and (B) pay any UK stamp duty or SDRT arising on the issue of such preference shares.

Where the General Partner has elected to procure the issue of Repackaged Instruments in accordance with the Limited Partnership Agreement, HBOS will pay or will procure that the issuer of such Repackaged Instruments will pay any UK stamp duty or SDRT arising on the issue thereof.

HBOS undertakes that as soon as practicable after a Mandatory Substitution Event or upon an Optional Substitution in each case where Qualifying Tier 1 Instruments which are in the form of preference shares of HBOS, or where applicable, Repackaged Instruments, are to be issued to Holders as contemplated in the Limited Partnership Agreement, it will (not later than the time of such notification to Holders) give written notice to the Holders enclosing a Substitution Confirmation which each Holder will be required to complete to the extent set out in the Limited Partnership Agreement. The form of such Substitution Confirmation shall also be made available at the offices of the Principal Paying and Transfer Agent.

Where the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depository for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, are to be represented by a single certificate registered in the name of such nominee or, where applicable, by a single bearer instrument deposited with such common depository, HBOS undertakes to procure that on the Substitution Date, each Holder shall receive Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, in an equivalent nominal amount to its holding of Preferred Securities.

Where the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depository for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, are to be represented in definitive form, the Holder shall provide a Beneficial Owner List of each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or any other clearing systems as a person with an entitlement in respect of the Preferred Securities, together with the address of each such person for delivery purposes as set out below. The Beneficial Owner List shall, in the case of Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, in definitive registered form, specify in whose name (or the name of the nominee for such person) such instruments should be registered and

their address for the purposes set out herein. In such case HBOS undertakes to use reasonable endeavours to procure that certificates (if any) for Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, in an equivalent nominal amount to each such person's entitlement in respect of Preferred Securities will be dispatched to the persons identified in the Beneficial Owner List (at the corresponding address), by mail free of charge (but uninsured and at the risk of the person entitled thereto, including as to the accuracy of the address presented in the Beneficial Owner List) within one month after the Substitution Date. In the case of Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, in definitive bearer form, the Beneficial Owner List shall specify the person entitled to surrender their certificate in respect of the Preferred Securities and receive in exchange therefor a definitive bearer instrument representing such Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be. For such purposes HBOS shall specify a bank in London or such other major recognised financial centre as the designated place of exchange and the definitive bearer instruments shall be available for exchange as soon as reasonably practicable.

Where the Preferred Securities are represented in definitive registered form, to receive Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS or Repackaged Instruments, as the case may be, which are in either definitive registered or definitive bearer form, in respect of its holding of Preferred Securities each Holder must deliver to the Principal Paying and Transfer Agent a completed 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.

Notwithstanding the provisions of the Limited Partnership Agreement with respect to Optional Substitution, if on the Substitution Date the relevant Qualifying Tier 1 Instruments do not comply with the criteria for Tier 1 Capital in effect on that date (but do comply with the corresponding criteria in effect as at the Closing Date), HBOS undertakes to procure that the issuer thereof shall not be permitted to redeem such Qualifying Tier 1 Instruments on terms analogous to a Regulatory Event solely as a consequence of such non-compliance.

HBOS undertakes that following such substitution, each Qualifying Tier 1 Instruments which are in the form of preference shares of HBOS, or, where applicable, Repackaged Instrument, as the case may be, issued, allotted and delivered (as applicable) to Holders 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.

Prior to the publication of any notice of substitution pursuant to the foregoing provisions, HBOS must first deliver to the Registrar a certificate, signed by two Directors, certifying that the securities to be offered in substitution for the Preferred Securities are, and an Independent Investment Bank appointed by HBOS for the purpose of making such an assessment agrees that they are, Qualifying Tier 1 Instruments which are in the form of preference shares of HBOS or, where applicable, Repackaged Instruments.

- 3.6 HBOS undertakes that it will, or procure that the relevant issuer will, obtain all relevant corporate authorisations for the issue, allotment and delivery of the Qualifying Tier 1 Instruments not being in the form of preference shares of HBOS. Where the Preferred Securities are being exchanged for Qualifying Tier 1 Instruments not being in the form of preference shares of HBOS, HBOS undertakes that it will or will procure that the relevant issuer will issue, allot and deliver to Holders Qualifying Tier 1 Instruments not being in the form of preference shares of HBOS in satisfaction of the rights of the Holders in the

circumstances and subject to the conditions described in the Limited Partnership Agreement. HBOS undertakes that it will take all reasonable steps to procure that such Qualifying Tier 1 Instruments not being in the form of preference shares of HBOS will at the relevant time be listed on a Recognised Stock Exchange.

HBOS undertakes that as soon as practicable following an election by the General Partner to substitute Qualifying Tier 1 Instruments not being in the form of preference shares of HBOS, it will (not later than the time of such notification to Holders) give written notice to the Holders enclosing a Substitution Confirmation which each Holder will be required to complete to the extent set out in the Limited Partnership Agreement. The form of such Substitution Confirmation shall also be made available at the offices of the Principal Paying and Transfer Agent.

Where the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depository for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) are to be represented by a single certificate registered in the name of such nominee or, where applicable, by a single bearer instrument deposited with such common depository, HBOS undertakes to procure that on the Substitution Date, Holders shall receive Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) in an equivalent nominal amount to its holding of Preferred Securities.

Where the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depository for Euroclear or Clearstream, Luxembourg and the Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) are to be represented in definitive form, the Holder shall provide a Beneficial Owner List of each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or any other clearing systems as a person with an entitlement in respect of the Preferred Securities, together with the address of each such person for delivery purposes as set out below. The Beneficial Owner List shall, in the case of Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) in definitive registered form, specify in whose name (or the name of the nominee for such person) such instruments should be registered and their address for the purposes set out herein. In such case HBOS undertakes to use reasonable endeavours to procure that certificates (if any) for Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) in an equivalent nominal amount to each such person's entitlement in respect of Preferred Securities will be dispatched to the persons identified in the Beneficial Owner List (at the corresponding address), by mail free of charge (but uninsured and at the risk of the person entitled thereto, including as to the accuracy of the address presented in the Beneficial Owner List) within one month after the Substitution Date. In the case of Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) in definitive bearer form, the Beneficial Owner List shall specify the person entitled to surrender their certificate in respect of the Preferred Securities and receive in exchange therefor a definitive bearer instrument representing such Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS). For such purposes HBOS shall specify a bank in London or such other major recognised financial centre as the designated place of exchange and the definitive bearer instruments shall be available for exchange as soon as reasonably practicable.

Where the Preferred Securities are represented in definitive registered form, to receive Qualifying Tier 1 Instruments (not being in the form of preference shares issued by HBOS) which are in either definitive registered or definitive bearer form, in respect of its holding of Preferred Securities each Holder must deliver to the Principal Paying and Transfer Agent a completed Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner.

Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations.

HBOS undertakes that, following such substitution, each Qualifying Tier 1 Instrument not being in the form of a preference share of HBOS, issued, allotted and delivered (as applicable), will rank for any distribution 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.

HBOS will pay or procure that the issuer of the relevant Qualifying Tier 1 Instruments (not being in the form of preference shares of HBOS, which excludes, for the avoidance of doubt, Repackaged Instruments) will pay any UK stamp duty or SDRT arising on issue of such Qualifying Tier 1 Instruments.

Prior to the publication of any notice of substitution pursuant to the foregoing provisions, HBOS must first deliver to the Registrar a certificate, signed by two Directors, certifying that the securities to be offered in substitution for the Preferred Securities are, and an Independent Investment Bank appointed by HBOS for the purpose of making such an assessment agrees that they are, Qualifying Tier 1 Instruments.

- 3.7 HBOS will procure that the General Partner will maintain at all times whilst the Preferred Securities are outstanding (a) whilst the Preferred Securities are admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange – Regulated Market, a Principal Paying and Transfer Agent in London, (b) a Registrar having its office outside the UK, and (c) a paying agent in an EU member state that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000.

#### **4 Termination**

With respect to the Preferred Securities, this Guarantee shall terminate and be of no further force and effect upon (i) full payment of the applicable Redemption Price on all Preferred Securities, (ii) purchase and cancellation of all Preferred Securities, (iii) full payment of the Liquidation Distribution or (iv) the issue and allotment of the Qualifying Tier 1 Instruments, 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 Qualifying Tier 1 Instruments 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 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 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: +44 (0) 131 442 7777  
Facsimile: +44 (0) 131 243 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. 4 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 Bank of Scotland plc at its office situated at 33 Old Broad Street, London EC2N 1HZ (Attention: Head of Legal).

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

## **Use of Proceeds**

The net proceeds from the issuance of the Preferred Securities will be used to acquire the Notes, the proceeds of the issue of which will be used to strengthen the capital base of the HBOS Group and to support the continuing growth of its business.



# HBOS Capital Funding No. 4 L.P.

## Introduction

HBOS Capital Funding No. 4 L.P. (the “Issuer”) was registered in Jersey on 5 September 2007 under the Law for an unlimited duration, with registered number LP954 and 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 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 the Closing Date (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 Issuer 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 Initial Preferential Limited Partner also hold partnership interests in HBOS Capital Funding L.P., HBOS Capital Funding No. 1 L.P., HBOS Capital Funding No. 2 L.P. and HBOS Capital Funding No. 3 L.P., which are separately established partnerships 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.

The Issuer has not prepared any financial statements to date.

## Administration

HBOS Capital Funding No. 4 L.P. will be operated by the General Partner. The registered office of the Issuer and the General Partner is 22 Grenville Street, St Helier, Jersey JE4 8PX, telephone number +44 (0)1534 609 000. No Holder may participate in the administration of the Issuer. The Directors of the General Partner are Helen Grant, Gareth Essex-Cater, Daniel Le Blancq, Simon Vardon and David Balai, whose business address is that set out for the General Partner, excluding David Balai, whose business address is 33 Old Broad Street, London EC2N 1HZ, United Kingdom.

The General Partner has agreed to contribute capital from time to time to the extent required for the Issuer to meet any operating expenses that 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 has been paid to or irrevocably set aside for such Holders.

### **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 Principal Paying and Transfer Agent 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.

### **Conflicts of Interest**

No potential conflicts of interest exist at the date of this Prospectus between the duties of the Directors to the General Partner and their private interests or other duties.

# HBOS

## Introduction

HBOS plc (“HBOS”) was incorporated and registered in Scotland in the Register of Companies on 3 May 2001, with registered number SC 218813, as a public limited company under the Companies Act 1985. HBOS together with its subsidiaries and subsidiary undertakings (as defined in the Companies Act 1985) is collectively referred to as the “HBOS Group”. As a consequence of the approval of schemes of arrangement for Bank of Scotland and Halifax plc, which became effective in 2001, HBOS became the holding company of the HBOS Group. The principal legislation under which HBOS operates is the Companies Act 1985. The registered office and head office of HBOS in the United Kingdom is The Mound, Edinburgh EH1 1YZ, telephone number +44 (0) 870 600 5000.

On 17 September 2007, in accordance with the provisions of the HBOS Group Reorganisation Act 2006 (the “Act”), the Governor and Company of the Bank of Scotland registered as a public limited company under the Companies Act 1985 and changed its name to Bank of Scotland plc (“Bank of Scotland”), registered number SC 327000. On the same day, under the Act, the business activities, assets (including investments in subsidiaries) and liabilities of Capital Bank plc, Halifax plc and HBOS Treasury Services plc transferred to Bank of Scotland. HBOS has three remaining principal directly held subsidiaries: Bank of Scotland, HBOS Insurance & Investment Group Limited and Halifax Share Dealing Limited. Bank of Scotland is among the largest commercial banks in the UK.

The HBOS Group is a diversified financial services group engaged in a range of banking, insurance broking, financial services and finance-related activities throughout the UK and internationally.

## Strategy

HBOS’s strategy focuses on five key elements designed to create enduring value for shareholders:

- growing the UK franchise;
- targeted international growth;
- cost leadership;
- capital discipline; and
- colleague development.

### *Growing the UK Franchise*

Growing its UK businesses remains the HBOS Group’s number one priority. The HBOS Group’s Retail business has around 23 million customers to whom it provides a wide range of financial services. The HBOS Group operates with several brands in the savings, mortgage and unsecured credit markets which allows it to segment and manage more effectively the risk: reward potential of individual customer groupings. The HBOS Group aims to secure, over time, market shares across its products within a 15-20 per cent. range. The actual market shares achieved in any operating period are, however, governed by the sustainability of returns. This will see the HBOS Group take more or less market share than its central assumptions, as competitive conditions dictate the right action for the creation of enduring value for shareholders.

In its Corporate business, the HBOS Group continues to concentrate on markets where it has expertise and can generate superior returns. Through a focus on the individual risk: reward characteristics of alternative asset classes, the HBOS Group aims to bring a clear value-enhancing specialisation to its customer relationships. Assets are originated on the basis that they will be held on the balance sheet in their entirety, even if subsequently a proportion of debt or equity positions are sold down to other market participants. This discipline ensures there is no disconnect between a decision to lend and the potential availability of higher returns through sell-down activity when market conditions are supportive.

In its Insurance & Investment businesses the HBOS Group believes it is uniquely well placed to benefit from opportunities from being the largest provider of UK liquid savings. This, together with ongoing supportive demographics, gives it a real opportunity to capture a strong share of the sector growth in investment sales. In General Insurance, the HBOS Group offers a range of insurance services from household to motor cover. The HBOS Group targets growth by aligning its insurance offerings to existing HBOS Group customers with other products and in the wider market to new customers, both via multi-brand propositions.

#### *Targeted International Growth*

Internationally, the HBOS Group continues to grow its businesses by taking the formula that has served it well in the UK to other markets that it understands. In Australia, where the HBOS Group has been operating for over 10 years, it is expanding on its strong West Coast presence and is now establishing its Commercial and Retail banking capability in eastern Australia. In Ireland, the HBOS Group is in its second full year of expansion into the provision of retail banking facilities through the now almost complete establishment of a branch network. In Europe and North America, the HBOS Group has increased its distribution capability in its European Financial Services operations and is expanding its corporate banking activities in the US and Canada.

#### *Cost Leadership*

The HBOS Group's cost leadership ambition (relative to its major competitors) is based on an understanding that this is a source of a sustainable competitive advantage. Cost leadership can provide pricing power and the ability to offer customers the same products or services for a lower price. It can also offer the opportunity to capture market share from competitors without any erosion of credit quality, thereby increasing sustainable revenues. Cost leadership at the HBOS Group does not mean reduced investment in its businesses, but it does mean a cultural focus on taking out the least productive costs and reinvesting these savings in growing value for its shareholders.

#### *Capital Discipline*

The HBOS Group accepts that capital is owned by its shareholders who expect it to treat it as a scarce resource, deploying it to achieve sustainable returns throughout the economic cycle. As the dislocation in financial markets in 2007 has shown, capital strength is also required to cushion against the shocks that are a periodic feature of banking. Whether capital is utilised for growth or returned to shareholders when in surplus is governed by the stability of target capital ratios and the sustainability of returns that can be generated by further capital deployment.

During 2007, the FSA approved the HBOS Group's "Advanced Measurement Approach" to operational risk and "Advanced Internal Ratings Based Approach" to credit risk and, as from 1 January 2008, the HBOS Group is now operating under the Basel II capital ratio regime. This advanced capital regime has redefined both the size and nature of the capital resources available to the HBOS Group as well as the level of risk weighted assets. It has not however changed the HBOS Group's approach to capital management.

#### *Colleague Development*

As the HBOS Group faces the unprecedented financial turmoil in global markets, its focus on colleague development has never been more important. The HBOS Group's ability to execute its strategy relies on engaging with, and motivating, all of its colleagues to deliver consistently outstanding performance. The HBOS Group's colleague strategy is therefore very clear. It aims to have the strongest leadership teams in the sector and it is very clear about the high expectations of both what its leaders deliver and how they do this. The HBOS Group provides colleagues with ongoing opportunities to learn and to develop their careers and it constantly evaluates its efforts to create a positive working environment that reflects the diversity of its colleagues. The HBOS Group keeps all aspects of its reward systems under continuous review to ensure they deliver the right reinforcement in respect of recruitment, retention and motivation. Through

the HBOS Group's "Colleague Opinion Survey", it tracks its leadership and capability indices as well as employer and product advocacy.

## **Business**

The HBOS Group's products and services can be categorised into the following business divisions:

- Retail;
- Corporate;
- Insurance & Investment;
- International; and
- Treasury & Asset Management.

### *Retail*

The Retail division provides financial services to approximately 23 million customers through a broad distribution base (ranging from branches to direct mail, telephone and internet services). Its range of multi-branded products includes personal and business banking services providing mortgages, savings, bank accounts, personal loans and credit cards.

As at 31 December 2007, the HBOS Group was the largest retail mortgage provider in the UK, with a market share of residential mortgages of 20 per cent., with balances of approximately £235 billion and customer deposits of more than £158 billion. Mortgages in the UK are currently provided by the Retail division under five mortgage brands: Halifax; Bank of Scotland; Intelligent Finance; Birmingham Midshires; and The Mortgage Business.

Savings products are offered through four brands: Halifax; Bank of Scotland; Birmingham Midshires and Intelligent Finance, catering for all segments of the savings market, including children's accounts, tax free, fixed rate and regular savings accounts. The HBOS Group is the current market leader for liquid savings, with a 16 per cent. market share. Bank accounts offered by the HBOS Group range from full facilities current accounts to basic social banking facilities.

Personal loans and credit cards are offered through the HBOS Group's Halifax, Bank of Scotland and Intelligent Finance brands. Credit cards are also provided through a number of affinity brands such as charity cards, where a proportion of income earned is donated to the charity. The Retail division also distributes the HBOS Group's insurance and investment products on behalf of the Insurance & Investment division and participates in a number of joint ventures, such as Sainsbury's Bank.

The Retail division's long-term strategy is to continue to grow its market share of major retail products such that each falls within the 15–20 per cent. range. The division intends to implement this strategy by attracting new customers with innovative and value-adding products, and maintaining long-term relationships with customers and meet a greater share of their financial needs. The division intends to achieve this by providing excellent service, offering additional products that are more effectively targeted to meeting customers needs and providing extra value that recognises the customer relationship. In addition to growing its market share, the Retail division aims to continue to target growth that achieves the right balance between risk and reward and keeps tight control of costs.

### *Corporate*

The Corporate division provides a range of banking services to the corporate business sector. Its principal market is UK and European based businesses with a turnover in excess of £1 million (or its currency equivalent). The division comprises a number of relationship banking and specialist lending teams. Their responsibilities include the provision of term loans, asset finance, motor finance, multi-currency loans and deposits, mezzanine funding, equity investment, fund investment, joint venture partnerships, working capital finance, 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 asset class approach and delivering specialist services to existing and new customers.

The Corporate division's real estate teams have experience in commercial property finance and offer a range of funding options. The Corporate division's commercial bank is a diverse business focusing on the needs of UK businesses with a turnover in excess of £1 million (or its currency equivalent). The integrated, structured and acquisition finance teams operate in the leveraged buy-out market, providing a range of financing vehicles to their customers. The private equity business has a reputation for innovative deal making and additionally invests in a number of private equity funds. The motor business finances car fleets, vans and buses. The asset finance teams cover a diverse market sector and are engaged in financing or owning tangible assets ranging from oil tankers, trains and aeroplanes to photocopiers, IT and vending machines. The energy and environmental team focuses on supplying funding to the renewable power generation sector, primarily across Europe. The oil and gas team delivers upstream funding for independent oil companies together with niche downstream project financing. The infrastructure and housing finance teams provide debt funding solutions and risk capital investments in economic and social infrastructure projects via government PFI and PPP projects. The telecoms and media team is dedicated to the provision of funding to corporate entities and financial sponsors across Europe.

The Corporate division's strategy is asset class management, which is applied to establish selective asset growth while preserving strong margins and exercising vigilant credit risk management. To this end, the Corporate division continues to seek quality opportunities at the right price and with the right partners, concentrating on returns rather than volumes. In addition, recognising that its success is dependent upon the success and prosperity of the communities and the society in which it operates, the Corporate division aims to maintain a leading role in the corporate and social responsibility area. Finally, the Corporate division aims to exercise cost discipline by driving value for money from all expenditure. The Corporate division thus continues to challenge how it can deliver a superior service, from innovation and delivery of differentiating strategic projects, while driving value for money from all expenditure and minimising costs.

As at 31 December 2007, the HBOS Group employed over 9,000 staff in the Corporate division across the UK and Europe.

#### *Insurance & Investment*

The HBOS Group's Insurance & Investment division is one of the UK's largest providers of general insurance and investment products, offering multi-brand life, pensions, mutual funds and general insurance products. The division uses a multi-channel, multi-brand operating model which it believes allows it to maximise both distribution reach and product and pricing flexibility. While low-cost access to the large Retail division customer base is a core strength, the division also benefits from solid third party distribution relationships with partners and intermediaries. Products offered by the Insurance & Investment division include savings, investments and pensions, life, household, repayment and motor insurance. Products are distributed through a number of different channels, including branches, independent financial advisers, a dedicated high net worth sales force, telephone and internet sales, and partnerships and joint ventures with third parties.

The Investment businesses focus on manufacturing and distributing investment funds, bond, pension and protection products. This business mix covers over 80 per cent. of the UK life, pensions and investment market. The Insurance & Investment division has chosen not to actively market annuities, given the longevity risk and capital requirements of such products, and instead offers its customers access to products from other providers via an in-house independent annuity service. The Investment businesses have three distinct distribution channels: Bancassurance, Intermediary and Wealth Management. In Bancassurance, Halifax-branded business is distributed principally through branch-based personal finance advisers with mass affluent and high net worth business sold under the Bank of Scotland Investment Service brand. Clerical Medical-branded products are distributed through the Intermediary channel and, in Wealth Management, HBOS owns a 60 per cent. stake in St. James's Place, a leader in the wealth management market.



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

The esure joint venture manufactures and distributes all of the motor insurance under the esure, Sheilas' Wheels, First Alternative, Halifax and Sainsbury's Bank brands. Distribution takes place largely through esure's direct channels as well as in Sainsbury's supermarkets and the Retail branch network.

The goal of the Insurance & Investment division is to be the UK's leading insurance and investment group, acting through its multi-channel, multi-brand operating model and accessing the significant HBOS Group's customer base to grow a profitable market share. Specifically, to implement this strategy, the Insurance & Investment division seeks to grow the market share of personal insurance lines, recognising that there are significant opportunities through the Retail division's network, intermediaries and joint ventures to grow market share, with a particular focus on using the HBOS Group's leading position in mortgages to grow market share in household insurance. The UK Competition Commission's investigation of payment protection (also known as repayment insurance) could affect the distribution and pricing of this product across the industry. The HBOS Group considers repayment insurance to be an important and valuable product for its customers. The Insurance & Investment division aims to grow its market share of investment products, using its place as part of the UK's largest liquid savings provider to benefit from higher savings ratios, supporting demographics and what the Insurance & Investment division believes is the increasing recognition by individuals that they will need to save for their retirement themselves. Finally, the Insurance & Investment division intends to place an emphasis on increasing customer satisfaction and maintaining cost leadership through maximum efficiency.

#### *International*

The International division is responsible for the development of the HBOS Group's strategic direction (including mergers and acquisitions activity) and has divisional responsibility for its main overseas interests in Australia, Ireland and Europe and North America ("ENA"). It consists of the following teams: (i) Group Strategy, which assists the HBOS Group's executive in the development of HBOS Group strategy in the UK and overseas and oversees the implementation of strategic initiatives that are controlled at HBOS Group level; (ii) International Operations, which oversees credit risk across the International division; (iii) Bank of Scotland (Ireland) which focuses on providing banking solutions to small and medium-sized enterprises in Ireland and has recently moved into full service retail banking; (iv) HBOS Australia, a full service offering in Australia; (v) ENA, which encompasses the HBOS Group's businesses in Europe and North America; and (vi) Public Policy, which manages the HBOS Group's interface with external policy and regulatory bodies.

The International division consists of three distinct businesses in Australia, Ireland and ENA. In Australia, the division's retail and commercial businesses operate under the BankWest brand, with a strong presence in Western Australia and what HBOS believes to be a growing presence nationally. The division's insurance and investment businesses in Australia operate under the St. Andrew's brand and the division's Australian corporate banking businesses, based in Sydney, operate under the BOS International brand. These provide, principally, mergers and acquisition finance, real estate lending and infrastructure/project finance. In Australia, the division's asset finance business operates under the Capital Finance brand.

In Ireland, the International division has become established in the business banking and intermediary markets, operating under the Bank of Scotland (Ireland) brand. The division has targeted establishing a full service bank in Ireland and, to that end, it is in the process of developing a nationwide branch network that will support the delivery of a more complete range of retail banking products including current accounts. Using the Halifax name, the HBOS Group expects the bank will offer simple, value-for-money products aimed at overcoming customer inertia and creating clear differentiation from competitor offerings.

In ENA, Corporate North America focuses on sectors in which HBOS Group has experience, including oil and gas, gaming and real estate. The retail activities consist of Banco Halifax Hispania, an expanding branch network in Spain, and an online and intermediary mortgage business, BOS Netherlands. The Investment business provides life insurance and pensions, predominantly to the German investment market through the Clerical Medical Europe and Heidelberger Leben brands.

Public Policy seeks to identify the agenda of public policy decision makers wherever in the world the HBOS Group has business interests and develop an internal understanding of these agendas, facilitate the HBOS Group's positioning on policy developments and engage and support senior executives in public policy formation and influencing.

Seeking to apply to certain targeted areas the same approach that HBOS considers to have been successful in the UK, the International division's ongoing strategies include growing nationally across Australia, creating a full service bank in Ireland as discussed above, growing products and sector specialisms in ENA and maintaining overall cost leadership.

#### *Treasury & Asset Management*

Bank of Scotland Treasury is the centralised treasury for the HBOS Group and provides and manages prudential and regulatory liquidity and wholesale multi-currency funding for the HBOS Group. It arranges the HBOS Group's debt capital issuance and asset securitisation programmes and offers a range of treasury services to HBOS Group customers from its offices in London and its branches in Glasgow, Grand Cayman, New York and Sydney. Bank of Scotland Treasury also has management responsibility for the treasury activities of Bank of Scotland (Ireland) Limited.

Asset Management, comprising Insight Investment Management Limited ("Insight") and Invista Real Estate Investment Management plc ("Invista") and their respective subsidiary companies, is the investment management business within the HBOS Group. It provides investment management services, investment advisory services and is also a retailer of shares in open-ended investment companies and other investment vehicles.

Insight is one of the largest UK fund managers, with funds under management of £109.1 billion. It operates a multi-channel business, managing money for the HBOS Group, retail investors, pension funds, insurance groups and other institutions. Insight's strategic product lines are Fixed Income, Cash, Liability Driven Investment, Equities and Absolute Return.

Invista was formed following the initial public offering of the real estate division of Insight and is the largest UK-listed real estate fund manager, with funds under management of £8.7 billion. Invista currently manages 21 real estate funds spread across the UK and continental Europe. This includes seven funds managed on behalf of the HBOS Group as well as other funds managed on behalf of third party clients.

The Treasury & Asset Management strategy involves the provision and management of the HBOS Group's funding and liquidity requirements to ensure it has sufficient financial resources to deliver its strategy, including maintaining a balance of short and medium-term funding. In addition, the division seeks to deliver top quality service to the HBOS Group and its customers supported by the appropriate level of investment in systems and infrastructure. The division intends to maximise cross-selling opportunities with HBOS Group customers, leveraging its product innovation and capability in the market to drive sales levels. With respect to Asset Management, HBOS is of the view that investment performance is at the heart of asset management, and accordingly the division will focus on the delivery of superior investment returns by focusing on those products that have a proven track record of exceptional performance.

## Principal HBOS Group Subsidiaries

HBOS is the holding company of the HBOS Group. The following table shows the principal direct and indirect subsidiary undertakings of HBOS as at 31 December 2007 which HBOS believes are likely to have a significant effect on the assessment of the assets and liabilities, the financial position and/or the profits and losses of the HBOS Group and HBOS' percentage interest in those companies. Under the Act (and with effect from 17 September 2007), all assets and liabilities in respect of three former principal subsidiaries of HBOS (HBOS Treasury Services plc, Capital Bank plc and Halifax plc) were assumed by Bank of Scotland.

Company	Activity	Total % of ordinary share capital held (directly by HBOS)	Country of incorporation or registration	Registered office/head office
Bank of Scotland plc . . . . .	Banking, financial and related services	100	Scotland	The Mound Edinburgh EH1 1YZ
Bank of Scotland (Ireland) Limited . . . . .	Banking	100	Ireland	Bank of Scotland House, 124-127 St. Stephen's Green, Dublin 2, Ireland
HBOS Covered Bonds LLP . . . . .	Residential mortgage funding	100	England and Wales	Trinity Road, Halifax, West Yorkshire, HX1 2RG
HBOS Australia Pty Limited . . . . .	Banking	100	Australia	BankWest Tower, 108 St Georges Terrace, Perth, Australia WA 6000
Bank of Western Australia Limited . . . . .	Banking	100	Australia	BankWest Tower, 108 St Georges Terrace, Perth, Australia WA 6000
Halifax Share Dealing Limited . . . . .	Execution only stockbroking	100	England and Wales	Trinity Road, Halifax, West Yorkshire HX1 2RG
HBOS Insurance & Investment Group Limited . . . . .	Investment holding	100	England and Wales	33 Old Broad Street, London EC2N 1HZ
Halifax General Insurance Services Limited . . . . .	General insurance brokerage	100	England and Wales	Trinity Road, Halifax, West Yorkshire HX1 2RG
St Andrew's Insurance plc . . . . .	General insurance	100	England and Wales	St Andrew's House, Portsmouth Road, Esher, Surrey KT10 9SA

<i>(continued)</i>				
<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly by HBOS)</b>	<b>Country of incorporation of registration</b>	<b>Registered office/head office</b>
Clerical Medical Investment Group Limited . . . . .	Life assurance	100	England and Wales	33 Old Broad Street, London EC2N 1HZ
Clerical Medical Managed Funds Limited . . . . .	Life assurance	100	England and Wales	33 Old Broad Street, London EC2N 1HZ
Halifax Life Limited . . . . .	Life assurance	100	England and Wales	Trinity Road, Halifax, West Yorkshire HX1 2RG
Halifax Investment Fund Managers Limited . . . . .	OEIC management	100	England and Wales	Trinity Road, Halifax, West Yorkshire, HX1 2RG
Insight Investment Management Limited . . . . .	Investment management	100	England and Wales	33 Old Broad Street, London EC2N 1HZ
Invista Real Estate Investment Management Holdings plc . . . . .	Property investment	55	England and Wales	Exchequer Court, 33 St. Mary Axe, London EC3A 8AA
St. James's Place plc . . . . .	Financial services	60	England and Wales	St. James's Place House, Dollar Street, Cirencester GL7 2AQ
St Andrew's Life Assurance plc . . . . .	Pensions	100	England and Wales	St Andrew's House, Portsmouth Road, Esher, Surrey KT10 9SA

### **Employees**

The HBOS Group employed on average 57,129 people on a full-time basis and 16,958 people on a part-time basis during the year ended 31 December 2007. Certain of the HBOS Group's employees in the UK are members of the unions UNITE and ACCORD, both of which are recognised by the HBOS Group as representing the interests of such employees. The HBOS Group considers its relations with its employees to be satisfactory.

### **Properties**

As at 31 December 2007, the HBOS Group operated throughout the world, principally in the UK, from both freehold and leasehold properties.

## **Competition**

### ***UK***

The banking market in the UK is characterised by continuing structural change that has increased competition in recent years from a variety of sources, including merged banks, demutualised life insurers and building societies and diversified consumer services companies. Increased regulatory intervention has also influenced the UK banking market.

As at 31 December 2007, the HBOS Group had over 985 branches in the UK (excluding Jersey and the Isle of Man), of which 850 were full branches and 135 were sub-branches through which banking services are offered. The HBOS Group competes with UK clearing banks, through which other major international banks are also represented, with UK building societies and with other financial services providers.

The UK markets for the HBOS Group's activities are characterised by competition putting pressure on new business lending margins. The HBOS Group has pursued a strategy based on delivering value and simplicity to customers combined with a disciplined approach to cost management, which, together with distribution power and efficiency gains, has achieved asset growth and increased net income.

### ***Australia***

The Australian market is dominated by four major trading banks, who also hold significant positions in the wealth management and insurance markets. Competition in the market continues to increase, as international banks increasingly take a more significant interest in the market, and a number of smaller regional banks seek to expand outside their traditional geographies. Consolidation among building societies and the smaller regional banks continues to be a feature of the market.

In Australia, the HBOS Group's Retail and Business Divisions, trading under the BankWest brands, have over 110 branches mostly in the state of Western Australia (which represents approximately 10 per cent. of the total market), although approximately 35 Business branches have opened in metro and regional areas of the eastern states, where the Business division continues to expand its operations. BankWest has announced plans to increase the stock of branches to 160 across the eastern seaboard over the next three to four years.

The HBOS Group continues its strategy to grow its Retail, Corporate and Insurance Investment businesses in the more populous eastern states via cost-effective distribution, both direct to customers and via third-party channels such as finance brokers.

### ***Ireland***

The Irish market is dominated by two major trading banks. However, regulatory initiatives are opening up the market and several international players have recently entered or extended their position in the market. For example, the HBOS Group, under the Bank of Scotland (Ireland) brand, is developing a more complete range of retail banking products and will continue the process of developing a full branch network during 2008.

### ***Other International***

The HBOS Group has other less significant overseas operations conducted through branches and subsidiaries in the United States, Canada and various European jurisdictions. In these locations, the HBOS Group competes with a wide variety of large domestic and international financial services companies.

## **Bank Charges Test Case**

On 27 July 2007 it was announced that members of the HBOS Group, along with seven other major UK current account providers, had reached agreement with the Office of Fair Trading to start legal

proceedings in the High Court of England and Wales for a declaration (or declarations) to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges (the “Test Case”). It was also announced that HBOS and those other providers will seek a stay of all current and potential future Court proceedings which are brought against them in the UK concerning these charges and have obtained the consent of the Financial Services Ombudsman not to proceed with consideration of the merits of any complaints concerning these changes that are referred to him prior to the resolution of the Test Case. By virtue of a waiver granted by the Financial Services Authority of its complaints handling rules, HBOS (and other banks, including the banks party to the Test Case) will not be dealing with or resolving customer complaints on unarranged overdraft charges while the test case is running. A definitive outcome of the Test Case is unlikely to be known for at least 12 months. Given the very early stage of these proceedings and the uncertainty as to its outcome, it is not practicable at this time to estimate any potential financial effect.

## Management of HBOS

### *Board of Directors of HBOS*

<b>Name</b>	<b>Position in the Company</b>	<b>Principal outside activity (if any) of significance to the Company</b>
Lord Stevenson of Coddenham	Chairman Non-executive Director	—
Sir Ronald Garrick	Deputy Chairman Non-executive Director	—
Andy Hornby	Chief Executive	—
Philip Gore-Randall	Chief Operating Officer	—
Mike Ellis	Group Finance Director	—
Peter Cummings	Chief Executive – Corporate	—
Jo Dawson	Chief Executive – Retail Distribution and Insurance & Investment	—
Colin Matthew	Chief Executive, Strategy, International and Treasury & Asset Management	—
Dan Watkins	Chief Executive – Retail Products	—
Richard Cousins	Non-executive Director	Compass Group plc
Charles Dunstone	Non-executive Director	Carphone Warehouse Group plc
Tony Hobson	Non-executive Director	—
Karen Jones	Non-executive Director	Food & Fuel Limited
John E. Mack	Non-executive Director	—
Coline McConville	Non-executive Director	—
Kate Nealon	Non-executive Director	—

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

### **Conflicts of Interest**

No potential conflicts of interest exist at the date of this Prospectus between the duties of the Directors to HBOS and their private interests or other duties.



### *Audit Committee*

Without diminishing its own accountability, the Board of Directors of HBOS (the “Board”) has delegated certain responsibilities to the Audit Committee, including ensuring that there is regular review of the adequacy and effectiveness of the internal control procedures. This role provides independent and objective assurance that there is an appropriate control structure throughout the HBOS Group.

### *Membership*

The members of the Audit Committee are Tony Hobson (Chair), Coline McConville, John E. Mack, Kate Nealon and John Ormerod. The Audit Committee comprises four independent Non-executive Directors and one additional member, John Ormerod, who is neither a Director of HBOS nor an employee of the HBOS Group. John brings industry specific expertise and additional experience, resource and perspective to its deliberations.

### *Attendance at meetings*

In 2007 the Audit Committee met on seven occasions. The Audit Committee invites the Chief Executive, senior executives from the Finance and Risk functions, the Head of Group Internal Audit and the external auditors to attend all of its meetings. Other senior management attend as requested by the Audit Committee to enable it to discharge its duties.

### *Principal activities and duties*

The Audit Committee’s activities include receiving and challenging reports from senior management and both the internal and external auditors. The Audit Committee assists the Board in relation to the HBOS Group’s external financial and regulatory reporting requirements; its risk and internal control environment and the HBOS Group’s compliance with the Combined Code. In particular, in 2007 the Audit Committee:

- considered and approved the accounting policies, principles and practices as presented in the HBOS Group’s accounts;
- assessed significant accounting and reporting issues and the key accounting and audit judgements;
- considered the external auditors’ annual Internal Control Report and management’s response;
- monitored the relationship of the HBOS Group with its regulators;
- reviewed and advised the Board on the HBOS Group’s interim and annual financial statements, the control of financial and business risks (including whistleblowing arrangements), the nature and scope of the work performed by internal and external auditors, the results of this audit work and the responses of management;
- assessed the resources, organisational structure and operational effectiveness of the HBOS Group Internal Audit function together with management’s response to the findings;
- reviewed the effectiveness of the HBOS Group’s system of internal control, including financial, operational, compliance and risk management on an on-going basis;
- made a recommendation to the Board (for shareholder approval) in relation to the re-appointment of the external auditors and considered the terms of their engagement;
- reviewed other services provided to the HBOS Group by the external auditors, and monitored their independence, concluding that they had maintained their independence throughout the year;
- reviewed management procedures for identifying business risks and controlling their financial impact; preventing or detecting fraud; ensuring compliance with regulatory and legal requirements and monitoring the operational effectiveness of policies and systems; and
- considered the activities of the divisional Risk Control Committees.

The Audit Committee also held private meetings on a regular basis with the external auditors, the Head of Group Internal Audit, the Group Risk Director, the Group Finance Director and other key

members of senior management as part of the Audit Committee's work on the effectiveness of the HBOS Group's risk management policies and procedures. The Group Risk Director and the Head of Group Internal Audit also have the right of direct access to the Chairman of the Audit Committee. The Chairman of the Audit Committee reports on the activities and recommendations of the Audit Committee at the Board meeting subsequent to each Audit Committee meeting.

#### *Risk Control Committees*

The Audit Committee is supported by divisional Risk Control Committees ("RCCs"), which act under delegated authority from the Audit Committee, under detailed terms of reference. Each divisional RCC reviews, on behalf of the Audit Committee, the adequacy of that division's system of internal control and risk management, the significant risks facing that business and how they are investigated and the techniques used to identify, assess and manage those risks particular to the business of the division. The RCCs also review divisional input to HBOS Group financial reports. At each of its meetings the Audit Committee reviews the minutes and work of the RCCs.

#### *Internal Audit*

Group Internal Audit supports the Audit Committee, divisional RCCs and senior executives by reviewing independently and objectively the effectiveness of the controls and risk environment.

#### *Compliance with Combined Code*

HBOS considers that it has complied throughout the year with all of the provisions within section 1 of the Combined Code Principles of Good Governance and Code of Best Practice (the "Combined Code"), other than provision C.3.1 of the Combined Code which recommends that the Audit Committee should comprise solely independent Non-executive Directors. Audit Committee membership includes John Ormerod, who is neither an HBOS Director nor an employee of the HBOS Group. He brings an entirely independent and experienced additional resource to the Audit Committee's deliberations which, HBOS believes, exceeds the spirit of the Combined Code, and is entirely consistent with the Combined Code's aim of protecting the independence of the Audit Committee.

#### *Meetings of the Board*

The Board meets regularly (at least nine times per year) to determine the strategic direction of the HBOS Group and review its performance against plan. The Board has a formal schedule of matters specifically reserved to it, which can only be amended by the Board itself.

#### *Terms of Office of Directors*

At every Annual General Meeting of HBOS one-third of the current Directors must retire as Directors. All Directors are required to submit themselves for re-election every three years in accordance with HBOS's Articles of Association.

#### *Remuneration of Directors*

The aggregate remuneration paid to the Directors by members of the HBOS Group for the year ended 31 December 2007 was £17.5 million, including bonuses, taxable benefits in kind, total potential pre-tax gains on share options exercised and the total value of shares vested under the long-term incentive scheme.

#### *Advances to Key Management Personnel*

As at 31 December 2007, there were loans (including credit card accounts) by the HBOS Group outstanding to seven Directors and other key management personnel then in office in the aggregate principal amount of £1.827 million.

## **Selected Annual Consolidated Financial Information of HBOS**

The statutory financial information set out on the following pages as at the end of and for each of the two years ended 31 December 2006 and 2007 has been extracted without material adjustment from the audited consolidated financial statements and notes thereto of the HBOS Group for the year ended 31 December 2007. The statutory consolidated financial statements and notes thereto have been placed on display at the specified office of the Principal Paying Agent and at the offices of Tods Murray LLP, Edinburgh Quay, 133 Fountainbridge, Edinburgh EH3 9AG for the life of the Issue. The consolidated financial statements and notes thereto have been audited by KPMG Audit Plc, independent auditors.

KPMG Audit Plc is a firm of chartered accountants and registered auditors.

### **2007 financial information**

The 2007 financial information has been prepared on the basis of the accounting policies adopted in the 2007 IFRS Financial Statements. These are described on pages 160 to 169 of the HBOS plc Annual Report and Accounts 2007 that contain the 2007 IFRS Financial Statements, and there are no significant changes to the accounting policies adopted for the 2006 financial information.

### **2006 financial information**

The 2006 financial information has been prepared on the basis of the accounting policies adopted in the 2006 IFRS Financial Statements for the year ended 31 December 2006.

## Summary Annual Consolidated Income Statements of HBOS

	Year ended 31 December	
	2007	2006
	(in £ millions, except per share)	
Net interest income	7,304	7,400
Non-interest income	13,987	15,314
Net operating income (continuing operations)	21,291	22,714
Operating expenses	(14,070)	(15,571)
Impairment losses on loans and advances	(2,012)	(1,742)
Impairment on investment securities	(60)	(71)
Operating profit (continuing operations)	5,149	5,330
Share of profits of jointly controlled entities	234	112
Share of profits of associated undertakings	91	14
Non-operating income	91	250
Profit before taxation	5,474	5,706
Tax on profit	(1,365)	(1,772)
Profit after taxation	4,109	3,934
Profit of disposal group	4	5
Profit for the year	4,113	3,939
Attributable to:		
Parent company shareholders	4,045	3,879
Minority interests	68	60
	4,113	3,939
Pence per share		
Basic earnings per share – continuing operations	106.2p	100.5p
Basic earnings per share – disposal group		0.1p
Basic earnings per share – total	106.2p	100.6p
Diluted earnings per share – continuing operations	105.5p	99.4p
Diluted earnings per share – disposal group		0.1p
Diluted earnings per share – total	105.5p	99.5p

## Summary Annual Consolidated Balance Sheets of HBOS

	As at 31 December	
	2007	2006
	(in £ millions, except per share)	
<i>Shareholders' Equity</i>		
Issued share capital and share premium .....	4,128	3,995
Reserves .....	17,721	16,690
Shareholders' Equity (excluding minority interests) .....	21,849	20,685
Minority interests .....	385	486
Total Shareholders' Equity .....	22,234	21,171
Other borrowed funds .....	24,253	19,692
Deposits by banks, customer accounts and debt securities in issue .....	491,254	426,064
Loans and advances to banks and customers .....	438,063	388,401
Impairment losses on loans and advances .....	3,373	3,089
Total assets .....	666,947	591,813
Net assets per share .....	551p	516p

## Other Annual Financial Data of HBOS

	Year ended 31 December	
	2007	2006
Group post-tax return on mean equity <sup>(1)(2)</sup>	19.7%	20.8%
Group net interest margin <sup>(2)</sup>	1.63%	1.72%
Cost: income ratio <sup>(2)(3)</sup>	40.9%	41.0%
<i>Capital Adequacy (Basel I)</i>		
Tier 1 capital	7.4%	8.1%
Total capital	11.1%	12.0%
<i>Capital Adequacy (Basel II)</i>		
Tier 1 capital	7.7%	
Total capital	11.0%	
Total impairment provisions as a percentage of closing advances	0.78%	0.82%

*Notes:*

- (1) Post tax return on mean equity is calculated by dividing underlying profit attributable to ordinary shareholders by the monthly average of ordinary shareholders' funds.
- (2) The 2006 figures exclude the impact of the sale of the Group's investment in Drive Financial Services ("Drive"), a sub-prime auto finance receivables business based in Texas.
- (3) The cost: income ratio is calculated on an underlying basis as follows:

	Year ended 31 December	
	2007	2006
	(in £ millions)	
Operating expenses	14,070	15,571
Regulatory provisions charge	(122)	(95)
Goodwill impairment	(5)	(55)
Drive		(43)
	13,943	15,378
Operating lease depreciation	(985)	(812)
Change in investment contract liabilities	(2,538)	(2,910)
Net claims paid on insurance contracts	(2,952)	(2,328)
Net change in insurance contract liabilities	(2,244)	(3,894)
Change in unallocated surplus	50	(569)
Underlying operating expenses	5,274	4,865
Net operating income	21,291	22,714
Gross up for policyholder tax	(18)	(220)
Short term fluctuations	115	81
Impact of the 2008 change in corporation tax rate on the value of leasing assets	10	
Drive		(253)
	21,398	22,322
Impairment on investment securities	(60)	(71)
Operating lease depreciation	(985)	(812)
Change in investment contract liabilities	(2,538)	(2,910)
Net claims incurred on insurance contracts	(2,952)	(2,328)
Net change in insurance contract liabilities	(2,244)	(3,894)
Change in unallocated surplus	50	(569)
Share of profits of associates and jointly controlled entities	234	126
Underlying net operating income	12,903	11,864



## Capitalisation and Indebtedness of HBOS

The following table and the notes thereto show the capitalisation and indebtedness of the HBOS Group as at the date set out below.

	As at 31 December 2007 <u>(£ millions)</u>
<b>Authorised capital</b>	
6.0884% Non-cumulative Preference Shares (of £1 each) . . . . .	1
6.475% Non-cumulative Preference Shares (of £1 each) . . . . .	198
6.125% Non-cumulative Redeemable Preference Shares (of £1 each) . . . . .	200
Sterling Preference Shares (of £1 each) . . . . .	2,597
8.117% Non-cumulative Perpetual Preference Shares Class "A" (of £10 each) . . . . .	3
7.754% Non-cumulative Perpetual Preference Shares Class "B" (of £10 each) . . . . .	1
Ordinary Shares (of 25p each) . . . . .	1,185
9 <sup>1</sup> / <sub>4</sub> % Non-cumulative Irredeemable Preference Shares (of £1 each) . . . . .	375
9 <sup>3</sup> / <sub>4</sub> % Non-cumulative Irredeemable Preference Shares (of £1 each) . . . . .	125
	<u>4,685</u>
	<u>4,685</u>
	<b>As at 31 December 2007 <u>(€ millions)</u></b>
Euro Preference Shares (of €1 each) . . . . .	3,000
	<u>3,000</u>
	<u>3,000</u>
	<b>As at 31 December 2007 <u>(U.S.\$ millions)</u></b>
US\$ Preference Shares (of US\$1 each) . . . . .	4,998
6.413% Preference Shares Series "A" (of US\$1 each) . . . . .	1
5.92% Preference Shares Series "B" (of US\$1 each) . . . . .	1
6.657% Preference Shares (of US\$1 each) . . . . .	1
	<u>5,001</u>
	<u>5,001</u>
	<b>As at 31 December 2007 <u>(AUS\$ millions)</u></b>
Aus\$ Preference Shares (of Aus\$1 each) . . . . .	1,000
	<u>1,000</u>
	<u>1,000</u>

	<b>As at 31 December 2007</b>
	<b>(Can\$ millions)</b>
Can\$ Preference Shares (of Can\$1 each) . . . . .	1,000
	<u>1,000</u>
	<u><u>1,000</u></u>
	<b>As at 31 December 2007</b>
	<b>(£ millions)</b>
6.457% Non-cumulative Preference Shares (of £1 each) . . . . .	198
Ordinary Shares (of 25p each) . . . . .	933
	<u>1,131</u>
Allotted called up and fully paid share capital . . . . .	20,718
Reserves . . . . .	<u>21,849</u>
Shareholders' Equity (excluding minority interests) . . . . .	21,849
Minority interests . . . . .	<u>385</u>
Total Shareholders' Equity . . . . .	<u>22,234</u>
Deposits by banks . . . . .	41,513
Customer accounts . . . . .	243,221
Financial liabilities held for trading . . . . .	22,705
Derivative liabilities . . . . .	12,311
Notes in circulation . . . . .	881
Insurance contract liabilities . . . . .	26,864
Investment contract liabilities . . . . .	52,828
Unallocated surplus . . . . .	1,493
Net post retirement liabilities . . . . .	347
Current tax and deferred tax liabilities . . . . .	2,900
Other liabilities . . . . .	5,072
Accruals and deferred income . . . . .	3,630
Other provisions . . . . .	175
Debt securities in issue . . . . .	206,520
Other borrowed funds <sup>(1)</sup> . . . . .	<u>24,253</u>
Total Indebtedness . . . . .	<u>644,713</u>
<b>Total Capitalisation and Indebtedness . . . . .</b>	<b><u><u>666,947</u></u></b>

*Note:*

- (1) Other borrowed funds also include those preference shares which are defined as liabilities: £300 million of 9<sup>3</sup>/<sub>4</sub> per cent. Non-cumulative Irredeemable Preference Shares, £100 million of 9<sup>3</sup>/<sub>4</sub> per cent. Non-cumulative Irredeemable Preference Shares, US\$750 million of 6.413 per cent. Fixed to Floating Rate US\$ Preference Shares Series "A", US\$750 million of 5.92 per cent. Fixed to Floating Rate US\$ Preference Shares Series "B" and US\$750 million 6.657 per cent. Fixed to Floating Rate US\$ Preference Shares.

Save for £7,009 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 £50,707 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, at 31 December 2007, are secured or guaranteed.

# Taxation

## General

Prospective investors should inform themselves as to the tax consequences within the countries of their residence and domicile of the acquisition, holding and disposal of Preferred Securities. The comments below are of a general nature based on law and, as appropriate, H.M. Revenue and Customs (“HMRC”) practice as at the date hereof (both of which may be subject to change), and do not constitute tax or legal advice, and should be treated with appropriate caution. They relate only to the position of persons who are the absolute beneficial owners of their Preferred Securities and who (unless otherwise specified) hold their Preferred Securities as an investment. In addition, they may not apply to certain classes of persons such as dealers. Unless otherwise stated, the comments below relate only to the acquisition, holding and/or disposal of Preferred Securities and do not relate to the acquisition, holding and/or disposal of Qualifying Tier 1 Instruments. Any investors who are in any doubt as to their tax position should consult their professional advisers. In assessing their tax position, investors should note that the Issuer is a Jersey limited partnership and not a legal entity separate from its partners.

## Jersey Taxation

The Issuer is not itself assessable to Jersey Tax. 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. The Comptroller of Income Tax in Jersey has confirmed in writing that there will be no withholding or similar tax required to be deducted from income or capital distributions to the Holders.

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.

## *European Union Code of Conduct on Business Taxation – Jersey*

On 3 June 2003, the European Union Council of Economics and Finance Ministers reached political agreement on certain issues relating to its Code of Conduct on Business Taxation. Jersey is not a member of the EU; however, the Policy & Resources Committee of the States of Jersey announced that, in keeping with Jersey’s policy of constructive international engagement, it intended to propose legislation to replace the Jersey exempt company regime by the end of 2008 with a general zero rate of corporate tax. In addition, such proposed legislation provides that the profits of certain companies which are regulated by the Jersey Financial Services Commission (the “JFSC”) will be taxed at 10 per cent.

The Income Tax (Amendment No. 28) (Jersey) Law (the “Income Tax Law”) has now been adopted and was registered by the Royal Court on 22 June 2007 and accordingly is now in force. The Income Tax Law provides that, subject to certain transitional provisions, from 1 January 2009, the general basic rate of income tax on the profits of companies regarded as resident in Jersey or having a permanent establishment in Jersey, will be zero per cent. and that only a limited number of financial services companies which are regulated by the JFSC under the Financial Services (Jersey) Law 1998, the Banking Business (Jersey) Law 1991 or the Collective Investment Funds (Jersey) Law 1988, shall be subject to income tax at a rate of 10 per cent. The Income Tax Law also provides that the new tax regime will apply for the year of assessment 2008 in relation to companies which are first regarded as resident in Jersey or which have a permanent establishment in Jersey, on or after 3 June 2008.

## *European Union Directive on the Taxation of Savings Income – Jersey*

As part of an agreement reached in connection with the EU directive on the taxation of savings income in the form of interest payments, and in line with steps taken by other relevant third countries, Jersey

introduced with effect from 1 July 2005 a retention tax system in respect of payments of interest, or other similar income, made to an individual beneficial owner resident in an EU Member State by a paying agent established in Jersey. The retention tax system applies for a transitional period prior to the implementation of a system of automatic communication to EU Member States of information regarding such payments. During this transitional period, such an individual beneficial owner resident in an EU Member State will be entitled to request a paying agent not to retain tax from such payments but instead to apply a system by which the details of such payments are communicated to the tax authorities of the EU Member State in which the beneficial owner is resident.

The retention tax system in Jersey is implemented by means of bilateral agreements with each of the EU Member States, the Taxation (Agreements with European Union Member States) (Jersey) Regulations 2005 and Guidance Notes issued by the Policy & Resources Committee of the States of Jersey. Based on these provisions and what is understood to be the current practice of the Jersey tax authorities, the Issuer would not be obliged to levy retention tax in Jersey under these provisions in respect of interest payments made by it to a paying agent established outside Jersey.

## **UK Taxation**

In this section, the term “UK Investors” means Holders who are persons resident (or, in the case of individuals, resident or ordinarily resident) in the United Kingdom for tax purposes or who carry on a trade, profession or vocation in the United Kingdom through a branch or agency or (in the case of a corporate Holder) a permanent establishment to which their holding of Preferred Securities is attributable.

### ***(a) Position of UK Investors***

#### *Classification of the Issuer*

HBOS has been advised that the Issuer should be classified as a partnership for UK tax purposes. Accordingly, UK Investors should, broadly, be subject to UK taxation on the basis that they are partners in the Issuer and hold their proportionate share of the Issuer’s assets (including the Notes).

**UK investors who are in any doubt as to their tax position in respect of the Preferred Securities (or on substitution of Preferred Securities with Qualifying Tier 1 Instruments (including where in the form of Repackaged Instruments)) are strongly recommended to take independent professional advice.**

#### *Corporate UK Investors*

Corporate UK Investors should be treated, for the purposes of the “loan relationship rules” in the Finance Act 1996 and/or the “derivative contract rules” in the Finance Act 2002, as being entitled to 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 the Notes. Such UK Investors 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 or on exchange for Qualifying Tier 1 Instruments.

The debits and credits to be brought into account as described above by corporate UK Investors will be those determined in accordance with generally accepted accounting practice which means accounts prepared in accordance with either international accounting standards or UK GAAP.

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

Payments of Distributions on the Preferred Securities may be made without withholding or deduction for or on account of UK income tax.

### ***(c) UK Withholding Tax on Interest on the Notes***

The Notes will constitute “quoted Eurobonds” within the meaning of section 987 of the Income Tax Act 2007 (the “Act”) so long as they are and continue to be listed on a “recognised stock exchange” within the meaning of section 1005 of the Act. This condition will be satisfied if the Notes are admitted to listing

on the Official List of the UK Listing Authority and to trading on the London Stock Exchange (which is a “recognised stock exchange” for these purposes). Accordingly, payments of interest on the Notes may be made without withholding or deduction for or on account of UK income tax provided the Notes are so listed at the time of payment.

***(d) Payments under the Guarantee***

It is possible that if HBOS makes any payments in respect of interest on the Preferred Securities (or other amounts due under the Preferred Securities other than amounts subscribed for the Preferred Securities) under the Guarantee, such payments may be subject to UK withholding tax at the appropriate rate. HBOS has undertaken in such circumstances, subject to certain exceptions, to pay additional amounts in respect of such payments under the Guarantee.

***(e) Stamp Duty and Stamp Duty Reserve Tax***

No stamp duty will be chargeable on the issue of the Preferred Securities. In addition, no stamp duty should be chargeable on subsequent transfers of interests in Preferred Securities represented by a Global Certificate in accordance with the procedures described in “*Summary of Provisions Relating to the Preferred Securities in Global Form – Transfers of Interests*”.

No liability to SDRT will arise either on the issue of the Preferred Securities or in respect of subsequent agreements to transfer interests in the Preferred Securities.

***Qualifying Tier 1 Instruments issued in the form of preference shares of HBOS (“preference shares”)***

If Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS are in registered certificated form and are held outside of a clearance service, then there should not be any charge to stamp duty or SDRT on the issue of such shares and any liability that does arise will be borne by HBOS. Subsequent transfers of such preference shares will be subject to stamp duty or SDRT at the rate of 0.5 per cent.

If Qualifying Tier 1 Instruments which are in the form of preference shares issued by HBOS are issued to a provider of clearance services (or to a nominee for such a person) which has not made an election under section 97A of the Finance Act 1986 that applies to the preference shares, then there will be a stamp duty or SDRT charge at the rate of 1.5 per cent. of their price when issued which will be borne by HBOS. Subsequent transfers of such preference shares within the clearance service should not be subject to stamp duty or SDRT.

***Repackaged Instruments***

It is envisaged that any Repackaged Instruments would be issued by a non-UK incorporated company into a clearance service. There should be no charge to stamp duty or SDRT on the issue of such securities or on their transfer within the clearance service.

***Qualifying Tier 1 Instruments which are not issued in the form of preference shares issued by HBOS***

Depending on the detailed terms of any Qualifying Tier 1 Instruments which are not preference shares issued by HBOS and whether they are issued in bearer or registered form, there may be a charge to SDRT at the rate of 1.5 per cent. on the issue of such instruments to a provider of clearance services (or to a nominee for such a person) which has not made an election under section 97A of the Finance Act 1986 that applies to the instruments or to a depositary receipt issuer (or to a nominee or agent for such a person) who has issued or is to issue depositary receipts for the instruments, or a charge to stamp duty or SDRT at the rate of 0.5 per cent. on the transfer of such Qualifying Tier 1 Instruments. However, HBOS will bear the cost of any SDRT that does arise on the issue of Qualifying Tier 1 Instruments which are not preference shares issued by HBOS.

### **EU Directive on the Taxation of Savings Income**

The European Union has adopted a Directive regarding the taxation of savings income (the “EU Directive”). The EU Directive requires Member States to provide to the tax authorities of other Member States details of payments of interest or other similar income paid by a person to an individual resident in another Member State except that Austria, Belgium, and Luxembourg will instead apply a withholding system for a transitional period in relation to such payments, unless during such period they elect otherwise.

A number of third countries and territories including Jersey have adopted similar measures to the EU Directive. See also “*Jersey Taxation – European Union Directive on the Taxation of Savings Income – Jersey*” above.



## Subscription and Sale

Pursuant to a Subscription Agreement (the “Subscription Agreement”) dated 17 March 2008, BNP PARIBAS, The Royal Bank of Scotland plc and UBS Limited (the “Managers”) have jointly and severally agreed to subscribe for the Preferred Securities at a price of 100 per cent. of their principal amount less a combined management and underwriting commission. 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 States of America

Each Manager understands that the Preferred Securities have not been and will not be registered under the United States Securities Act of 1933, as amended (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 accordance with Regulation S under the Securities Act or pursuant to an exemption 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, (a) it will not offer, sell or deliver 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, US persons, (b) neither it, its affiliates nor any persons acting on its or their behalf will engage in any directed selling efforts with respect to the Preferred Securities and (c) it will have sent to each distributor, manager or person to which it sells Preferred Securities during the distribution compliance period a confirmation or other notice setting forth the restrictions on offer and sales of the Preferred Securities within the United States or to, or for the account or benefit of, US persons. Terms used in this paragraph have the respective meanings given to them by Regulation S under the Securities Act.

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

### UK

Each Manager has represented to and agreed with the Issuer and HBOS that:

#### 1. *Financial promotion*

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 any Preferred Securities in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or HBOS; and

#### 2. *General compliance*

It has complied and will comply with all applicable provisions of the FSMA (and all rules and regulations made pursuant to the FSMA) with respect to anything done by it in relation to any Preferred Securities in, from or otherwise involving the United Kingdom.

### Jersey

The Preferred Securities may not be offered to, sold to or purchased or held by, or for the account of, persons (other than financial institutions in the normal course of business) resident for income tax purposes in Jersey.

**General**

No representation is made that any action has been taken in any country or jurisdiction by the Issuer or HBOS that would permit an offering of any of the Preferred Securities, or possession or distribution of the Prospectus in relation thereto, in any country or jurisdiction where action for that purpose is required.

Each Manager has agreed to comply with all applicable laws and regulations in each country or jurisdiction in or from which it purchases, offers, sells or delivers Preferred Securities or has in its possession or distributes offering material in relation thereto, in all cases at its own expense, and neither the Issuer nor HBOS shall have responsibility therefor.

Neither the Issuer nor HBOS represents that Preferred Securities may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

## General Information

- (1) This Prospectus which comprises a prospectus for the purposes of the Prospectus Directive was published on or about 17 March 2008, and the listing of the Preferred Securities is expected to be effective on or around the Closing Date.
- (2) Save as otherwise disclosed on page 67 of this Prospectus under the heading “*Bank Charges Test Case*” neither the Issuer, HBOS nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) during the 12 months preceding the date of this Prospectus, which may have or have had in the recent past, a significant effect on the financial position or profitability of the Issuer or of HBOS and its subsidiary undertakings.
- (3) There has been no significant change in the financial or trading position of the Issuer nor any material adverse change in the prospects of the Issuer since its establishment.
- (4) There has been no significant change in the financial or trading position nor any material adverse change in the prospects of HBOS or its subsidiaries since 31 December 2007.
- (5) The Issuer expects to publish its first financial statements in respect of the period ending 31 December 2008. The Issuer’s auditors are KPMG Channel Islands Limited, which is a member firm of the Institute of Chartered Accountants in England and Wales whose address is 5 St. Andrew’s Place, Charing Cross, St. Helier, Jersey, Channel Islands.
- (6) The financial statements of HBOS for the two years ended 31 December 2006 and 31 December 2007 have been audited without qualification by KPMG Audit Plc (“KPMG”), which is a member firm of the Institute of Chartered Accountants in England and Wales whose address is Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EG. The reports of KPMG dated 27 February 2007 and 26 February 2008 in respect of HBOS for the years ended 31 December 2006 and 31 December 2007, respectively, stated that the reports were made solely to HBOS’ members, as a body, in accordance with section 235 of the Companies Act 1985. The reports further stated that KPMG’s audit work had been undertaken so that KPMG might state to HBOS’ members those matters KPMG were required to state to them in an auditor’s report and for no other purpose. To the fullest extent permitted by law, KPMG did not accept or assume responsibility to anyone other than HBOS and HBOS’ members as a body, for their audit work, for their reports, or for the opinions KPMG formed.
- (7) Where information in this Prospectus has been sourced from third parties this information has been accurately reproduced and as far as the Issuer is aware and is able to ascertain from the information published by such third parties no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third party information is identified where used.
- (8) For so long as the Preferred Securities may be issued pursuant to this Prospectus, copies of the following documents may be inspected during normal business hours at the specified office of the Principal Paying and Transfer Agent and, in respect of HBOS, at the offices of Tods Murray LLP, Edinburgh Quay, 133 Fountainbridge, Edinburgh EH3 9AG, namely:
  - the memorandum and articles of association of HBOS;
  - the Limited Partnership Agreement;
  - the Paying and Transfer Agency Agreement;
  - the Prospectus; and
  - the audited financial statements of HBOS for the financial years ended 31 December 2006 and 31 December 2007.

- (9) The execution of the Limited Partnership Agreement to establish HBOS Capital Funding No. 4 L.P. has been duly authorised by a resolution of the Board of Directors of the General Partner passed on 7 March 2008.

The entering into of the Limited Partnership Agreement and the Guarantee by HBOS was authorised by a written resolution of a duly authorised committee of the Board of Directors of HBOS passed on 11 March 2008 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 27 April 2007.

- (10) The Preferred Securities will be accepted for clearance through Euroclear and Clearstream, Luxembourg or any other relevant clearing system (which will be the entities in charge of keeping the records with a Common Code of 035359036). The International Securities Identification Number (ISIN) for the Preferred Securities is XS0353590366.
- (11) The address of Euroclear is 1 Boulevard du Roi Albert 11, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855 Luxembourg.
- (12) The estimated total expenses related to the admission to trading are £2,750.
- (13) 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 Initial Preference Shares and other Priority Preference Shares (each as defined in the Articles of Association of HBOS) (see also “*Risk Factors*”). 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.

The Articles of Association of HBOS also restrict the circumstances in which HBOS can redeem or declare dividends on shares. Article 5.17 provides that HBOS cannot redeem or declare, or set aside any sum for the payment of any dividends on any series of preference shares or any other shares which rank equally with, or junior to, such series of preference shares in circumstances where, in respect of all other series of preference shares and any other shares which rank equally with the preference shares and have the benefit of Article 5.17, such preference shares are shares in respect of which the directors of HBOS are required (save where to do so would result in a breach of UK banking capital adequacy requirements) to declare dividends if there are profits available to do so and

(i) all dividends on cumulative preference shares (including dividend arrears) have not been fully paid or a sum has not been set aside for full payment or (ii) dividends on non-cumulative preference shares have not been fully paid or a sum has not been set aside for full payment or, if the holders of such non-cumulative preference shares are entitled to additional non-cumulative preference shares in lieu of a dividend, such additional shares have not been allotted and issued, in each such case (i) and (ii) on the relevant dividend date(s) or in respect of the relevant dividend period(s).

Article 5.17 also provides that HBOS cannot redeem or declare, or set aside any sum for the payment of, any dividends on any series of preference shares (or any other shares which rank equally with such preference shares) which (a) provide for the declaration and payment of dividends at the discretion of the directors of HBOS, and rank equally with, or (b) other than any series of preference shares which are issued in satisfaction of an obligation existing on 27 April 2004, rank junior to, preference shares (or any other shares which rank equally with preference shares and which have the benefit of Article 5.17), if, in relation to all other series of such shares on which the declaration of a dividend is at the discretion of the directors of HBOS (i) the directors of HBOS have decided, in their discretion, (and other than due to the absence of profits which can be distributed or in order to comply with UK banking capital adequacy requirements) not to declare a dividend in whole or in part or (ii) the directors of HBOS have decided, where they have discretion as to the allotment and issue of additional non-cumulative preference shares in lieu of a dividend, not to do so, in each such case (i) and (ii), on the relevant dividend payment date(s) or in respect of the relevant dividend period(s).

- (14) Members of the HBOS Group have issued various forms of Tier 1 Capital prior to the date of this Prospectus.

Certain of these prior issues, which rank equally with the Preferred Securities or the Guarantee in any winding-up or liquidation, contain terms which might, however, permit holders thereof to receive a dividend or other distribution in circumstances where holders of the Preferred Securities do not. Those securities issued on or prior to 24 June 2004 provide that the payment of dividends or other distributions in cash is mandatory (subject to certain limited conditions), not discretionary, as is the case with the HBOS preference shares issued after 24 June 2004. This applies therefore to:

£300,000,000 9¼ per cent. Non Cumulative Irredeemable Preference Shares issued by HBOS plc in exchange for the issue on identical terms by The Governor and Company of the Bank of Scotland on 12 December 1988;

£100,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares issued by HBOS plc in exchange for the issue on identical terms by The Governor and Company of Bank of Scotland on 19 December 1990;

£198,000,000 6.475 per cent. Non-Cumulative Perpetual Preference Shares issued by HBOS plc in exchange for £198,00,000 6.125 per cent. Non-cumulative Preference Shares issued by Halifax plc on 19 April 1999;

€415,000,000 Fixed-to-Floating Rate Guaranteed Non-Voting, Non-cumulative Preferred Securities issued by HBOS Euro Finance (Jersey) L.P. on 9 December 1999;

£600,000,000 6.461 per cent. Guaranteed Non-voting, Non-cumulative Series A Perpetual Preferred Securities issued by HBOS Capital Funding L.P. on 28 November 2001;

US\$1,000,000,000 Non-voting, Non-cumulative Perpetual Preferred Securities issued by HBOS Capital Funding No.1 L.P. on 21 March 2003; and

US\$750,000,000 6.071 per cent. Non-voting, Non-cumulative Perpetual Preferred Securities issued by HBOS Capital Funding No.2 L.P. on 24 June 2004.

In the case of the 7,500 American Depositary Receipts representing US\$750,000,000 Fixed-to-Floating Rate Series A Preference Shares issued by HBOS on 29 September 2005, and the 7,500 American Depositary Receipts representing US\$750,000,000 Fixed-to-Floating Rate Series B Preference Shares issued by HBOS on 29 September 2005, the payment of a cash dividend is discretionary but, in the event that such discretion is exercised and a cash dividend is not paid, additional preference shares must be issued and allotted to the holder in lieu of cash.

Certain issues simply provide, as with the Preferred Securities, that any dividend is purely discretionary with no allotment of shares in lieu. This applies to the £750,000,000 6.0884 per cent. Non-cumulative Preference Shares issued by HBOS on 12 May 2005, to the €750,000,000 Fixed-to-Floating Rate Non-voting Non-cumulative Perpetual Preferred Securities issued by HBOS Capital Funding No.3 L.P. on 23 May 2006, to the £350,000,000 Fixed-to-Floating Rate Non-Cumulative Preference Shares issued by HBOS on 16 June 2006 and to the 7,500 American Depositary Receipts representing US\$750,000,000 Fixed-to-Floating Rate Preference Shares issued by HBOS on 21 May 2007.

In addition, the following issues by or guaranteed by Bank of Scotland provide that the payment of dividends or other distributions in cash is also mandatory (subject to certain limited situations), and are obligations of Bank of Scotland plc not HBOS and so the claims of holders of the Preferred Securities are structurally subordinated to them:

£245,000,000 8.117 per cent. Non-Cumulative Class A Perpetual Preferred Securities issued by Bank of Scotland Capital Funding L.P. on 14 March 2000;

£150,000,000 7.754 per cent. Non-Cumulative Class B Perpetual Preferred Securities issued by Bank of Scotland Capital Funding L.P. on 14 March 2000;

£150,000,000 7.286 per cent. Series A Perpetual Regulatory Tier 1 Securities issued by The Governor and Company of the Bank of Scotland on 28 February 2001; and

£150,000,000 7.281 per cent. Series B Perpetual Regulatory Tier 1 Securities issued by The Governor and Company of the Bank of Scotland on 28 February 2001.



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