



## **Bank of Scotland plc**

*(a public limited company incorporated in Scotland)*

### **£3 billion Social Housing Covered Bond Programme unconditionally guaranteed by HBOS plc**

*(incorporated with limited liability in Scotland)*

and

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

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

Under this £3 billion social housing covered bond programme (the “**Programme**”), Bank of Scotland plc (“**Bank of Scotland**” and the “**Issuer**”) may from time to time issue bonds (the “**Covered Bonds**”) denominated in any currency agreed between the Issuer and the relevant Dealer(s) (as defined below).

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

**The maximum aggregate nominal amount of all Covered Bonds from time to time outstanding under the Programme will not exceed £3 billion (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.**

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

This base prospectus constitutes a “**Base Prospectus**” for the purposes of Directive 2003/71/EC (the “**Prospectus Directive**”). Application has been made to the Financial Services Authority in its capacity as the United Kingdom competent authority under the Financial Services and Markets Act 2000 for the purposes of the Prospectus Directive and relevant implementing measures in the United Kingdom (the “**UK Listing Authority**”), for approval of this Base Prospectus as a Base Prospectus issued in compliance with the Prospectus Directive and relevant implementing measures in the United Kingdom for the purpose of giving information with regard to the issue of Covered Bonds issued under the Programme during the period of 12 months from the date of this Base Prospectus 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 such Covered Bonds to be admitted to trading on the regulated market of the London Stock Exchange which is a “**regulated market**” for the purposes of the Markets in Financial Instruments Directive (2004/39/EC) (the “**regulated market of the London Stock Exchange**”). Admission to the Official List together with admission to the regulated market of the London Stock Exchange constitutes official listing on the London Stock Exchange. References in this Base Prospectus to Covered Bonds being “**listed**” (and all related references) shall mean that such Covered Bonds have been admitted to trading on the regulated market of the London Stock Exchange and have been admitted to the Official List. Notice of the aggregate nominal amount of Covered Bonds, interest (if any) payable in respect of Covered Bonds, the issue price of Covered Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under *Terms and Conditions of the Covered Bonds*) of Covered Bonds will be set out in a separate document containing the final terms for that Tranche (the “**Final Terms**”) which, with respect to Covered Bonds to be admitted to the Official List and admitted to trading by the regulated market of the London Stock Exchange, will be delivered to the UK Listing Authority and the regulated market of the London Stock Exchange on or before the date of issue of such Tranche of Covered Bonds.

The Programme provides that Covered Bonds may be listed on such other or further stock exchange(s) as may be agreed between the Issuer, the Guarantors, the Bond Trustee (as defined herein), the Security Trustee (as defined herein) and the relevant Dealer(s). The Issuer may also issue unlisted Covered Bonds **provided that** the terms of any such issue are made available to all holders of listed Covered Bonds.

The Issuer and the Guarantors may agree with any Dealer and the Bond Trustee that Covered Bonds may be issued in a form not contemplated by the Terms and Conditions of the Covered Bonds herein, in which event (in the case of Covered Bonds intended to be listed on the regulated market of the London Stock Exchange) a supplementary Base Prospectus, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Covered Bonds.

The Covered Bonds issued under the Programme are expected on issue to be assigned an “**AAA**” rating by Standard & Poor’s Rating Services, a division of The McGraw-Hill Companies, Inc. (“**S&P**”), and an “**Aaa**” rating by Moody’s Investors Service Limited (“**Moody’s**” and, together with S&P, the “**Rating Agencies**” and each a “**Rating Agency**”). 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 assigning rating organisation.

**Particular attention is drawn to the section herein entitled Risk Factors.**

**Arranger for the Programme**

**Bank of Scotland plc**

**Dealers**

**Dresdner Kleinwort**

**Morgan Stanley**

**UBS Investment Bank**

The date of this Base Prospectus is 15 May 2008.

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

Copies of each Final Terms (in the case of Covered Bonds to be admitted to the Official List) will be available from FT Business Research Centre, operated by FT Interactive Data at Fitzroy House, 13-17 Epworth Street, London EC2A 4DL and (in the case of Covered Bonds to be admitted to the Official List and also all unlisted Covered Bonds) from the specified office set out below of each of the Paying Agents (as defined below).

This Base 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). This Base Prospectus shall be read and construed on the basis that such documents are so incorporated and form part of this Base Prospectus.

Neither the Dealers, the Bond Trustee nor the Security Trustee have independently verified the accuracy or completeness of the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers, the Bond Trustee or the Security Trustee as to the accuracy or completeness of the information contained or incorporated in this Base Prospectus or any other information provided by the Issuer, the Guarantors, the HBOS Group and the LLP in connection with the Programme. Neither the Dealers nor the Bond Trustee nor the Security Trustee accepts any liability in relation to the information contained or incorporated by reference in this Base Prospectus or any other information provided by the Issuer, the Guarantors, the HBOS Group and the LLP in connection with the Programme.

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

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

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Covered Bonds shall in any circumstances imply that the information contained herein concerning the Issuer and/or HBOS and/or the LLP and/or the Sellers is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same. The Arranger, the Dealers, the Bond Trustee and the Security Trustee expressly do not undertake to review the financial condition or affairs of the Issuer, the Guarantors or the Sellers during the life of the Programme or to advise any investor in the Covered Bonds of any information coming to their attention. Investors should review, *inter alia*, the most recently published documents incorporated by reference into this Base Prospectus when deciding whether or not to purchase any Covered Bonds.

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Covered Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Covered Bonds may be restricted by law in certain jurisdictions. The Issuer, the Guarantors, the Sellers, the Arranger, the Dealers, the Bond Trustee and the Security Trustee do not represent that this Base Prospectus may be lawfully distributed, or that any Covered Bonds may be lawfully offered, in compliance with any

applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer, the Guarantors, the Sellers, the Arranger, the Dealers, the Bond Trustee or the Security Trustee which would permit a public offering of any Covered Bonds or distribution of this Base Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Covered Bonds may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Covered Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Base Prospectus and the offering and sale of Covered Bonds. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Covered Bonds in the United States, the European Economic Area (the “EEA”), the United Kingdom, Japan and the Netherlands see *Subscription and Sale*.

The Covered Bonds and the guarantees from the Guarantors have not been and will not be registered under the U.S. Securities Act of 1933 (the “Securities Act”). The Covered Bonds will be in bearer form and are therefore subject to U.S. tax law requirements. The Notes may not be offered, sold or delivered, directly or indirectly, in the United States or to, or for the account or benefit of, any U.S. persons (see *Subscription and Sale* below) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

All references in this Base Prospectus to “Sterling” and “£” refer to pounds sterling, references to “euro” and “€” refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended, references to U.S. Dollars and \$ refer to United States dollars.

In connection with the issue of any Tranche of Covered Bonds, the Dealer or Dealers (if any) designated as the stabilising manager(s) (the “Stabilising Manager(s)”) (or any duly appointed person acting for the Stabilising Manager(s)) in the applicable Final Terms may over-allot the Covered Bonds (provided that the aggregate principal amount of any Tranche of the Covered Bonds allotted does not exceed 105 per cent. of the aggregate principal amount of the relevant Tranche) or effect transactions which support the market price of the Covered Bonds and/or any associated securities at a level higher than that which might otherwise prevail, but in doing so the Stabilising Manager(s) shall act as principal and not as agent of the Issuer or any of the Guarantors. There is no assurance that the Stabilising Manager(s) (or any agent of the Stabilising Manager(s)) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the final terms of the offer of the relevant Tranche of Covered Bonds is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Covered Bonds and 60 days after the date of the allotment of the relevant Tranche of Covered Bonds. Such stabilising shall be conducted in accordance with all applicable laws and rules. Any loss resulting from over-allotment and stabilisation shall be borne, and any net profit arising therefrom shall be retained, by the Stabilising Manager(s) for its own account.

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

Capitalised terms used in this Base Prospectus, unless otherwise indicated, have the meanings set out in this Base Prospectus. An index of defined terms appears at the back of this Base Prospectus – see *Index of Defined Terms* below.

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## DOCUMENTS INCORPORATED BY REFERENCE

The following information which has previously been published or is published simultaneously with this Base Prospectus and has been approved by, notified to or filed with the Financial Services Authority shall be deemed to be incorporated in, and to form part of, this Base Prospectus:

- (a) the audited, consolidated annual financial statements of each of the Issuer and the Group Guarantor for the financial years ended 31 December 2006, and 31 December 2007 see *General Information – Auditors* for a description of the financial statements currently published by each of the Issuer and the Group Guarantor; and
- (b) the audited non-consolidated annual financial statements of the LLP for the financial years ended 31 December 2006 and 31 December 2007.

save that any statement contained herein or in a document which is deemed to be incorporated by reference in and forming part of, shall be deemed to be modified or superseded for the purpose of this Base Prospectus to the extent that a statement contained in any document subsequently incorporated by reference modifies or supersedes such statement (whether expressly, by implication or otherwise), **provided that** such modifying or superseding statement is made by way of supplements to this Base Prospectus pursuant to Articles 10 and 16 respectively of the Prospectus Directive. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Base Prospectus.

The Issuer and the Guarantors will provide, without charge, to each person to whom a copy of this Base Prospectus has been delivered, upon the request of such person, a copy of any or all of the documents deemed to be incorporated herein by reference unless such documents have been modified or superseded as specified above. Written requests for such documents should be directed either to the Issuer, the Group Guarantor or the LLP, at their respective offices set out at the end of this Base Prospectus. In addition, such documents will be available upon request from the principal office of Citibank, N.A. in England.

The Issuer, the Group Guarantor and the LLP have each undertaken to the Dealers in the Programme Agreement (as defined in *Subscription and Sale*) to comply with section 87G of the Financial Services and Markets Act 2000 (“FSMA”). In the event that a supplementary prospectus is produced pursuant to such undertaking, a copy of such supplementary prospectus will accompany this Base Prospectus.

If the terms of the Programme are modified or amended in a manner which would make this Base Prospectus, as so modified or amended, inaccurate or misleading, a supplement to this Base Prospectus or a new Base Prospectus will be prepared for use in connection with any subsequent issue of Covered Bonds.

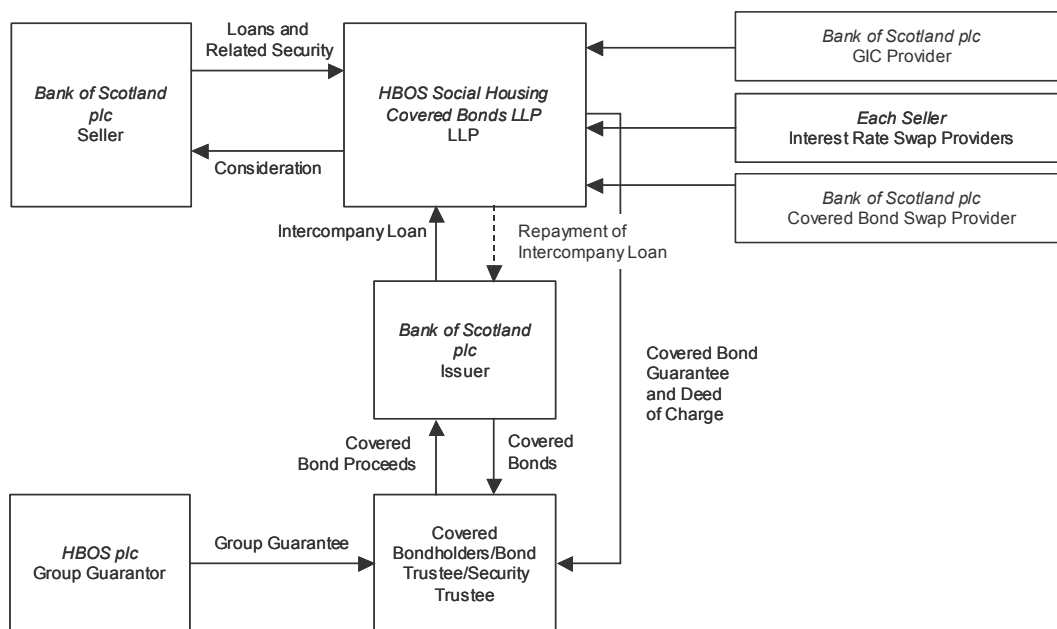
To the extent that any financial statements referred to in this section include pro forma financial information that does not relate to the most recently completed financial year, such information is not incorporated by reference in, and does not form part of, this Base Prospectus.

The financial statements of the Issuer for the financial year ended 31 December 2007 reflect the financial situation of the Issuer for the previous twelve-month period as though the corporate reorganisation effected pursuant to the HBOS Group Reorganisation Act had taken place on 1 January 2007. For more information on the HBOS Group Reorganisation Act, see *HBOS Group Banking Licence Consolidation in the Overview of the Programme* section of this Base Prospectus.

## STRUCTURE OVERVIEW

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

### Structure Diagram



### Structure Overview

- **Programme:** Under the terms of the Programme, the Issuer will issue Covered Bonds to Covered Bondholders on each issue date (each, an “**Issue Date**”). The Covered Bonds will be direct, unsecured and unconditional obligations of the Issuer.
- **Intercompany Loan Agreement:** Under the terms of the Intercompany Loan Agreement, the Issuer has agreed to make Term Advances to the LLP in an amount equal to the Sterling Equivalent of the gross proceeds of each Series or, as applicable, Tranche of Covered Bonds. The Term Advances will not be repaid by the LLP until all amounts payable under the corresponding Series of Covered Bonds have been repaid in full. Payments by the Issuer of amounts due under the Covered Bonds will be satisfied out of its own monies or, failing that, out of payments under the Group Guarantee and are not conditional upon receipt by the Issuer of payments from the LLP pursuant to the Intercompany Loan Agreement. Amounts owed by the LLP under the Intercompany Loan Agreement will be subordinated to amounts owed by the LLP under the Covered Bond Guarantee.
- **Group Guarantee:** The Group Guarantor has, under the terms of the Trust Deed, provided a guarantee, in respect of all Covered Bonds issued from time to time by the Issuer under the Programme and all other amounts payable by the Issuer under the Trust Deed. The obligations of the Group Guarantor under the Group Guarantee constitute direct, unsecured and unconditional obligations and rank *pari passu* with all other unsecured and unsubordinated obligations of the Group Guarantor.
- **Covered Bond Guarantee:** Under the terms of the Trust Deed, the LLP has also provided a guarantee on a several basis (as between the Group Guarantor and itself) as to payments of interest and principal under the Covered Bonds. The LLP has agreed to pay an amount equal to the Guaranteed Amounts when the same shall become Due for Payment but which would otherwise be unpaid by the Issuer or the Group Guarantor. The obligations of the LLP under the Covered Bond Guarantee constitute direct and (following the service of a Notice to Pay on the LLP and after the occurrence of an HBOS Event of Default and the service of an HBOS

Acceleration Notice or, if earlier, the service on the Issuer and the LLP of an LLP Acceleration Notice) unconditional and unsubordinated obligations of the LLP, secured as provided in the Deed of Charge. The recourse of the Covered Bondholders to the LLP under the Covered Bond Guarantee will be limited to the assets of the LLP from time to time. Payments made by the LLP under the Covered Bond Guarantee will be made subject to, and in accordance with, the Guarantee Priority of Payments or the Post-Enforcement Priority of Payments, as applicable.

- *The LLP's Assets:* The LLP will use the proceeds of the Term Advances received under the Intercompany Loan Agreement from time to time (i) to purchase the Initial Portfolio and each New Portfolio, consisting of Loans and their Related Security, from the Sellers in accordance with the terms of the Loan Sale Agreement and/or (ii) to invest in Substitution Assets in an amount not exceeding the prescribed limits and/or (iii) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced (by the issue of a further Series or Tranche of Covered Bonds) to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced and/or (iv) to make a deposit in the Principal GIC Sub-Account and/or (v) subject to written confirmation from the LLP that the Asset Coverage Test is met on the relevant Issue Date (both before and immediately following the making of the relevant Term Advance), to make a Capital Distribution to any Seller (in its capacity as a Member) by way of distribution of that Member's equity in the LLP in an amount equal to the Term Advance or any part thereof, which is to be paid to the Member on the relevant Issue Date. To protect the value of the Portfolio, under the terms of the LLP Deed the LLP and the Members will be obliged to ensure that the Asset Coverage Test (as described below) will be satisfied on each Calculation Date.
- *Consideration:* Under the terms of the Loan Sale Agreement, the consideration payable to the relevant Seller for the sale of Loans and their Related Security to the LLP on any Transfer Date will be (a) either (i) a cash payment paid by the LLP to the relevant Seller or (ii) a combination of a cash payment and the relevant Seller being treated as having made a Capital Contribution to the LLP (in an amount equal to the difference between the aggregate of the Current Balance of the Loans sold by the relevant Seller as at the relevant Transfer Date and the cash payment (if any) paid by the LLP for such Loans) and (b) a covenant to pay Deferred Consideration.
- *Security:* To secure its obligations under the Covered Bond Guarantee and the Transaction Documents to which it is a party, the LLP has granted security over the Charged Property (which consists principally of the LLP's interest in the Portfolio, the Substitution Assets, the Transaction Documents to which it is a party, the LLP Accounts and the Authorised Investments) in favour of the Security Trustee (for itself and on behalf of the other Secured Creditors) pursuant to the Deed of Charge.
- *Cashflows:* Prior to service of a Notice to Pay, the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice or the service of an LLP Acceleration Notice on the LLP under the Covered Bond Guarantee the LLP will:
  - apply Available Revenue Receipts to pay Deferred Consideration to each Seller in respect of the Loans sold by each Seller to the LLP, but only after payment of certain items ranking higher in the Pre-Acceleration Revenue Priority of Payments (including certain expenses, amounts due to the Interest Rate Swap Providers, amounts to be credited (if any) to the Reserve Fund and the relevant Liquidation GIC Sub-Accounts and interest due and payable on the Term Advances). For further details of the Pre-Acceleration Revenue Priority of Payments, see *Cashflows* below; and
  - apply Available Principal Receipts towards making Capital Distributions to the Members but only after, *inter alia*, funding any liquidity that may be required in respect of Covered Bonds following any breach of the Pre-Maturity Liquidity Test and acquiring New Loans and their Related Security offered by the Sellers to the LLP. For further details of the Pre-Acceleration Principal Priority of Payments, see *Cashflows* below.

Following service on the LLP of a Notice to Pay but prior to the service of an HBOS Acceleration Notice, the LLP will continue to apply Available Revenue Receipts and Available Principal Receipts as described above, except that:

- in respect of Available Revenue Receipts, no further amounts will be paid into the Reserve Fund, towards any indemnity amount due to the Members pursuant to the LLP Deed or due to the Asset Monitor pursuant to the Asset Monitor Agreement, towards any Deferred Consideration or towards any profit for the Members interest in the LLP; and
- in respect of Available Principal Receipts, no payments will be made other than into the relevant Liquidation GIC Sub-Accounts, see *Cashflows* below.

Following service on the LLP of a Notice to Pay, the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice (but prior to an LLP Event of Default and service of an LLP Acceleration Notice) the LLP will use all monies to pay Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment subject to paying certain higher ranking obligations of the LLP in the Guarantee Priority of Payments.

In such circumstances, the Sellers (as Members of the LLP) will only be entitled to receive any remaining income of the LLP after all amounts due under the Covered Bond Guarantee in respect of the Covered Bonds have been paid in full or have otherwise been provided for.

Following the occurrence of an LLP Event of Default and service of an LLP Acceleration Notice, the Covered Bonds will become immediately due and repayable as against the LLP and the Bond Trustee will then have a claim against the LLP under the Covered Bond Guarantee, for the Early Redemption Amount in respect of each Covered Bond together with accrued interest and any other amounts due under the Covered Bonds and the security created by the LLP over the Charged Property will become enforceable. Any monies recovered by the Security Trustee from realisation of the Charged Property following enforcement of the Security created by the LLP in accordance with the Deed of Charge will be distributed according to the Post-Enforcement Priority of Payments.

- *Asset Coverage:* The Programme provides that the assets of the LLP are subject to an asset coverage test in respect of the Covered Bonds. Accordingly, for so long as Covered Bonds remain outstanding, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date, the Adjusted Aggregate Loan Amount will be in an amount at least equal to the Principal Amount Outstanding of the Covered Bonds from time to time. The Asset Coverage Test will be tested by the Cash Manager on each Calculation Date. A breach of the Asset Coverage Test will require the Bond Trustee to serve a Notice to Pay on the LLP under the Covered Bond Guarantee.
- *Amortisation Test:* In addition, following service of a Notice to Pay on the LLP (but prior to service of an LLP Acceleration Notice) and, for so long as Covered Bonds remain outstanding, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date, the Amortisation Test Aggregate Loan Amount will be in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds from time to time. The Amortisation Test will be tested by the Cash Manager on each Calculation Date. A breach of the Amortisation Test will constitute an LLP Event of Default, which will entitle the Bond Trustee to serve an LLP Acceleration Notice on the Issuer and LLP declaring the Covered Bonds immediately due and repayable and entitle the Security Trustee to enforce the Security over the Charged Property.
- *Pre-Maturity Liquidity Test:* The Programme provides that the Covered Bonds are subject to a pre-maturity liquidity test which is intended to provide liquidity for the Covered Bonds when the Issuer's credit ratings or Deemed Ratings, as applicable, fall to a certain level within a certain period prior to the maturity of a Series of Covered Bonds as specified in the relevant Final Terms. If the Pre-Maturity Liquidity Test is breached within such specified period and certain actions are not taken, the Bond Trustee will serve a Notice to Pay on the LLP to require it to sell and/or refinance Selected Loans. The proceeds of any sale or refinancing (and any Cash Contribution in such circumstances) will be recorded on the relevant Liquidation GIC Sub-Accounts.
- *Extendable obligations under the Covered Bond Guarantee:* An Extended Final Maturity Date may be specified in the Final Terms for a Series of Covered Bonds. This means that if the Issuer and/or the Group Guarantor have failed to pay the Final Redemption Amount of the relevant Series of Covered Bonds on the Final Maturity Date specified in the Final Terms (or after the expiry of the grace period set out in Condition 9(a)(i) (*Events of Default and Enforcement – HBOS Events of Default*)) and the LLP or the Cash Manager on its behalf determines that the LLP has insufficient monies available under the Guarantee Priority of



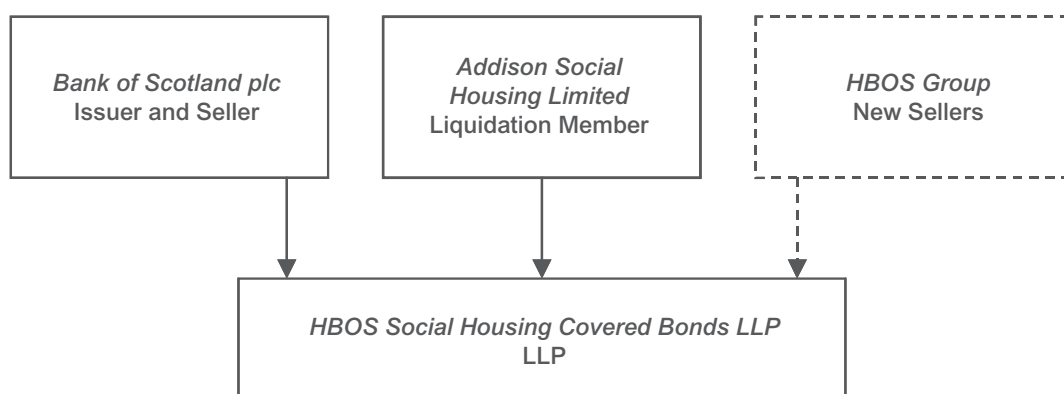
Payments to pay the Guaranteed Amounts corresponding to the Final Redemption Amount in full in respect of the relevant Series of Covered Bonds on the date falling on the earlier of (a) the date which falls two London Business Days after service of such Notice to Pay on the LLP or, if later, the Final Maturity Date (in each case after expiry of the relevant grace period) under the terms of the Covered Bond Guarantee and (b) the Extension Determination Date, then payment of the unpaid amount by the LLP under the Covered Bond Guarantee shall be deferred until the Extended Final Maturity Date, **provided that** any amount representing the Final Redemption Amount due and remaining unpaid on the earlier of (a) and (b) above may be paid by the LLP on any Interest Payment Date thereafter, up to (and including) the relevant Extended Final Maturity Date. Interest will continue to accrue on any unpaid amount during such extended period and be payable on the Original Due for Payment Date and on the Extended Final Maturity Date in accordance with Condition 4(a) (*Interest*).

- *Servicing*: In its capacity as Original Servicer, Bank of Scotland entered into an Original Servicing Agreement with the LLP and the Security Trustee, pursuant to which it has agreed to provide administrative services in respect of the Loans and their Related Security sold by itself as Original Seller to the LLP and the Loans and their Related Security sold by certain New Sellers to the LLP, unless any such New Seller and Bank of Scotland as Original Servicer agree that such New Seller shall act as Servicer in relation to the Loans and their Related Security sold by such New Seller to the LLP.
- *New Sellers*: Subject to meeting certain conditions precedent set out in the Transaction Documents, New Sellers may accede to the Programme by, amongst other things:
  - acceding to the Loan Sale Agreement and, accordingly, selling Loans and their Related Security to the LLP pursuant to the terms of the Loan Sale Agreement;
  - acceding to the LLP Deed;
  - if any New Seller and the Original Servicer agree that such New Seller shall act as Servicer in relation to the Loans and their Related Security sold by such New Seller to the LLP, entering into a New Servicing Agreement with the LLP and the Security Trustee on substantially the same terms as the Original Servicing Agreement; and
  - acceding to the Programme Agreement.

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

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

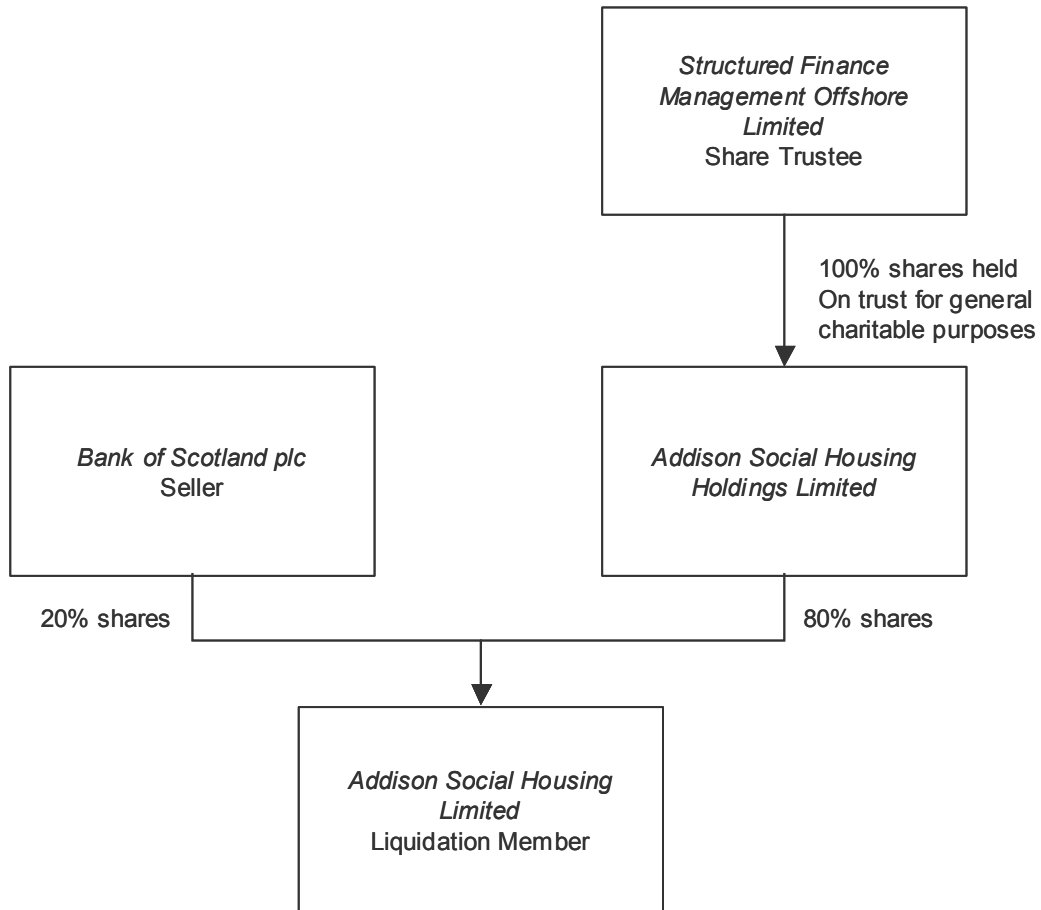
#### Ownership Structure of HBOS Social Housing Covered Bonds LLP



- As of the Consolidation Date, the Members of the LLP were Bank of Scotland (as Original Seller and Issuer) and Addison Social Housing Limited (as Liquidation Member).

- Any New Seller that wishes to sell Loans and their Related Security to the LLP will, amongst other things, become a Member of the LLP and will accede to, *inter alia*, the LLP Deed.
- Other than in respect of those decisions reserved to the Members, the Management Committee (comprised of, as at the date hereof, nominees of Bank of Scotland as the Original Seller and the Issuer) manages and conducts the business of the LLP and has all the rights, power and authority to act at all times for and on behalf of the LLP.

**Ownership Structure of Addison Social Housing Limited**



## OVERVIEW OF THE PROGRAMME

*The following overview does not purport to be complete and is taken from, and is qualified in its entirety by, the remainder of this Base Prospectus and, in relation to the terms and conditions of any particular Tranche of Covered Bonds, the applicable Final Terms. Any decision to invest in any Covered Bonds should be based on a consideration of this Base Prospectus as a whole, including the documents incorporated by reference. Words and expressions defined elsewhere in this Base Prospectus shall have the same meanings in this overview. An index of certain defined terms is contained at the end of this Base Prospectus.*

**Issuer:** Bank of Scotland plc (the successor to HBOS Treasury Services plc's business pursuant to the HBOS Group Reorganisation Act 2006), incorporated in Scotland on 17 September 2007 with limited liability (registered no. SC327000).

Pursuant to the provisions of the HBOS Group Reorganisation Act, on the Consolidation Date (as defined below) The Governor and Company of the Bank of Scotland was registered as a public limited company under the Companies Act 1985 (the "**Companies Act**") and changed its corporate name to Bank of Scotland plc. On the same day Bank of Scotland succeeded to the business, assets and liabilities, of the Transferor Entities (as defined below) and assumed any existing obligations relating to the Transferor Entities, (including those in relation to any outstanding Covered Bonds of HBOS Treasury Services plc issued by it prior to the Consolidation Date.

On the Consolidation Date, the existing undertakings, including all assets and liabilities, of the original issuer under the Programme, HBOS Treasury Services plc, were transferred to the Issuer. See *HBOS Group Banking Licence Consolidation* below.

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

**Group Guarantor:** HBOS plc, a public limited company incorporated in Scotland (registered no. SC218813) has unconditionally guaranteed all Covered Bonds issued from time to time under the Programme and all other obligations of the Issuer under the Trust Deed.

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

Any references in this Base Prospectus to "**Bank of Scotland**" prior to the Consolidation Date shall be to The Governor and Company of the Bank of Scotland, and any references in this Base Prospectus to "**Bank of Scotland**" from and after the Consolidation Date shall be to Bank of Scotland plc.

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

**LLP:** HBOS Social Housing Covered Bonds LLP, a limited liability partnership incorporated in England and Wales (registered no. OC310386). The LLP is a subsidiary of Bank of Scotland and its Members as of the Consolidation Date were Bank of Scotland and the Liquidation Member. The LLP is a special purpose vehicle whose business is, *inter alia*, to acquire the Portfolio pursuant to the terms of the Loan Sale Agreement and hold it in accordance with the terms of the Transaction Documents.

Under the terms of the Trust Deed, the LLP has provided a guarantee covering all Guaranteed Amounts when the same shall become Due for Payment, but only following the service on the LLP of a Notice to Pay. The obligations of the LLP under such guarantee and the other Transaction Documents to which it is a party are secured by the assets from time to time of the LLP and recourse against the LLP is limited to such assets.

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

Original Seller: Bank of Scotland (the “**Original Seller**”) (as legal successor to the business, assets and liabilities of Halifax plc and The Governor and Company of the Bank of Scotland pursuant to the HBOS Group Banking Licence Consolidation) which is in the business of carrying out a range of banking activities including originating secured Loans to providers of social housing including housing associations and other registered social landlords.

Any references in this Base Prospectus to the “**Original Seller**” prior to the Consolidation Date shall be to Halifax plc and The Governor and Company of the Bank of Scotland, and any references in this Base Prospectus to the “**Original Seller**” from and after the Consolidation Date shall be to Bank of Scotland.

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

New Sellers: Any other member of the HBOS Group which accedes to, amongst other things, the Loan Sale Agreement, the LLP Deed and the Programme Agreement at any time after the Programme Date.

Sellers: The Original Seller and any New Sellers.

Original Servicer: Pursuant to the terms of the Original Servicing Agreement, Bank of Scotland has been appointed to service, on behalf of the LLP, the Initial Portfolio and any New Portfolio sold by the Original Seller and any New Portfolio sold by New Sellers to the LLP, unless any New Seller and the Original Servicer agrees that such New Seller shall act as servicer in relation to the New Portfolio sold by such New Seller to the LLP pursuant to the terms of a New Servicing Agreement.

New Servicers: Upon agreement with the Original Servicer, each New Seller may be appointed to service, on behalf of the LLP, the New Portfolio sold by such New Seller to the LLP pursuant to the terms of a New Servicing Agreement.

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

Cash Manager: Bank of Scotland has also been appointed by the LLP, *inter alia*, to provide cash management services to the LLP and to monitor compliance by the LLP with the Asset Coverage Test and the Amortisation Test pursuant to the terms of the Cash Management Agreement.

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

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

- Security Trustee: Citicorp Trustee Company Limited, having its registered office at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB, has been appointed to act as Security Trustee to hold the benefit of the security granted by the LLP to the Security Trustee (for itself, the Covered Bondholders and other Secured Creditors) under the Deed of Charge.
- Asset Monitor: KPMG Audit Plc, having its registered office at 8 Salisbury Square, London, EC4Y 8BB has been appointed pursuant to the Asset Monitor Agreement as an independent monitor to perform tests in respect of the Asset Coverage Test and the Amortisation Test when required.
- Covered Bond Swap Provider: Bank of Scotland (in its capacity as the Covered Bond Swap Provider) has agreed to act as Covered Bond Swap Provider to the LLP to hedge (after service on the LLP of a Notice to Pay, the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice) certain interest rate, currency and/or other risks in respect of amounts received by the LLP under the Loans and the Interest Rate Swaps and amounts payable by the LLP under the Covered Bond Guarantee in respect of the Covered Bonds by entering into Covered Bond Swaps with the LLP and the Security Trustee under the Covered Bond Swap Agreements. The Covered Bond Swap Provider will be required to obtain a guarantee of its obligations by a suitably rated entity, transfer its obligations to a suitably rated entity or put in place some other arrangement supporting such obligations in the event that the ratings or the Deemed Ratings, as applicable, of the Covered Bond Swap Provider fall below a specified ratings level.
- For a more detailed description of the Covered Bond Swap Provider, see *The Issuer and Original Seller* below.
- Original Interest Rate Swap Provider: Bank of Scotland (in its capacity as Original Interest Rate Swap Provider) has agreed to act as a swap provider to the LLP in respect of possible variances between the rates of interest payable on the Loans sold by such Original Seller to the LLP (and the interest payable on any Substitution Assets and Authorised Investments) and the rate of interest applicable to the relevant Term Advances by entering into an Original Interest Rate Swap with the LLP and the Security Trustee under the Original Interest Rate Swap Agreement. The Original Interest Rate Swap Provider will be required to obtain a guarantee of its obligations under the applicable Original Interest Rate Swap Agreement from a suitably rated entity, transfer its obligations to a suitably rated entity or put in place some other arrangement supporting such obligations in the event that the ratings of the Original Interest Rate Swap Provider fall below a specified ratings level.
- For a more detailed description of the Original Interest Rate Swap Provider, see *The Issuer and Original Seller*, below.
- New Interest Rate Swap Providers: Each New Seller (in its capacity as a New Interest Rate Swap Provider) will act as a swap provider to the LLP in respect of possible variances between the rates of interest payable on the Loans sold by the relevant New Seller to the LLP and the rate of interest applicable to the relevant Term Advances, by entering into a New Interest Rate Swap with the LLP and the Security Trustee under a New Interest Rate Swap Agreement. Each New Interest Rate Swap Provider will be required to obtain a guarantee of its obligations under the applicable New Interest Rate Swap Agreement from a suitably rated entity, transfer its obligations to a suitably rated entity or put in place some other arrangement

supporting such obligations in the event that the ratings of such New Interest Rate Swap Provider falls below a specified ratings level.

Interest Rate Swap Providers:	The Original Interest Rate Swap Provider and any New Interest Rate Swap Providers.
GIC Provider:	<p>Bank of Scotland has agreed to act as GIC Provider to the LLP pursuant to the terms of the Guaranteed Investment Contract.</p> <p>The GIC Provider will be required to obtain a guarantee of its obligations under the Guaranteed Investment Contract from a suitably rated entity or put in place some other arrangement supporting such obligations in the event that the ratings of the GIC Provider fall below a specified ratings level.</p>
Account Bank:	<p>Bank of Scotland has agreed to act as Account Bank to the LLP pursuant to the terms of the Bank Account Agreement.</p> <p>The Account Bank will be required to obtain a guarantee of its obligations under the Bank Account Agreement from a suitably rated entity or put in place some other arrangement supporting such obligations in the event that the ratings of the Account Bank fall below a specified ratings level.</p>
Liquidation Member:	Addison Social Housing Limited (the “ <b>Liquidation Member</b> ”), a special purpose vehicle incorporated in England and Wales as a private limited company (registered no. 5216575). The Liquidation Member is 20 per cent. owned by Bank of Scotland and 80 per cent. owned by Holdings.
Holdings:	Addison Social Housing Holdings Limited (“ <b>Holdings</b> ”), a special purpose vehicle incorporated in Jersey as a private limited company (registered no. 89017). All of the shares of Holdings are held by a trustee (the “ <b>Share Trustee</b> ”) on trust for general charitable purposes.
Share Trustee:	Structured Finance Management Offshore Limited (registered no. 83135) having its registered office at 47 Esplanade, St. Helier, Jersey JE1 0BD in its capacity as share trustee (“ <b>Share Trustee</b> ”) of the capital of Holdings in accordance with the terms of a share trust deed entered into by the Share Trustee (the “ <b>Share Trust Deed</b> ”).
Corporate Services Providers:	Structured Finance Management Offshore Limited, having its registered office at 47 Esplanade, St. Helier, Jersey JE1 0BD, in its capacity as Jersey corporate services provider (the “ <b>Jersey Corporate Services Provider</b> ”), has been appointed to provide certain corporate services to Holdings pursuant to the Jersey Corporate Services Agreement. Structured Finance Management Limited, having its registered office at 35 Great St Helen’s, London EC3A 6AP in its capacity as English corporate services provider (the “ <b>English Corporate Services Provider</b> ”), has been appointed to provide certain corporate services to the Liquidation Member pursuant to the English Corporate Services Agreement.
Description:	Social Housing Covered Bond Programme.
Arranger:	Bank of Scotland plc.
Dealers:	Dresdner Bank AG London Branch, Morgan Stanley & Co. International plc and UBS Limited and any other dealers appointed from time to time in accordance with the Programme Agreement.
Certain Restrictions:	Each issue of Covered Bonds denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or

reporting requirements from time to time (see *Subscription and Sale*) including the following restrictions applicable at the date of this Base Prospectus.

Programme Size:	Up to £3 billion (or its equivalent in other currencies calculated as described in the Programme Agreement) outstanding at any time. The Issuer and the Guarantors may increase the amount of the Programme in accordance with the terms of the Programme Agreement.
Distribution:	Covered Bonds may be distributed outside the United States to persons other than U.S. persons (as such terms are defined in Regulation S under the Securities Act) by way of private or public placement and in each case on a syndicated or non-syndicated basis, subject to the restrictions set forth in <i>Subscription and Sale</i> , below.
Specified Currencies:	Subject to any applicable legal or regulatory restrictions, such currencies as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).
Redenomination:	The applicable Final Terms in respect of a Series or Tranche of Bonds may provide that certain Covered Bonds denominated in Sterling may be redenominated in euro.
Maturities:	Such maturities as may be agreed between the Issuer and the relevant Dealer(s), subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank or regulatory authority (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.
Issue Price:	Covered Bonds may be issued on a fully-paid or a partly-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Form of Covered Bonds:	The Covered Bonds will be issued in bearer form as described in <i>Form of the Covered Bonds</i> .
Fixed Rate Covered Bonds:	Fixed interest will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer(s) and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).
Floating Rate Covered Bonds:	<p>Floating Rate Covered Bonds will bear interest at a rate determined:</p> <ul style="list-style-type: none"><li>(i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the ISDA Definitions; or</li><li>(ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li><li>(iii) on such other basis as may be agreed between the Issuer and the relevant Dealer(s) (as set out in the applicable Final Terms).</li></ul> <p>The margin (if any) relating to such floating rate will be agreed between the Issuer and the relevant Dealer(s) for each Series of Floating Rate Covered Bonds.</p>
Index Linked Covered Bonds:	Payments of principal in respect of Index Linked Redemption Covered Bonds or of interest in respect of Index Linked Interest Covered Bonds will be calculated by reference to such index and/or

formula or to changes in the prices of securities or commodities or to such other factors as the Issuer and the relevant Dealer(s) may agree (as set out in the applicable Final Terms).

Other provisions in relation to Floating Rate Covered Bonds and Index Linked Interest Covered Bonds:

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

Dual Currency Covered Bonds:

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

Zero Coupon Covered Bonds:

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

Redemption:

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

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

Extendable Obligations under the Covered Bond Guarantee:

The applicable Final Terms may also provide that the LLP's obligations under the Covered Bond Guarantee to pay the Guaranteed Amounts corresponding to the Final Redemption Amount of the applicable Series of Covered Bonds on their Final Maturity Date (subject to applicable grace periods) shall be deferred until the Extended Final Maturity Date, **provided that** any amount representing the amount due on the Final Maturity Date as set out in the relevant Final Terms (the "**Final Redemption Amount**") due and remaining unpaid on the date falling three Business Days after the expiry of seven days from (and including) the Final Maturity Date of the relevant Series of Covered Bonds (the "**Extension Determination Date**") may be paid by the LLP on any Interest Payment Date thereafter, up to (and including) the relevant Extended Final Maturity Date. Such deferral will occur automatically if the Issuer and/or the Group Guarantor fail to pay the Final Redemption Amount of the relevant Series of Covered Bonds on their Final Maturity Date (subject to applicable grace periods) and if the Guaranteed Amounts equal to the Final Redemption Amount in respect of such Series of Covered Bonds are not paid in full by the Extension Determination Date. To the extent that the LLP has received a Notice to Pay in sufficient time to pay in part the Final Redemption Amount, such partial repayment shall be made as described in Condition 5(g) (*Payments*). Interest will continue to accrue and be payable on



any unpaid amount up to the Extended Final Maturity Date in accordance with Condition 4 (*Interest*) and the LLP will make payments of Guaranteed Amounts constituting Scheduled Interest on each relevant Original Due for Payment Date and Extended Final Maturity Date.

- Denomination of Covered Bonds: Covered Bonds will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer(s) save that the minimum denomination of each Covered Bond will be at least €50,000 (or, if the Covered Bonds are denominated in a currency other than euro, at least the equivalent amount in such currency) or such other higher amount as may be allowed or required from time to time by the relevant central bank or regulatory authority (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency.
- Taxation: All payments in respect of the Covered Bonds will be made without withholding or deduction for or on account of taxes imposed by any Tax Jurisdiction, subject as provided in Condition 7 (*Taxation*). In the event that any such withholding or deduction is made, the Issuer or, as the case may be, the Group Guarantor will, save in certain limited circumstances provided in Condition 7 (*Taxation*), be required to pay additional amounts to cover the amounts so deducted. The LLP will not be liable to pay any such additional amounts under the Covered Bond Guarantee.
- Cross Default: Each Series of Covered Bonds will cross accelerate at the same time but will not otherwise contain a cross default provision.
- Status of the Covered Bonds: The Covered Bonds issued from time to time in accordance with the Programme will constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and will rank *pari passu* among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Issuer, from time to time outstanding.
- Guarantees: The Covered Bonds are unconditionally guaranteed by the Group Guarantor. The obligations of the Group Guarantor under its guarantee constitute direct, unconditional, unsubordinated and unsecured obligations and rank *pari passu* and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Group Guarantor from time to time outstanding.
- As of the Consolidation Date, the then existing undertakings, including all assets and liabilities, of HBOS Treasury Services plc were transferred to Bank of Scotland which assumed any then existing obligations of HBOS Treasury Services plc. As a consequence of Bank of Scotland assuming the obligations of HBOS Treasury Services plc, in its capacity as Issuer prior to the Consolidation Date, and Bank of Scotland being unable to maintain any action against itself, the guarantee given by Bank of Scotland prior to the Consolidation Date was discharged as of the Consolidation Date. The guarantee given by HBOS prior to the Consolidation Date, on the other hand, survives the HBOS Group Banking Licence Consolidation.
- Payment of Guaranteed Amounts in respect of the Covered Bonds when Due for Payment are irrevocably and severally (as between the Group Guarantor and the LLP) guaranteed by the LLP. The obligations of the LLP to make payment in respect of the Guaranteed Amounts when Due for Payment are subject to the condition that (i) a Notice to Pay is served on the LLP, an HBOS

	<p>Event of Default has occurred and an HBOS Acceleration Notice has been served or (ii) an LLP Acceleration Notice has been served. The obligations of the LLP under its guarantee constitute direct obligations of the LLP secured against the assets from time to time of the LLP and recourse against the LLP is limited to such assets.</p>
<p>Listing:</p>	<p>Application has been made for Covered Bonds issued under the Programme to be admitted to the Official List and to trading on the regulated market of the London Stock Exchange. The Covered Bonds may also be listed, quoted and/or traded on or by such other or further competent listing authority(ies), stock exchange(s) and/or quotation system(s) as may be agreed between the Issuer and the relevant Dealer(s) in relation to each Series.</p> <p>Unlisted Covered Bonds may also be issued.</p> <p>The applicable Final Terms will state whether or not the relevant Covered Bonds are to be listed, quoted and/or traded and, if so, on or by which competent listing authority(ies) or stock exchange(s) and/or quotation system(s).</p>
<p>Governing Law:</p>	<p>The Covered Bonds are governed by, and construed in accordance with, English law.</p>
<p>Selling Restrictions:</p>	<p>There are restrictions on the offer, sale and transfer of the Covered Bonds in the United States, the EEA, the United Kingdom, Japan and The Netherlands. Other restrictions may apply in connection with the offering and sale of a particular Tranche of Covered Bonds. See <i>Subscription and Sale</i>.</p>
<p>HBOS Group Banking Licence Consolidation:</p>	<p>On 21 June 2006, the HBOS Group Reorganisation Act 2006 (the “<b>HBOS Group Reorganisation Act</b>”) received Royal Assent. Pursuant to the provisions of the HBOS Group Reorganisation Act, on 17 September 2007 (the “<b>Consolidation Date</b>”). The Governor and Company of the Bank of Scotland became registered as a public limited company under the Companies Act and changed its corporate name to Bank of Scotland plc. On the same day, Bank of Scotland plc, the continuing legal entity, as universal successor succeeded to the business, assets and liabilities, of Capital Bank plc, Halifax plc and HBOS Treasury Services plc (the “<b>Transferor Entities</b>”) and (including those in relation to any outstanding Covered Bonds of HBOS Treasury Services plc) assumed any existing obligations relating to the Transferor Entities. This series of transactions is referred to as the HBOS Group Banking Licence Consolidation.</p>

## RISK FACTORS

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

*The Issuer and the LLP believe that the factors described below represent all the material and principal risks inherent in investing in the Covered Bonds issued under the Programme, but the inability of the Issuer or the LLP to pay interest, principal or other amounts on or in connection with any Covered Bonds may occur for other reasons, and the Issuer and the LLP do not represent that the statements below regarding the risks of holding any Covered Bonds are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision. This section of the Base Prospectus is split into three main sections – General Risk Factors, Risks Relating to the Issuer and Group Guarantor and Risk Factors relating to the LLP.*

### GENERAL RISK FACTORS

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

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

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

#### **Group Guarantee may be withdrawn**

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

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

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

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

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

Covered Bonds issued under the Programme will either be fungible with an existing Series of Covered Bonds or have different terms to an existing Series of Covered Bonds (in which case they will constitute a new Series). All Covered Bonds issued from time to time will rank *pari passu* with each

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

- the Issuer will be obliged to apply the proceeds of any issue of Covered Bonds to make a Term Advance to the LLP. The LLP will use the proceeds of such Term Advance (i) to acquire Loans and their Related Security from the Sellers and/or (ii) to acquire Substitution Assets up to the prescribed limits and/or (iii) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced and/or (iv) to make a deposit in the Principal GIC Sub-Account and/or (v) subject to written confirmation from the LLP that the Asset Coverage Test is met on the relevant Issue Date (both before and immediately following the making of the relevant Term Advance), to make a Capital Distribution to any Seller (in its capacity as a Member) by way of distribution of that Member's equity in the LLP in an amount equal to the Term Advance or any part thereof; and
- the Asset Coverage Test will be required to be met both before and immediately after any further issue of Covered Bonds; and
- on or prior to the date of issue of any further Covered Bonds, the Issuer will be obliged to obtain written confirmation from the Rating Agencies (addressed to the Issuer, the Bond Trustee and the Security Trustee) that such further issue would not adversely affect the then current ratings of the existing Covered Bonds.

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

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

If, in connection with the exercise of its powers, trusts, authorities or discretions, the Security Trustee is of the opinion that the interests of the holders of the Covered Bonds of any one or more Series would be materially prejudiced thereby, the Security Trustee shall not exercise such power, trust, authority or discretion without the approval of such Covered Bondholders by Extraordinary Resolution or by a written resolution of such Covered Bondholders of more than 50 per cent. of the Principal Amount Outstanding of Covered Bonds of the relevant Series then outstanding.

#### **Absence of Secondary Market; Limited Liquidity**

There is at present a secondary market for Covered Bonds, however there is no assurance that this market will be liquid or active at all relevant times. This secondary market may not continue for the life of the Covered Bonds or it may leave Covered Bondholders with illiquidity of investment. Illiquidity can have an adverse effect on the market value of the Covered Bonds. Any Series of the Covered Bonds may experience illiquidity, although generally illiquidity is more likely to occur in respect of Series that are especially sensitive to prepayment, credit or interest rate risk, or that have been structured to meet the investment requirements of limited categories of Covered Bondholders.

In addition, Covered Bondholders should be aware of the prevailing and widely reported global credit market conditions (which continue at the date of this Base Prospectus), whereby there is a general lack of liquidity in the secondary market for instruments similar to the Covered Bonds. Such lack of

liquidity may result in investors suffering losses on the Covered Bonds in secondary resales even if there is no decline in the credit strength of the Issuer or the performance of the Portfolio and/or Substitution Assets (as the case may be). The Issuer cannot predict when these circumstances will change and if and when they do whether there will be a more liquid market for the Covered Bonds and instruments similar to the Covered Bonds at that time.

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

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

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

#### **Interest rate risks**

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

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

The ratings assigned to the Covered Bonds address:

- the likelihood of full and timely payment to Covered Bondholders of all payments of interest on each Interest Payment Date; and
- the likelihood of ultimate payment of principal in relation to Covered Bonds on (i) the Final Maturity Date thereof or (ii) if the Covered Bonds are subject to an Extended Final Maturity Date in respect of the Covered Bond Guarantee in accordance with the applicable Final Terms, on the Extended Final Maturity Date thereof.

The expected ratings of the Covered Bonds will be set out in the relevant Final Terms for each Series of Covered Bonds. Any Rating Agency may lower its rating or withdraw its rating if, *inter alia*, in the sole judgement of the Rating Agency, the credit quality of the Covered Bonds has declined or is in question. If any rating assigned to the Covered Bonds is lowered or withdrawn, the market value of the Covered Bonds may be reduced. 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. Rating agencies have in the past, and may in the future, fail to properly assess risk.

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

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

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

Pursuant to the terms of the Deed of Charge, the Security Trustee may, without the consent or sanction of the other Secured Creditors, concur with any person in making or sanctioning any modifications to the Covered Bonds of one or more Series, the related Receipts and/or Coupons or any Transaction Documents to which the Security Trustee is a party or over which it has Security

(and shall be entitled in so doing to disregard whether any such modification relates to a Series Reserved Matter):

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

The Security Trustee shall be obliged to concur in and to effect any modifications to the Transaction Documents that are requested by the LLP or the Cash Manager, **provided that**:

- each of the Interest Rate Swap Providers and each of the Covered Bond Swap Providers provide written confirmation to the Security Trustee consenting to such modification of those documents to which they are a party (such consent not to be unreasonably withheld) (which consent shall be deemed to be given by each of the Interest Rate Swap Providers and each of the Covered Bond Swap Providers (as the case may be) if no written response is received by the Security Trustee from each party, respectively, by the tenth Business Day after the Security Trustee's request for such consent);
- the LLP or the Cash Manager, as the case may be, has certified to the Security Trustee in writing that such modifications are required in order to accommodate the addition of New Sellers to the Programme; and
- all other conditions precedent to the accession of a New Seller to the Programme set out in the Programme Agreement and the Loan Sale Agreement have been satisfied at the time of the accession.

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

Pursuant to the terms of the Trust Deed, the Bond Trustee may, without the consent or sanction of any of the Covered Bondholders or any of the other Secured Creditors, concur with the Issuer in making or sanctioning any modifications to the Covered Bonds of one or more Series, the related Receipts and/or Coupons or any Transaction Documents to which the Bond Trustee is a party (and shall be entitled in doing so to disregard whether any such modification is a Series Reserved Matter):

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

The Bond Trustee shall be obliged to concur in and to effect any modifications to the Transaction Documents that are requested by the LLP or the Cash Manager, **provided that**:

- each of the Interest Rate Swap Providers and each of the Covered Bond Swap Providers provide written confirmation to the Bond Trustee consenting to such modification of those documents to which they are a party (such consent not to be unreasonably withheld) (which consent shall be deemed to be given by each of the Interest Rate Swap Providers and each of the Covered Bond Swap Providers (as the case may be) if no written response is received by the Bond Trustee from each party, respectively, by the tenth Business Day after the Bond Trustee's request for such consent);
- the LLP or the Cash Manager, as the case may be, has certified to the Bond Trustee in writing that such modifications are required in order to accommodate the addition of New Sellers to the Programme; and

- all other conditions precedent to the accession of a New Seller to the Programme set out in the Programme Agreement and the Loan Sale Agreement have been satisfied at the time of the accession.

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

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

#### **European Monetary Union**

It is possible that prior to the maturity of the Covered Bonds the United Kingdom may become a participating member state in the European economic and monetary union and that the euro may become the lawful currency of the United Kingdom. In that event, (a) all amounts payable in respect of any Covered Bonds denominated in pounds Sterling may become payable in euro; (b) applicable provisions of law may allow or require the Covered Bonds to be re-denominated into euro and additional measures to be taken in respect of such Covered Bonds; and (c) the introduction of the euro as the lawful currency of the United Kingdom may result in the disappearance of published or displayed rates for deposits in pounds Sterling used to determine the rates of interest on such Covered Bonds or changes in the way those rates are calculated, quoted and published or displayed. The introduction of the euro could also be accompanied by a volatile interest rate environment which could adversely affect a Borrower's ability to repay its Loan as well as adversely affect investors. It cannot be said with certainty what effect, if any, adoption of the euro by the United Kingdom will have on investors in the Covered Bonds.

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

#### **European Union Savings Directive**

Under EC Council Directive 2003/48/EC on the taxation of savings income, each European Union ("EU") member state is required to provide to the tax authorities of another EU member state details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State; however, for a transitional period, Austria, Belgium and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Also a number of non-EU countries, and certain dependent or associated territories of certain EU member states, have agreed to adopt similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a EU member state. In addition, the EU member states have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one of those territories.

If a payment were to be made or collected through a EU member state which has opted for a withholding system and as a consequence of such a system, an amount of, or in respect of tax were to be withheld from that payment, neither the Issuer, the LLP, any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Covered Bond as a result of the imposition of such withholding tax. If such a withholding tax would be imposed on a payment made by a Paying Agent pursuant to the Directive the Issuer will be required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive (if there is any such Member State).

#### **Insolvency Act 2000**

Significant changes to the United Kingdom insolvency regime have recently been enacted, including the Insolvency Act 2000, the relevant provisions of which came into force on 1 January 2003 and

which amends the Insolvency Act 1986 (as amended from time to time the “**Insolvency Act** ”). The Insolvency Act 2000 allows certain “small” companies to seek protection from their creditors for a period of 28 days for the purposes of putting together a company voluntary arrangement with the option for creditors to extend the moratorium for a further two months. Prior to October 2005 the moratorium provisions of the Insolvency Act 2000 did not expressly state that they applied to limited liability partnerships such as the LLP. On 1 October 2005 the Limited Liability Partnership (Amendment) Regulations 2005 confirmed that the moratorium provisions apply to limited liability partnerships, such as the LLP, subject to certain modifications.

A “small” company is defined as one which (in respect of financial periods, or parts of periods, falling on or after 6 April 2008) satisfies two or more of the following criteria: (i) its turnover is not more than £6.5 million, (ii) its balance sheet total is not more than £3.26 million and (iii) the number of employees is not more than 50. The position as to whether or not a company is a “small” company may change from time to time and consequently no assurance can be given that the LLP will not, at any given time, be determined to be a “small” company. The United Kingdom Secretary of State for Trade and Industry may by regulation modify the eligibility requirements for “small” companies and can make different provisions for different cases. No assurance can be given that any such modification or different provisions will not be detrimental to the interests of holders of the Covered Bonds.

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

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

### **Enterprise Act 2002**

On 15 September, 2003, the corporate insolvency provisions of the Enterprise Act 2002 came into force, amending certain provisions of the Insolvency Act and, in particular, the administration provisions which were reformed by introducing a new Schedule B1 to the Insolvency Act. These provisions introduced significant reforms to corporate insolvency law. In particular, the reforms restrict the right of the holder of a floating charge to appoint an administrative receiver (unless the floating charge was created prior to 15th September 2003 or an exception applies) and instead give primacy to collective insolvency procedures (in particular, administration). Previously, the holder of a floating charge over the whole or substantially the whole of the assets of a company had the ability to block the appointment of an administrator by appointing an administrative receiver, who would act primarily in the interests of the floating charge holder.

From 1 October 2005, the Limited Liability Partnership (Amendment) Regulations 2005 have applied the new administration provisions of Schedule B1 of the Insolvency Act to the LLP with certain modifications.

The Insolvency Act contains provisions which continue to allow for the appointment of an administrative receiver in relation to certain transactions in the capital markets. These provisions apply to the LLP as if it were a company. The relevant exception provides that the right to appoint an administrative receiver is retained for certain types of security (such as the Security) which form part of a capital market arrangement (as defined in the Insolvency Act), which would include the issue of covered bonds, and which involves indebtedness of at least £50,000,000 (or, when the relevant



security document (being in respect of the transactions described in this Base Prospectus, the Deed of Charge) was entered into, a party to the relevant transaction (such as the Issuer) was expected to incur a debt of at least £50,000,000) and the arrangement involves the issue of a capital market investment (also defined but generally a rated, listed or traded bond). The Secretary of State may, by secondary legislation, modify the capital market exception and/or provide that the exception shall cease to have effect. No assurance can be given that any such modification or provision in respect of the capital market exception, or its ceasing to be applicable to the transactions described in this Base Prospectus, will not be detrimental to the interests of the holders of the Covered Bonds.

The Insolvency Act also contains a new out-of-court route into administration for a qualifying floating charge-holder, the relevant company itself or its directors. These provisions have been applied to limited liability partnerships (such as the LLP) with certain modifications from 1 October 2005. The relevant provisions provide for a notice period during which the holder of the floating charge can either agree to the appointment of the administrator proposed by the directors or the company or appoint an alternative administrator, although a moratorium on enforcement of the relevant security will take effect immediately after notice is given. If the qualifying floating charge-holder does not respond to the directors' or company's notice of intention to appoint, the directors' or, as the case may be, the company's appointee will automatically take office after the notice period has elapsed. Where the holder of a qualifying floating charge which was created prior to 15 September 2003 or within the context of a capital market transaction retains the power to appoint an administrative receiver, such holder may prevent the appointment of an administrator (either by the new out-of-court route or by the court based procedure) by appointing an administrative receiver prior to the appointment of the administrator being completed.

The new administration provisions of the Insolvency Act give primary emphasis to the rescue of a company as a going concern and achieving a better result for the creditors as a whole. The purpose of realising property to make a distribution to secured creditors is secondary. As noted above, these new administration provisions will now apply to limited liability partnerships (such as the LLP) and have done so from 1 October 2005. From this date, no assurance could be given that the primary purpose of the new provisions would not conflict with the interests of the holders of the Covered Bonds were the LLP ever subject to administration.

In addition to the introduction of a prohibition on the appointment of an administrative receiver as set out above, section 176A of the Insolvency Act provides that any receiver (including an administrative receiver), liquidator or administrator of a company is required to make a "prescribed part" of the company's "net property" available for the satisfaction of unsecured debts in priority to the claims of the floating charge holder. These provisions apply to the LLP as if it were a company. The company's "net property" is defined as the amount of the chargor's property which would be available for satisfaction of debts due to the holder(s) of any debentures secured by a floating charge and so refers to any floating charge realisations less any amounts payable to the preferential creditors or in respect of the expenses of the liquidation or administration. The "prescribed part" is defined in the Insolvency Act 1986 (Prescribed Part) Order 2003 (SI 2003/2097) to be an amount equal to 50 per cent. of the first £10,000 of floating charge realisations plus 20 per cent. of the floating charge realisations thereafter, **provided that** such amount may not exceed £600,000.

This obligation does not apply if the net property is less than a prescribed minimum and the relevant officeholder is of the view that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. The relevant officeholder may also apply to court for an order that the provisions of section 176A of the Insolvency Act should not apply on the basis that the cost of making a distribution would be disproportionate to the benefits.

Floating charge realisations upon the enforcement of the Security may be reduced by the operation of these "ring fencing" provisions.

### **The Housing and Regeneration Bill**

The Housing and Regeneration Bill (the "**Housing Bill**") was introduced to Parliament on 15<sup>th</sup> November 2007. The Housing Bill in its current form if enacted will have a significant impact on the legislative framework surrounding the social housing sector in England. In particular, the Housing Bill enables the abolition of the Housing Corporation and in so doing creates two new organisations, the Homes and Communities Agency (the "**HCA**") and the Office for Tenants and Social Landlords (the "**Office**"). Under the Housing Bill the HCA will undertake certain functions currently undertaken by the Housing Corporation relating to investment in housing and take over the role of English Partnerships in land acquisition and regeneration, with the Office, in its role as regulator of social

housing in England, to assume the Housing Corporation's regulatory functions, developing an approach to regulation that is justified and tailored to individual housing associations, while relying increasingly on associations' self assessment and self regulation. The Housing Bill makes many other changes to the area of social housing, such as amending the way the Right to Buy scheme works.

The preceding paragraph is in no way intended to give a comprehensive and detailed summary of the Housing Bill and how, if enacted in its current form, it will affect the social housing sector and its surrounding legislative framework, but is merely intended to introduce prospective purchasers of Covered Bonds to its existence and potential impact on the Housing Corporation in particular. Prospective investors are urged to seek advice and to consult their professional advisers as to the possible consequences of the Housing Bill and how it will affect the social housing sector in general.

#### **Changes of law**

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

#### **Exchange of the Covered Bonds following the Regulated Covered Bond Regulations 2008 coming into force in the United Kingdom**

The Conditions of the Covered Bonds permit the Issuer to exchange, without the consent of the Bond Trustee, the Security Trustee or the Covered Bondholders, any existing Covered Bonds then outstanding for new Covered Bonds following the coming into force in the United Kingdom of the Regulated Covered Bonds Regulations 2008 (the "**RCB Regulations**") on 6 March 2008 **provided that**, amongst other things, each of the Rating Agencies then rating the existing Covered Bonds confirms in writing that any such new Covered Bonds will be assigned the same ratings as are then applicable to the existing Covered Bonds. Any such new Covered Bonds will qualify as covered bonds under the RCB Regulations and will be in identical form, amounts and denominations and will be subject to the same economic terms and conditions as the existing Covered Bonds then outstanding.

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

On 6 March 2008 the RCB Regulations came into force in the United Kingdom. These Regulations will permit UK structured covered bonds to fall within the requirements of "special public supervision" for the purposes of Article 22(4) of Council Directive 85/611/EC on Undertakings for Collective Investment in Transferable Securities (the "**UCITS Directive**"). The Issuer has not applied to the Financial Services Authority (the "**FSA**") to become recognised as an issuer of regulated covered bonds under the Covered Bonds Regulations and/or apply to have the Covered Bonds admitted to the register of covered bonds under the RCB Regulations, however it may choose to do so in the future.

Should the Issuer choose to apply to the FSA in the future to become recognised as an issuer of regulated covered bonds under the RCB Regulations and/or apply to have the Covered Bonds admitted to the register of covered bonds under the Covered Bonds Regulations, no assurance can be given that such application will be successful. If the Issuer decides to make such applications in the future, it may take up to six months for the FSA to consider each application, or longer if the FSA requests further information in respect of any application. If the Issuer becomes recognised as an issuer of regulated covered bonds it may nevertheless be removed at any time from the register if it appears to the FSA that the Issuer is failing, or has failed, to comply with any obligation imposed upon it under the RCB Regulations.

In addition, there are proposals to amend the RCB Regulations and no assurance can be given that the current legislation or the amended legislation will have no impact on the Programme. (See also Exchange of the Covered Bonds following the Regulated Covered Bond Regulations 2008 coming into force in the United Kingdom).

#### **UK Banking (Special Provisions) Act 2008**

Under the Banking (Special Provisions) Act 2008 (the "**Special Provisions Act**"), until 21 February 2009 the UK Treasury has very wide powers to make certain orders in respect of a UK authorised deposit-taking institution and, in certain circumstances, certain related corporate undertakings. The Special Provisions Act was drafted to address certain matters in the context of the nationalisation of Northern Rock plc. The Government indicated at the time that the Special Provisions Act received

Royal Assent that it had no intention to use its powers under the Special Provisions Act to bring any UK authorised deposit-taking institution other than Northern Rock plc into temporary public ownership. However there can be no assurance that this will not change and that Covered Bondholders would not be adversely affected if any order was made in relation to the Issuer, the Group Guarantor or the LLP under the Special Provisions Act.

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

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

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

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

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

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

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

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

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

Unless the Temporary Global Covered Bond is exchanged for a Permanent Global Covered Bond, which exchange will only occur in the limited circumstances set out under Form of the Covered Bonds, the beneficial ownership of the Covered Bonds will be recorded in book-entry form only with Euroclear and Clearstream, Luxembourg. The fact that the Covered Bonds are not represented in physical form could, among other things:

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

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

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

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

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

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

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

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

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

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

### *Partly-paid Covered Bonds*

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

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

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

### *Inverse Floating Rate Covered Bonds*

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

### *Fixed/Floating Rate Covered Bonds*

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

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

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

### *Extendable obligations under the Covered Bond Guarantee*

Failure by the LLP to make payment in respect of the Final Redemption Amount on the Final Maturity Date (subject to any applicable grace period) in respect of a Series of Covered Bonds with an Extended Final Maturity Date shall not constitute an LLP Event of Default in respect of such Series. However, failure by the LLP to pay the Guaranteed Amounts corresponding to the Final Redemption Amount, or the balance thereof, on or prior to the Extended Final Maturity Date and/or Guaranteed Amounts constituting Scheduled Interest when Due for Payment will (subject to any applicable grace periods) be an LLP Event of Default. This may mean Covered Bondholders of the relevant Series may suffer losses resulting from a delay in enforcing the LLP Security between the Final Maturity Date and the Extended Final Maturity Date.

Furthermore, in relation to all Guaranteed Amounts constituting Scheduled Interest up to (and including) the Extended Final Maturity Date, as provided in the relevant Final Terms, the LLP may pay such Scheduled Interest pursuant to the floating rate set out in the applicable Final Terms, notwithstanding that the relevant Covered Bond was a Fixed Rate Covered Bond as at its relevant Issue Date. This may mean Covered Bondholders of the relevant Series suffer losses in their investments resulting from the different interest bases applicable.

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

### *Modification, waivers and substitution*

The conditions of the Covered Bonds contain provisions for calling meetings of Covered Bondholders to consider matters affecting their interests generally. These provisions permit defined majorities to

bind all Covered Bondholders including Covered Bondholders who did not attend and vote at the relevant meeting and Covered Bondholders who voted in a manner contrary to the majority.

The conditions of the Covered Bonds also provide that the Bond Trustee may, without the consent of Covered Bondholders, agree to (i) any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of Covered Bonds or (ii) determine at its discretion whether certain events of default shall not be treated as such or (iii) the substitution of the Group Guarantor as principal debtor under any Covered Bonds in place of the Issuer, in the circumstances described in Condition 14 of the conditions of the Covered Bonds.

## **RISKS RELATING TO THE ISSUER AND GROUP GUARANTOR**

The financial performances are 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 the Issuer's and Group Guarantor's businesses. Adverse changes in the credit quality of the Issuer's and Group Guarantor's 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 the Issuer's and Group Guarantor's assets and require an increase in the Issuer's and Group Guarantor's impairment provisions for bad and doubtful debts and other provisions.

Changes in interest rates, foreign exchange rates, equity prices, house prices and other market factors affect the Issuer's and Group Guarantor's business.

Among the most significant market risks the Issuer and Group Guarantor face 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 relevant Issuer's and Group Guarantor'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 Issuer's and Group Guarantor's investment and trading portfolios. The Issuer and Group Guarantor have implemented risk management methods to mitigate and control these and other market risks to which they are 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 the Issuer's and Group Guarantor's financial performance and business operations.

### *Along with increased market turbulence comes increased funding and liquidity risks*

The Issuer and certain other members of the HBOS Group provide financial intermediation in the form of maturity transformation, whereby they hold assets of a longer duration than the liabilities that support those assets. In order to ensure that the HBOS Group continues to meet its funding obligations and to maintain or grow its business generally, it relies on customer savings and transmission balances, as well as ongoing access to the wholesale lending markets. In wholesale markets, the HBOS Group looks to achieve a geographically diverse investor base and product set, of an appropriate maturity profile to ensure it is not overly exposed to short term market dislocation. In addition, the HBOS Group holds a significant stock of marketable assets that are available through either outright sale or proven sale and repurchase arrangements with other market participants or Central Banks to generate funds. Furthermore, the HBOS Group has the capacity to generate additional collateral through the use of certain of its assets to achieve the same goal. In times of systemic market liquidity stress, the cost of wholesale funds is likely to rise and the maturity profile shorten. If the extent of this market stress were for an extended period, then it may have an adverse effect on the HBOS Group's ability to meet its obligations as they fall due.

Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that either the Issuer or the Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA.

The Issuer and Group Guarantor are subject to capital requirements that could limit their operations.

The Issuer 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 I capital. The Issuer's failure to maintain its

ratios may result in administrative actions or sanctions against it which may impact the Issuer's ability to fulfill its obligations under the Covered Bonds.

In addition, the risk-adjusted capital guidelines (the "Basel II Accord") promulgated by the Basel Committee on Banking Supervision, which form the basis for the FSA's capital adequacy guidelines, have been revised and implemented in the UK with effect from 1 January 2007. The principal changes effected by the revised guidelines include a range of options to determine risk-weighting. In this regard, HBOS has adopted the Advanced Internal Ratings Based Approach (for Credit Risk) and the Advanced Measurement Approach (for Operational Risk). These are the most sophisticated approaches to capital determination for the HBOS Group and its applicable subsidiaries (including the Issuer) with effect from 1 January 2008.

The Issuer and Group Guarantor are not responsible for informing Covered Bondholders of the effects for investors of the changes to risk weighting from the adoption by their own regulator of the Basel Accord (whether or not implemented in its current form or otherwise).

#### **Operational risks are inherent in the Issuer's and Group Guarantor's businesses**

The Issuer's and Group Guarantor's businesses are dependent on the ability to process a very large number of transactions efficiently and accurately. Operational risks 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 Issuer's and Group Guarantor's suppliers or counterparties. Although the Issuer and Group Guarantor have 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. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that either the Issuer or the Group Guarantor will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA.

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

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

Following service of an HBOS Acceleration Notice on the Issuer and the Group Guarantor, a Notice to Pay will be served by the Bond Trustee on the LLP. However, a failure by the Issuer to make a payment in respect of one or more Series of Covered Bonds will not automatically result in the service of an HBOS Acceleration Notice. The Bond Trustee may, but is not obliged to, serve an HBOS Acceleration Notice unless and until requested or directed by all Series of Covered Bondholders then outstanding in accordance with Condition 9(a) (*Events of Default*).

Following service of a Notice to Pay on the LLP after the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice, under the terms of the Covered Bond Guarantee the LLP will be obliged to pay Guaranteed Amounts as and when the same are Due for Payment on each Scheduled Payment Date **provided that** in respect of any Series of Covered Bonds in the case of any amounts representing the Final Redemption Amount due and remaining unpaid as at the Original Due for Payment Date, the LLP may pay such amounts on any Interest Payment Date thereafter, up to (and including) the Extended Final Maturity Date. Such Guaranteed Amounts will be paid subject to and in accordance with the Guarantee Priority of Payments or the Post-Enforcement Priority of Payments, as applicable. In these circumstances the LLP will not be obliged to pay any other amounts which become payable for any other reason.

A Notice to Pay will also be served by the Bond Trustee on the LLP following (i) a breach of the Pre-Maturity Liquidity Test, if certain actions are not taken within a specified time period and (ii) a breach of the Asset Coverage Test. However, service of a Notice to Pay in such circumstances will not oblige the LLP to make payments under the Covered Bond Guarantee until an HBOS Event of Default has occurred and an HBOS Acceleration Notice has been served.

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

any payments in respect of additional amounts which may become payable by the Issuer under Condition 7 (*Taxation*).

Subject to any applicable grace periods, if the LLP fails to make a payment when Due for Payment under the Covered Bond Guarantee or any other LLP Event of Default occurs then the Bond Trustee may accelerate the Covered Bonds (if not already accelerated) by service of an LLP Acceleration Notice, whereupon the Bond Trustee will have a claim under the Covered Bond Guarantee for the Early Redemption Amount of each Covered Bond, together with accrued interest and all other amounts then due under the Covered Bonds, although in such circumstances the LLP will not be obliged to pay any additional amounts in respect of any withholding which may be required in respect of any payment under Condition 7 (*Taxation*). Following service of an LLP Acceleration Notice, the Security Trustee may enforce the Security over the Charged Property. The proceeds of enforcement of the Security shall be applied by the Security Trustee in accordance with the Post-Enforcement Priority of Payments in the Deed of Charge and Covered Bondholders will receive amounts from the LLP on an accelerated basis. If an LLP Acceleration Notice is served on the LLP then the Covered Bonds may be repaid sooner or later than expected or not at all.

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

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

Each Covered Bondholder shall be deemed to have irrevocably directed the Bond Trustee to pay the Excess Proceeds to the LLP in the manner as described above.

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

Following the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice on the Issuer and Group Guarantor, all amounts payable under the Covered Bonds will be accelerated by the Bond Trustee as against the Issuer and the Group Guarantor following which a Notice to Pay will be served by the Bond Trustee on the LLP. A Notice to Pay may also be served by the Bond Trustee on the LLP following (i) a breach of the Pre-Maturity Liquidity Test, if certain actions are not taken within a specified time period and (ii) a breach of the Asset Coverage Test, but service of a Notice to Pay in such circumstances will not oblige the LLP to make payments under the Covered Bond Guarantee until an HBOS Event of Default has occurred and an HBOS Acceleration Notice has been served. The LLP’s ability to meet its obligations under the Covered Bond Guarantee will depend on the realisable value through a sale or refinancing of Selected Loans and their Related Security in the Portfolio, the amount of Revenue Receipts and Principal Receipts generated by the Portfolio, any Substitution Assets and any Authorised Investments and the timing thereof and amounts received from the Swap Providers and the GIC Provider. The LLP will not have any other source of funds available to meet its obligations under the Covered Bond Guarantee.

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

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



Covered Bondholders should note that the Asset Coverage Test has been structured to ensure that the Adjusted Aggregate Loan Amount is greater than the aggregate Principal Amount Outstanding of the Covered Bonds for so long as Covered Bonds remain outstanding, which should reduce the risk of there ever being a shortfall (although there is no assurance of this). The LLP and the Sellers (in their capacity as Members) must ensure that following the service of a Notice to Pay on the LLP (but prior to the service of an LLP Acceleration Notice), the Amortisation Test is met on each Calculation Date and a breach of the Amortisation Test will constitute an LLP Event of Default and will entitle the Bond Trustee to serve an LLP Acceleration Notice on the Issuer and the LLP declaring the Covered Bonds immediately due and payable and will entitle the Security Trustee to enforce the Security over the Charged Property (see *Summary of the Principal Documents – LLP Deed – Asset Coverage Test and Credit Structure – Asset Coverage Test*).

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

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

If a Servicer Event of Default occurs pursuant to the terms of a Servicing Agreement, then the LLP and/or the Security Trustee will be entitled to terminate the appointment of the relevant Servicer and appoint a new servicer in its place. There can be no assurance that a substitute servicer with sufficient experience of administering assets similar to the Loans would be found who would be willing and able to service the Loans on the terms of the Servicing Agreement. The ability of a substitute servicer to perform fully the required services would depend, among other things, on the information, software and records available at the time of the appointment. Any delay or inability to appoint a substitute servicer may affect the realisable value of the Portfolio or any part thereof and/or the ability of the LLP to make payments under the Covered Bond Guarantee. However, if a Servicer ceases to be assigned a long-term unsecured, unguaranteed and unsubordinated debt obligation rating by Moody's of at least Baa3 or by Standard & Poor's of at least BBB- it will use reasonable efforts to enter into a master servicing agreement with a third party who is so rated.

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

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

### **Reliance on Swap Providers**

To provide a hedge against possible variances in (i) the rates of interest payable on the Loans in the Portfolio (which may, for instance, include variable rates of interest (based on LIBOR as determined in the relevant Loan Agreement), fixed rates and rates linked to RPI or other index linked rates) and on Substitution Assets or Authorised Investments and (ii) the rate of interest payable on the outstanding Term Advances, the LLP has entered into the Original Interest Rate Swap Agreement with the Original Interest Rate Swap Provider and, if any New Seller accedes to the Programme, the LLP will enter into a New Interest Rate Swap Agreement with the New Interest Rate Swap Provider. In addition, to provide a hedge against interest rate, currency and/or other risks in respect of amounts received by the LLP under the Loans and the Interest Rate Swaps and amounts payable by the LLP (following service on the LLP of a Notice to Pay, the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice) under the Covered Bond Guarantee in respect of the Covered Bonds, the LLP will enter into the Covered Bond Swap Agreements (together with the Interest Swap Agreements, the "Swap Agreements" and each a "Swap Agreement") with the

Covered Bond Swap Provider (together with the Interest Rate Swap Providers, the “**Swap Providers**” and each a “**Swap Provider**”).

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

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

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

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

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

#### **Change of counterparties**

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

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

In addition, should the applicable criteria cease to be satisfied, then the parties to the relevant Transaction Document may agree to amend or waive certain of the terms of such document, including the applicable criteria, in order to avoid the need for a replacement entity to be appointed.

The consent of Covered Bondholders may not be required in relation to such amendments and/or waivers.

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

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

- prepayments by the Borrowers;
- the Sellers selling additional Loans and their Related Security to the LLP;
- New Sellers acceding to the Transaction and selling Loans and their Related Security to the LLP; and
- each Seller repurchasing Loans and their Related Security pursuant to its obligations under, or its right of pre-emption under, the Loan Sale Agreement.

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

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

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

The fixed charges purported to be granted by the LLP (other than by way of assignment in security) may take effect under English law as floating charges only, if, for example, it is determined that the Security Trustee does not exert sufficient control over the Charged Property for the security to be said to “fix” over those assets. If the charges take effect as floating charges instead of fixed charges, then the claims of the Security Trustee will be subject to the matters which are given priority over a floating charge by law, including (*inter alia*) prior charges, certain subsequent charges, the expenses of any winding up or administration and the claims of preferential creditors.

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

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

### *Liquidation Expenses*

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

While it is not clear, it appears that the provisions referred to above apply in respect of limited liability partnerships. On this basis and as a result of the changes described above, at all times when

the RCB Regulations do not apply to the LLP, upon the enforcement of the floating charge security granted by the LLP, floating charge realisations which would otherwise be available to satisfy the claims of Secured Creditors under the Deed of Charge may be reduced by at least a significant proportion of any liquidation expenses. There can be no assurance that the Covered Bondholders will not be adversely affected by such a reduction in floating charge realisations.

### **Maintenance of Portfolio**

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

Alternatively, the Members of the LLP (other than the Liquidation Member) may make a Cash Capital Contribution to the LLP pursuant to the LLP Deed in order to ensure that the LLP is in compliance with the Asset Coverage Test. If a breach of the Asset Coverage Test occurs the Bond Trustee will serve a Notice to Pay on the LLP which will result, *inter alia*, in the sale or refinancing of Selected Loans, see further *Summary of Principal Documents – LLP Deed – Sale or Refinancing of Selected Loans and their Related Security if the Pre-Maturity Liquidity Test or Asset Coverage Test is breached*. There is no specific recourse by the LLP to the Sellers in respect of the failure to sell Loans and their Related Security to the LLP nor is there any specific recourse to the Members if they do not make Cash Capital Contributions to the LLP.

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

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

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

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

### **Sale or Refinancing of Selected Loans and their Related Security where Pre-Maturity Liquidity Test (if applicable) is breached**

If the Pre-Maturity Liquidity Test is breached and certain actions are not taken within a specified time period, a Notice to Pay will be served on the LLP, and the LLP will be obliged to sell or refinance Selected Loans and their Related Security in order to make funds available to make payments to its creditors including under the Covered Bond Guarantee in the event of the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice (see *Summary of the Principal Documents – LLP Deed – Sale or Refinancing of Selected Loans and their Related Security if the Pre-Maturity Test or Asset Coverage Test is breached*).

There is no guarantee (i) that a buyer will be found to acquire Selected Loans and their Related Security, or (ii) that the Selected Loans and their Related Security may be refinanced, in each case, at the times required and there can be no guarantee or assurance as to the price which may be able to be obtained, which may affect payments under the Covered Bond Guarantee.

#### **Realisation of Charged Property following the occurrence of an LLP Event of Default**

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

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

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

#### **Factors that may affect the realisable value of the Portfolio**

The realisable value of Selected Loans and their Related Security comprised in the Portfolio may be reduced by:

- no representations or warranties being given by the LLP to a purchaser regarding the Loans or (unless otherwise agreed with the relevant Seller) the Sellers;
- the nature of the business of the Borrowers whose income is limited to receipt of rents from tenants and other letting income and disposal proceeds of vacant properties;
- payment delinquency or default by Borrowers of amounts due on their Loans (see *Default by Borrowers in paying amounts due on their Loans* below);
- changes to the lending criteria of the Sellers in respect of New Loans sold to the LLP;
- the Loans of New Sellers being included in the Portfolio;
- the LLP not having legal title to the Loans or Related Security in the Portfolio;
- limited recourse to the Sellers;
- possible regulatory changes by the Housing Corporation and other regulatory authorities.

A reduction in the value of the Portfolio may affect the ability of the LLP to realise sufficient funds to make payments under the Covered Bond Guarantee.

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

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

Following a breach of the Pre-Maturity Liquidity Test (see *Credit Structure – Pre-Maturity Liquidity* below) and/or the occurrence of an HBOS Event of Default and/or a breach of the Amortisation Test, the LLP will be obliged (i) to sell Selected Loans and their Related Security to third party purchasers, subject to a right of pre-emption enjoyed by the Sellers pursuant to the terms of the Loan Sale Agreement or (ii) refinance Selected Loans and their Related Security (see *Summary of the Principal Documents – LLP Deed – Method of Sale or Refinancing of Selected Loans and their Related Security*). In respect of any sale of Selected Loans and their Related Security to third parties, however, the LLP will not be permitted to give warranties or indemnities in respect of those Selected Loans and their Related Security (unless expressly permitted to do so by the Security Trustee). There is no assurance that the Sellers would give any warranties or representations in respect of the Selected Loans and their Related Security. Any Representations or Warranties previously given by the Sellers

in respect of the Loans in the Portfolio may not have value for a third party purchaser or as part of the terms of any refinancing if the Sellers are then insolvent. Accordingly, there is a risk that the realisable value of the Selected Loans and their Related Security could be adversely affected by the lack of representations and warranties at that time which in turn could adversely affect the ability of the LLP to realise sufficient funds to meet its obligations under the Covered Bond Guarantee.

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

Borrowers may default on their obligations due under the Loans and failure by the relevant Seller to repurchase a Defaulted Loan within the specified time will mean that the aggregate of the Current Balance of such Defaulted Loan will be excluded from the calculation of the Asset Coverage Test. Defaults may occur for a variety of reasons. The Loans are affected by credit, liquidity, regulatory and interest rate risks. Various factors influence Loan delinquency rates, prepayment rates and the ultimate payment of interest and principal, such as changes in the national or international economic climate, regional economic or housing conditions, changes in tax laws, interest rates, inflation, the availability of financing, political developments and government policies. Other factors in Borrowers' financial circumstances may affect the ability of Borrowers to repay the Loans:

- the primary source of funds for a Borrower from which it will meet its payment obligations under its Loan Agreement is the rents payable to it by its tenants. There can be no assurance that sufficient rents will be received to enable a Borrower to meet its payment obligations under its Loan Agreement;
- a dwelling may remain un-tenanted whilst a tenant for that dwelling is found or a tenant occupying a dwelling from time to time could fail to pay the rent then falling due; many reasons exist for dwellings being untenanted;
- a tenant may refuse to pay rent as a result of a breach by a Borrower of its obligations as a landlord under a tenancy agreement, including a failure to perform essential repairs to the relevant property, although the Borrowers are regulated by the Housing Corporation in a manner intended to make such outcome unlikely;
- a proportion of the rent received by a Borrower is derived from housing benefit payable by the local authority in whose area the property is situated. The reduction or termination of housing benefit or changes in the way such benefit is paid may accordingly have an adverse impact on the level of rent received;
- a Borrower may have other preferential creditors which are paid before the Sellers and this would affect the ability of a Borrower to meet its payment obligations under its Loan Agreement;
- the Borrowers may also experience the effect of substantial delay in the payment of housing benefit while the local authority establishes a new claimant's entitlement thereto;
- the timely payment of housing benefit may be adversely affected through industrial action or other action or inaction by the relevant local authority or by changes imposed by central Government;
- the inability of each Borrower to effectively collect rents, repair and maintain its Properties, maintain insurance coverage, evict non-paying tenants and re-let its Properties may adversely affect the amount of rents collected and result in such Borrower defaulting in its payment obligations to the Sellers under the Loan, although the Borrowers are regulated by the Housing Corporation such as to ensure that this is not likely to occur;
- the security created by the Borrowers in favour of Sellers may be invalid to the extent the relevant Borrower was insolvent at time of grant and, to the extent that any security is created by a Borrower over rents receivable from tenants, this will only be equitable security as no notice of such security will be given to any tenants. However, this risk is mitigated by the representation given by the Sellers that at the time of entry into the relevant Loan Agreement and granting of the Legal Charge, the relevant Borrower represented that no Insolvency Event exists in relation to any Borrower or of the assets or undertaking of any Borrower;
- rental levels in relation to rented properties of Borrowers are heavily regulated by rules set down by the Housing Corporation;
- the ability of a Borrower to sell a Property given as security for a Loan may be adversely affected by an administrator being appointed to a Borrower or the 28 day moratorium imposed on the disposal of any land held by a housing association under Section 42 of the Housing Act,

which moratorium may be extended with the consent of all a housing association's creditors (which would include, following the service of a notice of assignment of such Borrower's Loan under the Loan Sale Agreement, the LLP). During the moratorium, the consent of the Housing Corporation is required for the disposal of any land; and

- some housing associations in the United Kingdom have diversified their businesses away from the sole provision of rented housing. These other activities may expose housing associations to additional risks if management lacks expertise in these other activities.

Prior to the occurrence of an HBOS Event of Default or an LLP Event of Default, each Seller will have the option, as applicable, to repurchase each Defaulted Loan sold by it to the LLP for an amount equal to the aggregate of the Current Balance of the relevant Loan. Failure by each Seller to repurchase a Defaulted Loan within the specified time will mean that the Current Balance of the relevant Loan will be excluded from the calculation of the Asset Coverage Test.

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

Each of the Loans originated by each Seller will have been originated in accordance with its Lending Criteria at the time of origination. It is expected that each Seller's Lending Criteria will generally consider type of borrower, security package, financial covenant package and the financial and management strength of the Borrower. In the event of the sale or transfer of any Loans and Related Security (sold by any Seller) to the LLP, each Seller will warrant only that such Loans and Related Security were originated in accordance with such Seller's Lending Criteria applicable at the time of origination. Each Seller retains the right to revise its Lending Criteria from time to time. If the Lending Criteria change in a manner that affects the creditworthiness of the Loans, that may lead to increased defaults by Borrowers and may affect the realisable value of the Portfolio, or part thereof, and the ability of the LLP to make payments under the Covered Bond Guarantee. As noted above, however, Defaulted Loans that are not repurchased by the relevant Seller thereof will be excluded for the purposes of the calculation of the Asset Coverage Test.

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

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

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

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

The sale by the Sellers to the LLP of the Loans and their Related Security will take effect by way of an equitable assignment. As a result, legal title to the Loans and their Related Security will remain with the relevant Seller. The LLP, however, will have the right to demand that the relevant Seller transfers to the LLP the legal title to the Loans and the Related Security (if the Loans are bilateral Loans but not syndicated Loans) in the circumstances described in *Summary of the Principal Documents – Loan Sale Agreement – Transfer of title to the Loans to the LLP* and until then, the LLP will not give notice of the sale of the Loans and their Related Security to any Borrower or apply to the Land Registry or the Central Land Charges Registry to register or record its equitable interest in the Loans and their Related Security.

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

- first, if the relevant Seller wrongly sells a Loan and its Related Security, which has already been sold to the LLP, to another person and that person acted in good faith and did not have notice of the interests of the LLP in the Loan and its Related Security, then she or he might obtain good title to the Loan and its Related Security, free from the interests of the LLP. If this occurred then the LLP would not have good title to the affected Loan and its Related Security

and it would not be entitled to payments by a Borrower in respect of that Loan. However, the risk of third party claims obtaining priority to the interests of the LLP would be likely to be limited to circumstances arising from a breach by the relevant Seller of its contractual obligations or fraud, negligence or mistake on the part of the relevant Seller or the LLP or their respective personnel or agents; and

- second, the rights of the LLP may be subject to the rights of the Borrowers against the relevant Seller, such as rights of set-off, which occur in relation to transactions or deposits made between Borrowers and the relevant Seller and the rights of Borrowers to repay their Loans by payment directly to the relevant Seller. However in respect of each Loan in the Initial Portfolio the Borrower has agreed with the relevant Seller in its Loan Agreement to exclude such Borrower's right to set-off and this explicit contractual prohibition will be effective to prevent any claim by a Borrower that set-off should be allowed as a result of deposits or transactions made with the Seller.

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

For so long as the LLP does not have legal title, each Seller will undertake for the benefit of the LLP and the Secured Creditors that it will lend its name to, and take such other steps as may be reasonably required by the LLP and/or the Security Trustee in relation to, any legal proceedings in respect of the Loans and their Related Security.

#### **Limited Rights in respect of Syndicated Loans**

Loans sold to the LLP may form part of a larger syndicated Loan. In such cases, the Seller's rights may be exercised by weighted voting by all the lenders under the syndicated Loan. In addition, security for the syndicated Loan is generally held under a security trust for all lenders. In such cases the LLP will only acquire the Seller's rights under the relevant Loan Agreement and security trust, which may be limited by the rights of other lenders in the syndicate or the powers of any trustee of such security trust.

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

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

If any Loan sold by a Seller does not materially comply with any of the Representations and Warranties made by that Seller as at the Transfer Date of that Loan, then the relevant Seller will be required to remedy the breach within 60 London Business Days of that Seller becoming aware of the same or of receipt by it of a notice from the LLP requiring the Seller to remedy the breach.

If the relevant Seller fails to remedy the breach of a Representation and Warranty within 60 London Business Days, then that Seller will be required to repurchase on or before the next following Calculation Date (or such other date that may be agreed between the LLP and the Seller) the relevant Loan and its Related Security at an amount equal to the Current Balance as of the date of repurchase.

In addition, each Seller will have the option to repurchase Defaulted Loans in the Portfolio sold by it to the LLP, within 60 London Business Days of that Seller becoming aware of the Defaulted Loan in the Portfolio or of receipt by it of a notice from the LLP. The relevant Seller will have the option to repurchase the relevant Loan and its Related Security at an amount equal to the Current Balance as at the date of repurchase.

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



### **Limited Liability Partnerships**

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

### **Pensions Act 2004**

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

A contribution notice could be served on the LLP if it was party to an act, or a deliberate failure to act, the main purpose or one of the main purposes of which was either (i) to prevent the recovery of the whole or any part of a debt which was, or might become, due from the employer under Section 75 of the Pensions Act 1995 or (ii) otherwise than in good faith, to prevent such a debt becoming due, to compromise or otherwise settle such a debt, or to reduce the amount of such a debt which would otherwise become due.

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

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

## FORM OF THE COVERED BONDS

Each Tranche of Covered Bonds will be in bearer form and will be initially issued in the form of a temporary global covered bond without interest coupons attached (a “**Temporary Global Covered Bond**”) or, if so specified in the applicable Final Terms (the “**applicable Final Terms**”), a permanent global covered bond without interest coupons attached (a “**Permanent Global Covered Bond**” and, together with the Temporary Global Covered Bonds, the “**Global Covered Bonds**” and each a “**Global Covered Bond**”) which, in either case, will be delivered on or prior to the original issue date of the Tranche to a common safekeeper (the “**Common Safekeeper**”) for Euroclear Bank S.A./N.V.(“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”).

On 13 June 2006 the European Central Bank (the “**ECB**”) announced that Notes in new global note (“**NGN**”) form are in compliance with the “Standards for the use of EU securities settlement systems in ESCB credit operations” of the central banking system for the euro (the “**Eurosystem**”), **provided that** certain other criteria are fulfilled. At the same time the ECB also announced that arrangements for Notes in NGN form will be offered by Euroclear and Clearstream, Luxembourg as of 30 June 2006 and that debt securities in global bearer form issued through Euroclear and Clearstream, Luxembourg after 31 December 2006 will only be eligible as collateral for Eurosystem operations if the NGN form is used.

Whilst any Covered Bond is represented by a Temporary Global Covered Bond, payments of principal, interest (if any) and any other amount payable in respect of the Covered Bonds due prior to the Exchange Date (as defined below) will be made against presentation of the Temporary Global Covered Bond only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Covered Bond are not U.S. persons or persons who have purchased for resale to any U.S. person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Agent.

On and after the date (the “**Exchange Date**”) which is 40 days after a Temporary Global Covered Bond is issued, interests in such Temporary Global Covered Bond will be exchangeable (free of charge) upon a request as described therein either for (i) interests in a Permanent Global Covered Bond of the same Series or (ii) for definitive Covered Bonds of the same Series with, where applicable, receipts, interest coupons and talons attached (as indicated in the applicable Final Terms and subject, in the case of definitive Covered Bonds, to such notice period as is specified in the applicable Final Terms), in each case against certification of non-US beneficial ownership as described above unless such certification has already been given. The holder of a Temporary Global Covered Bond will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Global Covered Bond for an interest in a Permanent Global Covered Bond or for definitive Covered Bonds is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Global Covered Bond will be made through Euroclear and/or Clearstream, Luxembourg against presentation or surrender (as the case may be) of the Permanent Global Covered Bond without any requirement for certification.

The applicable Final Terms will specify that a Permanent Global Covered Bond will be exchangeable (free of charge), in whole but not in part, for definitive Covered Bonds with, where applicable, receipts, interest coupons and talons attached upon either (i) not less than 60 days’ written notice from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Covered Bond) to the Agent as described therein or (ii) only upon the occurrence of an “**Exchange Event**”. For these purposes, Exchange Event means that (i) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (ii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Covered Bonds represented by the Permanent Global Covered Bond in definitive form. The Issuer will promptly give notice to Covered Bondholders of each Series in accordance with Condition 13 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Covered Bond) or the Bond Trustee may give notice to the Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in

(ii) above, the Issuer may also give notice to the Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Agent.

Global Covered Bonds and definitive Covered Bonds will be issued pursuant to the Agency Agreement.

The following legend will appear on all Covered Bonds which have an original maturity of more than 1 year and on all receipts and interest coupons relating to such Covered Bonds:

“ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS, INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(J) AND 1287(A) OF THE INTERNAL REVENUE CODE.”

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on Covered Bonds, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of such Covered Bonds, receipts or interest coupons.

Covered Bonds (including rights representing an interest in a Global Covered Bond) which are not High Denomination Notes may only be offered, directly or indirectly, as part of their initial distribution or at any time thereafter, in The Netherlands, to Dutch Residents qualifying as “Professional Market Parties” or “PMPs” provided they acquire the Notes for their own account and **provided that** the Covered Bonds bear a legend to the following effect:

“THIS COVERED BOND (OR ANY INTEREST THEREIN) MAY NOT BE SOLD, TRANSFERRED OR DELIVERED TO INDIVIDUALS OR LEGAL ENTITIES WHO ARE ESTABLISHED, DOMICILED OR HAVE THEIR RESIDENCE IN THE NETHERLANDS (“DUTCH RESIDENTS”) OTHER THAN PROFESSIONAL MARKET PARTIES WITHIN THE MEANING OF THE EXEMPTION REGULATION UNDER THE DUTCH ACT ON THE SUPERVISION OF CREDIT INSTITUTIONS 1992 (AS AMENDED OR RE-ENACTED) (EACH, A “PMP”).

EACH DUTCH RESIDENT HOLDER OF THIS COVERED BOND (OR ANY INTEREST THEREIN), BY PURCHASING THIS COVERED BOND (OR ANY INTEREST THEREIN), WILL BE DEEMED TO HAVE REPRESENTED AND AGREED FOR THE BENEFIT OF THE ISSUER THAT (1) IT IS A PMP AND IS ACQUIRING THIS COVERED BOND (OR ANY INTEREST THEREIN) FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A PMP, THAT (2) THIS COVERED BOND (OR ANY INTEREST THEREIN) MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED TO DUTCH RESIDENTS OTHER THAN A PMP ACQUIRING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A PMP AND THAT (3) IT WILL, IN ACCORDANCE WITH THE 2005 POLICY RULES ON KEY CONCEPTS OF MARKET ACCESS AND ENFORCEMENT OF THE WTK (BELEIDSREGEL 2005 KERNBEGRIPPEN MARKTTOETREDING EN HANDHAVING WTK 1992) BY THE DUTCH CENTRAL BANK (DE NEDERLANDSCHE BANK N.V.), VERIFY THAT SUCH TRANSFEREE QUALIFIES AS A PMP; AND (4) IT WILL PROVIDE NOTICE OF THE TRANSFER RESTRICTIONS DESCRIBED HEREIN TO ANY SUBSEQUENT TRANSFEREE”.

Covered Bonds which are represented by a Global Covered Bond will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be.

Pursuant to the Agency Agreement (as defined under *Terms and Conditions of the Covered Bonds*), the Agent shall arrange that, where a further Tranche of Covered Bonds is issued which is intended to form a single Series with an existing Tranche of Covered Bonds, the Covered Bonds of such further Tranche shall be assigned a common code and ISIN which are different from the common code and ISIN assigned to Covered Bonds of any other Tranche of the same Series until at least the expiry of the distribution compliance period (as defined in Regulation S under the United States Securities Act of 1933, as amended (the “**Securities Act**”)) applicable to the Covered Bonds of such Tranche.

Any reference herein to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms or as may otherwise be approved by the Issuer, the Agent and the Bond Trustee.

No Covered Bondholder, Receiptholder or Couponholder shall be entitled to proceed directly against the Issuer or any Guarantor unless the Bond Trustee or, as the case may be, the Security Trustee, having become bound so to proceed, fails so to do within a reasonable period and the failure shall be continuing.

## FORM OF FINAL TERMS

Set out below is the form of Final Terms which, subject to any necessary amendment, will be completed for each Tranche of Covered Bonds issued under the Programme.

**Final Terms dated [●]**

**Bank of Scotland plc**

**Issue of [Aggregate Nominal Amount of Tranche] [Title of Covered Bonds] Social Housing Covered Bonds**

**Unconditionally guaranteed by HBOS plc**

**and**

**Irrevocably and unconditionally guaranteed as to payments of principal and interest by**

**HBOS Social Housing Covered Bonds LLP**

**under the £3 billion**

**Social Housing Covered Bond Programme**

### PART A — CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated [the original date] which constitutes a base prospectus for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the “**Prospectus Directive**”). This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with such Base Prospectus. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Base Prospectus. The Base Prospectus is available for viewing at the registered office of the Issuer and the specified office of any Dealer.

*The following alternative language applies if the first tranche of an issue which is being increased was issued under a Base Prospectus with an earlier date.*

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions (the “**Conditions**”) set forth in the Base Prospectus dated [the original date]. This document constitutes the Final Terms of the Covered Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the “**Prospectus Directive**”) and must be read in conjunction with the [Base Prospectus dated [current date]<sup>1</sup>, which constitutes a base prospectus for the purposes of the Prospectus Directive, save in respect of the Conditions which are extracted from the] Base Prospectus dated [original date] and are attached hereto. Full information on the Issuer and the offer of the Covered Bonds is only available on the basis of the combination of these Final Terms and the Base Prospectuses dated [original date]<sup>2</sup> [and [current date]].

*[Include whichever of the following apply or specify as “Not Applicable” (N/A). Note that the numbering should remain as set out below, even if “Not Applicable” is indicated for individual paragraphs or sub-paragraphs. Italics denote directions for completing the Final Terms.]*

*[When completing final terms or adding any other final terms or information consideration should be given as to whether such terms or information constitute “significant new factors” and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive]*

1. (i) Issuer: Bank of Scotland plc
- (ii) Guarantors: HBOS plc and HBOS Social Housing Covered Bonds LLP
2. (i) Series Number: [●]
- (ii) Tranche Number: [●]  
*(If fungible with an existing Series, details of that Series, including the date on which the Covered Bonds become fungible)*
3. Specified Currency or Currencies: [●]

<sup>1</sup> Current date is the date of any supplement produced for new issuance.

<sup>2</sup> Original date is the date of this Base Prospectus or any later update.

4. Aggregate Nominal Amount of Covered Bonds:
- (i) Series: [●]
- (ii) Tranche: [●]
5. [(i)] Issue Price: [●] per cent. of the Aggregate Nominal Amount [plus accrued interest from [insert date] (in the case of fungible issues only, if applicable)]
- [(ii)] Net proceeds: [●]  
    (Required only for listed issues)
6. (i) Specified Denominations: [●]
- [N.B. Where multiple denominations above €50,000 or equivalent are being used the following sample wording should be followed: €50,000 and integral multiples of [€1,000] in excess thereof up to and including [€99,000]. No Covered Bonds in definitive form will be issued with a denomination above [€99,000].]*
- [N.B. if an issue of Covered Bonds is (i) NOT admitted to trading on a European Economic Area exchange; and (ii) only offered in the European Economic Area in circumstances where a prospectus is not required to be published under the Prospectus Directive the €50,000 minimum denomination is not required]*
- (ii) Calculation Amount [(●)]
- [If only one Specified Denomination, insert the Specified Denomination.*
- If more than one Specified Denomination, insert the highest common factor. Covered Bond: There must be a common factor in the case of two or more Specified Denominations.]*
7. (i) Issue Date: [●]
- (ii) Interest Commencement Date: [●]
8. (i) Final Maturity Date: [Fixed rate - specify date  
Floating rate - Interest Payment Date falling in or nearest to [specify month and year]]
- (ii) Extended Final Maturity Date of amounts corresponding to Final Redemption Amount under the Covered Bond Guarantee: [Fixed rate - specify date  
Floating rate - Interest Payment Date falling in or nearest to [specify month; in each case falling [●] year[s] after the Final Maturity Date]]
9. (i) Pre-Maturity Short-Term Rating Period: [●]
- (ii) Pre-Maturity Long-Term Rating Period: [●]
10. Interest Basis: [[●] per cent. Fixed Rate]  
[[LIBOR/EURIBOR] +/- [●] per cent. Floating Rate]  
[Zero Coupon]  
[Index Linked Interest]  
[Dual Currency Interest]  
[specify other]  
(further particulars specified below)
11. Redemption/Payment Basis: [Redemption at par]  
[Index Linked Redemption]  
[Dual Currency Redemption]

[Instalment]  
[Partly Paid]  
[specify other]

*[N.B If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply. Note that some regulatory authorities may require the inclusion of information or placeholders addressing Paragraph 5 of Annex XII even though (noting that such information is not required by Annex XIII) the denomination of the Covered Bonds is €50,000 or more. Where Annex XII is not applicable but income on the Covered Bonds is linked to an underlying, nevertheless consider including disclosure in relation to the underlying.]*

12. Change of Interest Basis or Redemption/  
Payment Basis: *[Specify details of any provision for change of Covered Bonds into another Interest Basis or Redemption/  
Payment Basis]*
13. Call Option: *[Issuer Call]  
[(further particulars specified below)]*
14. (i) Status of the Covered Bonds: Senior  
(ii) Status of the Guarantees: Senior
15. Method of distribution: *[Syndicated/Non-syndicated]*

#### **PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE**

16. Fixed Rate Covered Bond Provisions *[Applicable/Not Applicable]  
[If not applicable, delete the remaining sub-paragraphs of this paragraph]*
- (i) Rate(s) of Interest: *[●] per cent. per annum [payable [annually/semi-annually/ quarterly] in arrear]  
[If payable other than annually, consider amending Condition 4]*
- (ii) Interest Payment Date(s): *[●] in each year up to and including the Final Maturity Date/[specify other]  
[NB: This will need to be amended in the case of long or short Coupons]*
- (iii) Fixed Coupon Amount(s): *[●] per Calculation Amount  
[Applicable to Covered Bonds in definitive form]*
- (iv) Broken Amount(s): *[●] per Calculation Amount payable on the Interest Payment Date falling [in/on][●]  
[Applicable to Covered Bonds in definitive form]*
- (v) Day Count Fraction: *[30/360 or Actual/Actual (ICMA) or [specify other]]*
- (vi) Determination Date(s): *[●] in each year  
[Insert regular Interest Payment Dates, ignoring Issue Date or Maturity Date in the case of a long or short first or last Coupon  
NB: This will need to be amended in the case of regular Interest Payment Dates which are not of equal duration  
NB: Only relevant where Day Count Fraction is Actual/Actual (ICMA)]*

- (vii) Other terms relating to the method of calculating interest for Fixed Rate Covered Bonds: [None/*Give details*]
17. Floating Rate Covered Bond Provisions [Applicable/Not Applicable]  
[If not applicable, delete the remaining sub-paragraphs of this paragraph]
- (i) Interest Period(s): [●]
- (ii) Specified Period(s)/Specified Interest Payment Dates: [●]
- (iii) First Interest Payment Date: [●]
- (iv) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/Specify Other]
- (v) Additional Business Centre(s): [●]
- (vi) Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/*specify other*]
- (vii) Party responsible for calculating the Rate(s) of Interest and/or Interest Amount(s) (if not the Agent): [●]
- (viii) Screen Rate Determination:
- Reference Rate: [●]  
[*Either LIBOR, EURIBOR or other, although additional information is required if other - including fallback provisions in the Agency Agreement*]
- Interest Determination Date(s): [●]  
[*Second London Business Day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second TARGET Day prior to the start of each Interest Period if EURIBOR or euro LIBOR*]
- Relevant Screen Page: [●]  
[*In the case of EURIBOR, if not Reuters Page EURIBOR01 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately*]
- (ix) ISDA Determination:
- Floating Rate Option: [●]
- Designated Maturity: [●]
- Reset Date: [●]
- (x) Margin(s): [+/-] [●] per cent. per annum
- (xi) Minimum Rate of Interest: [●] per cent. per annum
- (xii) Maximum Rate of Interest: [●] per cent. per annum
- (xiii) Day Count Fraction: [Actual/365  
Actual/Actual (ISDA)  
Actual/365 (Fixed)  
Actual/365 (Sterling)  
Actual/360  
30/360  
360/360  
Bond Basis30E/360  
Eurobond Basis]



- Other*  
[See Condition 4 for alternatives]
- (xiv) Fall back provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Covered Bonds, if different from those set out in the Conditions: [●]
18. Zero Coupon Covered Bond Provisions [Applicable/Not Applicable]  
*[If not applicable, delete the remaining sub-paragraphs of this paragraph]*
- (i) Accrual Yield: [●] per cent. per annum  
[●]
- (ii) Reference Price:
- (iii) Any other formula/basis of determining amount payable: [●]
- (iv) Day Count Fraction in relation to Early Redemption Amounts and late payments: [Conditions 6(d)(iii) and (j) apply/specify other]  
  
*[Consider applicable Day Count Fraction if not U.S. dollar denominated]*
19. Index Linked Interest Covered Bond Provisions [Applicable/Not Applicable]  
*[If not applicable, delete the remaining sub-paragraphs of this paragraph]*  
  
*[N.B If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply. Note that some regulatory authorities may require the inclusion of information or placeholders addressing Paragraph 5 of Annex XII even though (noting that such information is not required by Annex XIII) the denomination of the Covered Bonds is €50,000 or more. Where Annex XII is not applicable but income on the Covered Bonds is linked to an underlying, nevertheless consider including disclosure in relation to the underlying.]*
- (i) Index/Formula: *[give or annex details]*
- (ii) Party responsible for calculating the Rate(s) of Interest and/or Interest Amounts (if not the Principal Paying Agent): [●]
- (iii) Provisions for determining Coupon where calculation by reference to Index and/or Formula and/or other variable: *[need to include a description of market disruption or settlement disruption events and adjustment provisions]*
- (iv) Determination Date(s): [●]
- (v) Provisions for determining Coupon where calculation by reference to Index and/or Formula and/or other variable is impossible or impracticable or otherwise disrupted: [●]
- (vi) Specified Period(s)/Specified Interest Payment Dates: [●]

- (vii) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/*specify other*]
- (viii) Additional Business Centre(s): [●]
- (ix) Minimum Rate of Interest: [●] per cent. per annum
- (x) Maximum Rate of Interest: [●] per cent. per annum
- (xi) Day Count Fraction: [●]
20. Dual Currency Interest Covered Bond Provisions [Applicable/Not Applicable]  
*[If not applicable, delete the remaining sub-paragraphs of this paragraph]*  
*[N.B If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply. Note that some regulatory authorities may require the inclusion of information or placeholders addressing Paragraph 5 of Annex XII even though (noting that such information is not required by Annex XIII) the denomination of the Covered Bonds is €50,000 or more. Where Annex XII is not applicable but income on the Covered Bonds is linked to an underlying, nevertheless consider including disclosure in relation to the underlying.]*
- (i) Rate of Exchange/method of calculating Rate of Exchange [give details]
- (ii) Party if any, responsible for calculating the principle and/or interest due (if not the Principal Paying Agent): [●]
- (iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable: [●]
- (iv) Person at whose option Specified Currency(ies) is/are payable: [●]

## PROVISIONS RELATING TO REDEMPTION

21. Issuer Call: [Applicable/Not Applicable]  
*[If not applicable, delete the remaining sub-paragraphs of this paragraph]*
- (i) Optional Redemption Date(s): [●]
- (ii) Optional Redemption Amount of each Covered Bond and method, if any, of calculation of such amount(s): [●] per Calculation Amount
- (iii) If redeemable in part:
- (a) Minimum Redemption Amount: [●] per Calculation Amount
- (b) Maximum Redemption Amount: [●] per Calculation Amount
- (iv) Notice period (if other than as set out in the Conditions): [●]
- [N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised*

*to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent]*

22. Final Redemption Amount of each Covered Bond:  per Calculation Agent/specify other/ see Appendix  
*[N.B If the Final Redemption Amount is other than 100 per cent. of the nominal value, the Covered Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply. Note that some regulatory authorities may require the inclusion of information or placeholders addressing Paragraph 5 of Annex XII even though (noting that such information is not required by Annex XIII) the denomination of the Covered Bonds is €50,000 or more. Where Annex XII is not applicable but income on the Covered Bonds is linked to an underlying, nevertheless consider including disclosure in relation to the underlying.]*
23. Early Redemption Amount per Calculation Amount payable on redemption for taxation reasons, on acceleration following an HBOS Event of Default as against the Issuer and the Group Guarantor or an LLP Event of Default and/or the method of calculating the same (if required or if different from that set out in Condition 6(d)):  per Calculation Amount/specify other/see Appendix

#### **GENERAL PROVISIONS APPLICABLE TO THE COVERED BONDS**

24. Form of Covered Bonds:  Bearer Covered Bonds:  
 [Form:]  [Temporary Global Covered Bond exchangeable for a Permanent Global Covered Bond which is exchangeable for definitive Covered Bonds [on not less than 60 days written notice from Euroclear and/or Clearstream, Luxembourg] in the limited circumstances specified in the Permanent Global Covered Bond]  
 [Temporary Global Covered Bond exchangeable for definitive Covered Bonds on and after the Exchange Date [on not less than 60 days written notice from Euroclear and/or Clearstream, Luxembourg]]  
 [Permanent Global Covered Bond exchangeable for definitive Covered Bonds [on not less than 60 days written notice from Euroclear and/or Clearstream, Luxembourg] in the limited circumstances specified in the Permanent Global Covered Bond]]  
 [N.B. Any Temporary Global Covered Bond or Permanent Global Covered Bond with a Specified Denomination of €50,000 (or equivalent) and integral multiples of €1,000 (or equivalent) shall only be exchangeable for definitive Covered Bonds upon the occurrence of an Exchange Event]
25. New Global Note Form  [Yes][No]
26. Additional Financial Centre(s) or other  [Not Applicable/give details]

- special provisions relating to payment: *[Note that this item relates to the place of payment and not Interest Period end dates to which items 17(ii), 18(iii) and 20(vi) relate]*
27. Talons for future Coupons or Receipts to be attached to definitive Covered Bonds (and dates on which such Talons mature): *[Yes/No. If yes, give details]*
28. Details relating to Partly Paid Covered Bonds amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Covered Bonds and interest due on late payment: *[Not Applicable/give details. NB: a new form of Temporary Global Covered Bond and/or Permanent Global Covered Bond may be required for Partly Paid issues]*
29. Details relating to Instalment Covered Bonds:
- (i) Instalment Amount(s): *[Not Applicable/give details]*
- (ii) Instalment Date(s): *[Not Applicable/give details]*
30. Redenomination applicable: *Redenomination [not] applicable*  
*[If Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating rate interest calculation (including alternative reference rates)]*
31. Other terms or special conditions: *[Not Applicable/give details]*  
*[When adding any other final terms consideration should be given as to whether such terms constitute a “significant new factor” and consequently trigger the need for a supplement to the Prospectus under Article 16 of the Prospectus Directive]*

## **DISTRIBUTION**

32. (i) If syndicated, names of Managers: *[Not Applicable/give names]*  
*[If the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies, include names of entities agreeing to underwrite the issue on a firm commitment basis and names of the entities agreeing to place the issue without a firm commitment or on a “best efforts” basis if such entities are not the same as the Managers]*
- (ii) Stabilising Manager (if any): *[Not Applicable/give name]*
33. If non-syndicated, name of relevant Dealer(s): *[Not Applicable/give name(s)]*
34. Whether TEFRA D or TEFRA C rules applicable or TEFRA rules not applicable: *[TEFRA D/TEFRA C/TEFRA not applicable]*
35. Additional selling restrictions: *[Not Applicable/give details]*

## **PURPOSE OF FINAL TERMS**

This Final Terms comprises the final terms required for issue and admission to trading on the regulated market of the London Stock Exchange of the Covered Bonds described herein pursuant to the £3,000,000,000 Social Housing Covered Bond Programme of Bank of Scotland plc.

**RESPONSIBILITY**

Each of the Issuer, the Group Guarantor and the LLP accepts responsibility for the information contained in these Final Terms. [●] has been extracted from [●]. Each of the Issuer, the Group Guarantor and the LLP confirms that such information has been accurately reproduced and that, so far as it is aware and is able to ascertain from information published by [specify source], no facts have been omitted which would render the reproduced inaccurate or misleading.

Signed on behalf of the Issuer:

Signed on behalf of HBOS plc:

By:

By:

*Duly authorised*

*Duly authorised*

Signed on behalf of the LLP

By:

*Duly authorised*

*If the applicable Final Terms specifies any modification to the Terms and Conditions of the Covered Bonds as described herein, it is envisaged that, to the extent that such modification relates only to Conditions 1, 3, 4, 5, 6, 10, 11, 12, 13 (insofar as such Covered Bonds are not listed or admitted to trade on any stock exchange) or 16, they will not necessitate the preparation of a supplementary Base Prospectus. If the Terms and Conditions of the Covered Bonds of any Series are to be modified in any other respect, a supplementary Base Prospectus will be prepared, if appropriate.*

## PART B — OTHER INFORMATION

### 1. LISTING

- (i) Admission to trading: [Application has been made by the Issuer (or on its behalf) for the Covered Bonds to be admitted to trading on the [London Stock Exchange] [Bourse de Luxembourg] with effect from [●].] [Application is expected to be made by the Issuer (or on its behalf) for the Covered Bonds to be admitted to trading on the [London Stock Exchange] [Bourse de Luxembourg] with effect from [●].] [Not Applicable.]  
[Where documenting a fungible issue need to indicate that original Covered Bonds are already admitted to trading]
- (ii) Estimate of total expenses related to admission to trading: [●] [Not applicable]

### 2. RATINGS

- Ratings: The Covered Bonds to be issued have been rated: S & P: [[●][●][●]]
- Moody's: [●]  
[ [Other]: ●]
- (The above disclosure should reflect the rating allocated to Covered Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)*

### 3. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE [ISSUE/OFFER]

[Save as discussed in *Subscription and Sale and Transfer and Selling Restrictions*, so far as the Issuer, Group Guarantor and the LLP are aware, no person involved in the issue of the Covered Bonds has an interest material to the offer. - *Amend as appropriate if there are other interests*]

### 4. REASONS FOR THE OFFER, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

- [(i) Reasons for the offer: [ ]
- (See [“Use of Proceeds”] wording in Base Prospectus - if reasons for offer differ from general corporate purposes and/or making profit and/or hedging certain risks will need to include those reasons here.)*
- [(ii) Estimated net proceeds: [ ]
- (If proceeds are intended for more than one use will need to split out and present in order of priority. If proceeds insufficient to fund all proposed uses state amount and sources of other funding.)*
- [(iii) Estimated total expenses: [ ] [Include breakdown of expenses.
- [(If the Notes are derivative securities to which Annex XII of the Prospectus Directive Regulation applies it is only necessary to include disclosure of net proceeds and total expenses at (ii) and (iii) above where disclosure is included at (i) above.)]*

### 5. [Fixed Rate Covered Bonds only — YIELD

- Indication of yield: [●]
- The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.]

**6. [Index-Linked or other variable-linked Notes only - PERFORMANCE OF INDEX/FORMULA/ OTHER VARIABLE AND OTHER INFORMATION CONCERNING THE UNDERLYING**

*Need to include details of where past and future performance and volatility of the index/formula/ other variable can be obtained. Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained. Where the underlying is not an index need to include equivalent information. Include other information required by Paragraph 4.2 of Annex XII of the Prospectus Directive Regulation.]*

*[(When completing this paragraph, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Prospectus under Article 16 of the Prospectus Directive.)]*

The Issuer [intends to provide post-issuance information [specify what information will be reported and where it can be obtained] [does not intend to provide post-issuance information]. (Required for derivative Covered Bonds to which Annex XII applies).

**7. [Dual Currency Notes only - PERFORMANCE OF RATE[S] OF EXCHANGE**

*Need to include details of where past and future performance and volatility of the relevant rate[s] can be obtained.]*

*[(When completing this paragraph, consideration should be given as to whether such matters described constitute “significant new factors” and consequently trigger the need for a supplement to the Prospectus under Article 16 of the Prospectus Directive.)]*

*[This paragraph 7 only applies if the Covered Bonds are derivative securities to which Annex XII of the Prospectus Directive Regulation applies]*

**OPERATIONAL INFORMATION**

- 8. ISIN Code:
- 9. Common Code:
- 10. Other:
- 11. Any clearing system(s) other than Euroclear and Clearstream, Luxembourg and the relevant identification number(s):  [Not Applicable/give name(s) and number(s)]
- 12. Delivery: Delivery [against/free of] payment
- 13. Name and address of additional paying agent(s) (if any):
- 14. New Global Note intended to be held in a manner which would allow Eurosystem eligibility:  [Yes/No]

[Note that the designation “Yes” simply means that the Notes are intended upon issue to be deposited with Euroclear or Clearstream, Luxembourg as Common Safekeeper and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria.] [Include this text if “yes” selected in which case the Covered Bonds must be issued in NGN form.]

## TERMS AND CONDITIONS OF THE COVERED BONDS

*The following are the Terms and Conditions of the Covered Bonds which will be incorporated by reference into each Global Covered Bond (as defined below) and each definitive Covered Bond, in the latter case only if permitted by the relevant stock exchange or other relevant authority (if any) and agreed by the Issuer and the relevant Dealer(s) at the time of issue but, if not so permitted and agreed, such definitive Covered Bond will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Final Terms in relation to any Tranche of Covered Bonds may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Covered Bonds. The applicable Final Terms (or the relevant provisions thereof) will be endorsed upon, or attached to, each Global Covered Bond and definitive Covered Bond.*

This Covered Bond is one of a Series (as defined below) of Covered Bonds issued by Bank of Scotland plc (the “**Issuer**”) constituted by a trust deed (such trust deed as modified and/or supplemented and/or restated from time to time, the “**Trust Deed**”) dated on or about 21 December 2004 (the “**Programme Date**”) made between the Issuer, HBOS plc as guarantor (“**HBOS**” and the “**Group Guarantor**”), HBOS Social Housing Covered Bonds LLP as guarantor (the “**LLP**” and, together with the Group Guarantor, the “**Guarantors**” and each a “**Guarantor**”, which expression shall include any additional or successor guarantor) and Citicorp Trustee Company Limited as bond trustee (in such capacity, the “**Bond Trustee**”, which expression shall include any successor as Bond Trustee) and Citicorp Trustee Company Limited as security trustee (in such capacity, the “**Security Trustee**”, which expression shall include any successor as Security Trustee).

Save as provided for in Conditions 9 (*Events of Default and Enforcement*) and 14 (*Meetings of Covered Bondholders, Modification, Waiver and Substitution*) references herein to the Covered Bonds shall be references to the Covered Bonds of this Series and shall mean:

- (i) in relation to any Covered Bonds represented by a global bond (a “**Global Covered Bond**”), units of the lowest Specified Denomination in the Specified Currency;
- (ii) any Global Covered Bond; and
- (iii) any definitive Covered Bonds issued in exchange for a Global Covered Bond.

The Covered Bonds, the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an agency agreement (such agency agreement as amended and/or supplemented and/or restated from time to time, the “**Agency Agreement**”) dated the Programme Date and made between the Issuer, the Group Guarantor, the LLP, the Bond Trustee, Citibank, N.A., London Branch as issuing and principal paying agent and agent bank (the “**Principal Paying Agent**”, which expression shall include any successor agent) and the other paying agents named therein (together with the Principal Paying Agent, the “**Paying Agents**”, which expression shall include any additional or successor paying agents).

Interest bearing definitive Covered Bonds have (unless otherwise indicated in the applicable Final Terms) interest coupons (“**Coupons**”) and, if indicated in the applicable Final Terms, talons for further Coupons (“**Talons**”) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Covered Bonds repayable in instalments have receipts (“**Receipts**”) for the payment of the instalments of principal (other than the final instalment) attached on issue. Global Covered Bonds do not have Receipts, Coupons or Talons attached on issue.

The Final Terms for this Covered Bond (or the relevant provisions thereof) is attached to or endorsed on this Covered Bond and supplements these Terms and Conditions (the “**Conditions**”) and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the Conditions, replace or modify the Conditions for the purposes of this Covered Bond. References to the applicable Final Terms are to the Final Terms (or the relevant provisions thereof) attached to or endorsed on this Covered Bond.

The Bond Trustee acts for the benefit of the holders for the time being of the Covered Bonds (the “**Covered Bondholders**”, which expression shall, in relation to any Covered Bonds represented by a Global Covered Bond, be construed as provided below), the holders of the Receipts (the “**Receiptholders**”) and the holders of the Coupons (the “**Couponholders**”, which expression shall, unless the context otherwise requires, include the holders of the Talons), and for holders of each other Series of Covered Bonds in accordance with the provisions of the Trust Deed.



As used herein, “**Tranche**” means Covered Bonds which are identical in all respects (including as to listing and admission to trading) and “**Series**” means a Tranche of Covered Bonds together with any further Tranche or Tranches of Covered Bonds which are (i) expressed to be consolidated and form a single series and (ii) identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

The Group Guarantor has, in the Trust Deed, unconditionally guaranteed the due and punctual payment of principal and interest and other amounts due by the Issuer under or in respect of the Covered Bonds and the Trust Deed as and when the same shall become due and payable (including accelerated amounts).

The LLP has, in the Trust Deed, irrevocably and unconditionally guaranteed (on a several basis as between the Group Guarantor and itself) the due and punctual payment of Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment, but only after service of a Notice to Pay on the LLP by the Bond Trustee, the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice or the service of an LLP Acceleration Notice.

The security for the obligations of the LLP under the Covered Bond Guarantee and the other Transaction Documents to which it is a party, has been created in and pursuant to, and on the terms set out in, a deed of charge (such deed of charge as amended and/or supplemented and/or restated from time to time, the “**Deed of Charge**”) dated the Programme Date and made between the LLP, the Bond Trustee and Security Trustee and certain other Secured Creditors.

These Conditions include summaries of, and are subject to, the provisions of the Trust Deed, the Deed of Charge and the Agency Agreement.

Copies of the Trust Deed, the Deed of Charge, the Master Definitions and Construction Agreement (as defined below), the Agency Agreement and each of the other Transaction Documents are available for inspection during normal business hours at the registered office for the time being of the Bond Trustee being at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB and at the specified office of each of the Paying Agents. Copies of the applicable Final Terms for all Covered Bonds of each Series (including in relation to Covered Bonds of any Series which are unlisted or not admitted to trading) are obtainable during normal business hours at the specified office of each of the Paying Agents and any Covered Bondholder must produce evidence satisfactory to the Issuer and the Bond Trustee or, as the case may be, the relevant Paying Agent as to its holding of Covered Bonds and identity. The Covered Bondholders, the Receiptholders and the Couponholders are deemed to have notice of, are bound by, and are entitled to the benefit of, all the provisions of, and definitions contained in, the Trust Deed, the Deed of Charge, the Master Definitions and Construction Agreement, the Agency Agreement, each of the other Transaction Documents and the applicable Final Terms which are applicable to them and to have notice of each Final Terms relating to each other Series.

Except where the context otherwise requires, capitalised terms used and not otherwise defined in these Conditions shall bear the meanings given to them in the applicable Final Terms and/or the master definitions and construction agreement made between the parties to the Transaction Documents on or about the Programme Date, as amended, (the “**Master Definitions and Construction Agreement**”), a copy of each of which may be obtained as described above.

## 1. FORM, DENOMINATION AND TITLE

The Covered Bonds are in bearer form and, in the case of definitive Covered Bonds, serially numbered, in the currency specified in the relevant Final Terms (the “**Specified Currency**”) and the denomination(s) specified in the Final Terms, being always greater than €50,000 (or, if the Covered Bonds are denominated in a currency other than euro, at least the equivalent amount in amount in such currency) or such other higher amount (the “**Specified Denomination(s)**”). Covered Bonds of one Specified Denomination may not be exchanged for Covered Bonds of another Specified Denomination.

This Covered Bond may be a Fixed Rate Covered Bond, a Floating Rate Covered Bond, a Zero Coupon Covered Bond, an Index Linked Interest Covered Bond, a Dual Currency Interest Covered Bond or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms.

This Covered Bond may be an Index Linked Redemption Covered Bond, an Instalment Covered Bond, a Dual Currency Redemption Covered Bond, a Partly Paid Covered Bond or a combination of any of the foregoing, depending upon the Redemption/Payment Basis shown in the applicable Final Terms.

Definitive Covered Bonds are issued with Coupons attached, unless they are Zero Coupon Covered Bonds in which case references to Coupons and Couponholders in these Conditions are not applicable.

Subject as set out below, title to the Covered Bonds, Receipts and Coupons will pass by delivery. The Issuer, the Group Guarantor, the LLP, the Paying Agents, the Security Trustee and the Bond Trustee may (except as otherwise required by law) deem and treat the bearer of any Covered Bond, Receipt or Coupon as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any previous loss or theft thereof) for all purposes but, in the case of any Global Covered Bond, without prejudice to the provisions set out in the next succeeding paragraph.

For so long as any of the Covered Bonds are represented by a Global Covered Bond held on behalf of Euroclear Bank S.A./N.V. (“**Euroclear**”) and/or Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”), each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Covered Bonds (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Covered Bonds standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer, the Group Guarantor, the LLP, the Paying Agents, the Security Trustee and the Bond Trustee as the holder of such nominal amount of such Covered Bonds for all purposes other than with respect to the payment of principal or interest or other amounts on such nominal amount of such Covered Bonds, for which purpose the bearer of the relevant Global Covered Bond shall be treated by the Issuer, the Group Guarantor, the LLP, any Paying Agent, the Security Trustee and the Bond Trustee as the holder of such nominal amount of such Covered Bonds in accordance with and subject to the terms of the relevant Global Covered Bond and the expressions “**Covered Bondholder**” and “**holder of Covered Bonds**” and related expressions shall be construed accordingly. In determining whether a particular person is entitled to a particular nominal amount of Covered Bonds as aforesaid, the Bond Trustee may rely on such evidence and/or information and/or certification as it shall, in its absolute discretion, think fit and, if it does so rely, such evidence and/or information and/or certification shall, in the absence of manifest error or an error established as such to the satisfaction of the Bond Trustee, be conclusive and binding on all concerned.

Covered Bonds which are represented by a Global Covered Bond will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be.

References to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms or as may otherwise be approved by the Issuer, the Principal Paying Agent and the Bond Trustee.

## **2. STATUS OF THE COVERED BONDS AND THE GUARANTEES**

### **(a) *Status of the Covered Bonds***

The Covered Bonds and any relative Receipts and Coupons constitute direct, unconditional, unsubordinated and unsecured obligations of the Issuer and rank *pari passu* without any preference among themselves and at least *pari passu* with all other unsecured and unsubordinated obligations of the Issuer, present and future, other than any obligations preferred by mandatory provisions of applicable law.

### **(b) *Status of the Group Guarantee***

The payment of principal and interest in respect of the Covered Bonds and all other monies (including default interest) payable by the Issuer under or pursuant to the Trust Deed has been unconditionally guaranteed by the Group Guarantor (the “**Group Guarantee**”) in the Trust Deed. The obligations of the Group Guarantor under the Group Guarantee are direct, unconditional (subject to a written demand by the Bond Trustee on the Group Guarantor for

payment under the Group Guarantee), unsubordinated and unsecured obligations of the Group Guarantor and claims under the Group Guarantee rank at least *pari passu* with all other unsecured and unsubordinated obligations of the Group Guarantor, present and future, other than any obligations preferred by mandatory provisions of applicable law.

(c) ***Status of the Covered Bond Guarantee***

The payment of Guaranteed Amounts in respect of the Covered Bonds when the same shall become Due for Payment has been unconditionally and irrevocably guaranteed (on a several basis as between the Group Guarantor on the one hand and the LLP on the other) by the LLP (the “**Covered Bond Guarantee**”) in the Trust Deed. However, the LLP shall have no obligation under the Covered Bond Guarantee to pay any Guaranteed Amount when the same shall become Due for Payment under the Covered Bonds or the Trust Deed until the occurrence of an HBOS Event of Default and the service by the Bond Trustee on the Issuer and the Group Guarantor of an HBOS Acceleration Notice or, if earlier, the occurrence of an LLP Acceleration Notice. The obligations of the LLP under the Covered Bond Guarantee are direct (following service of a Notice to Pay, an HBOS Event of Default and the service of an HBOS Acceleration Notice or, if earlier, the occurrence of an LLP Acceleration Notice) unconditional and unsubordinated obligations of the LLP, which are secured as provided in the Deed of Charge.

As security for the LLP’s obligations under the Trust Deed (including its obligations under the Covered Bond Guarantee) and the Transaction Documents (as defined in the Master Definitions and Construction Agreement) to which it is a party, the LLP has granted fixed and floating security over all of its assets under the Deed of Charge in favour of the Security Trustee (for itself and on behalf of the other Secured Creditors).

**3. REDENOMINATION**

(a) ***Redenomination***

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Covered Bondholders, the Receiptholders and the Couponholders, on giving prior written notice to the Bond Trustee, the Security Trustee, the Principal Paying Agent, the Paying Agents, Euroclear and Clearstream, Luxembourg and at least 30 days’ prior notice to the Covered Bondholders in accordance with Condition 13, elect that, with effect from the Redenomination Date specified in the notice, the Covered Bonds shall be redenominated in euro in relation to any Covered Bonds where the applicable Final Terms provided for the Minimum Specified Denomination and which are admitted to trading on a regulated market in the European Economic Area, it shall be a term of any such article that the holder of any Covered Bonds held through Euroclear and/or Clearstream, Luxembourg must have credited to its securities account with the relevant clearing system a minimum balance of Covered Bonds of at least €50,000.

The election will have effect as follows:

- (i) the Covered Bonds and the Receipts shall be deemed to be redenominated in euro in the denomination of €0.01 with a nominal amount for each Covered Bond and Receipts equal to the nominal amount of that Covered Bond or Receipt in the Specified Currency, converted into euro at the Established Rate, **provided that**, if the Issuer determines, in consultation with the Principal Paying Agent and the Bond Trustee, that the then market practice in respect of the redenomination in euro of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Covered Bondholders, the competent listing authority, stock exchange, and/or market (if any) on or by which the Covered Bonds may be listed and/or admitted to trading and the Paying Agents of such deemed amendments;
- (ii) save to the extent that an Exchange Notice has been given in accordance with paragraph (iv) below, the amount of interest due in respect of the Covered Bonds will be calculated by reference to the aggregate nominal amount of Covered Bonds presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest €0.01;

- (iii) if definitive Covered Bonds are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations of €50,000 and/or such higher amounts as the Principal Paying Agent and the Bond Trustee may determine and notify to the Covered Bondholders and any remaining amounts less than €50,000 shall be redeemed by the Issuer and paid to the Covered Bondholders in euro in accordance with Condition 5 (*Payments*);
- (iv) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Covered Bonds) will become void with effect from the date on which the Issuer gives notice (the “**Exchange Notice**”) that replacement euro-denominated Covered Bonds, Receipts and Coupons are available for exchange (**provided that** such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Covered Bonds, Receipts and Coupons so issued will also become void on that date although those Covered Bonds, Receipts and Coupons will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Covered Bonds, Receipts and Coupons will be issued in exchange for Covered Bonds, Receipts and Coupons denominated in the Specified Currency in such manner as the Principal Paying Agent may specify and as shall be notified to the Covered Bondholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Covered Bonds;
- (v) after the Redenomination Date, all payments in respect of the Covered Bonds, the Receipts and the Coupons, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in euro as though references in the Covered Bonds to the Specified Currency were to euro. Payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque;
- (vi) if the Covered Bonds are Fixed Rate Covered Bonds and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention;
- (vii) if the Covered Bonds are Floating Rate Covered Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest; and
- (viii) such other changes shall be made to this Condition (and the Transaction Documents) as the Issuer may decide, after consultation with the Principal Paying Agent and the Bond Trustee, and as may be specified in the notice, to conform it to conventions then applicable to instruments denominated in euro.

(b) ***Definitions***

In these Conditions, the following expressions have the following meanings:

“**Established Rate**” means the rate for the conversion of the relevant Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Community regulations) into euro established by the Council of the EU pursuant to Article 123 of the Treaty. “**euro**” means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty.

“**Redenomination Date**” means (in the case of interest-bearing Covered Bonds) any date for payment of interest under the Covered Bonds or (in the case of Zero Coupon Covered Bonds) any date, in each case specified by the Issuer in the notice given to the Covered Bondholders pursuant to paragraph (a) above and which falls on or after the date on which the country of the relevant Specified Currency first participates in the third stage of European economic and monetary union.

“**Treaty**” means the Treaty establishing the European Community, as amended.

#### 4. INTEREST

##### (a) *Interest on Fixed Rate Covered Bonds*

Each Fixed Rate Covered Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Final Maturity Date.

Except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such date will amount to the Fixed Coupon Amount. Payments of interest on any Interest Payment Date will, if so specified in the applicable Final Terms, amount to the Broken Amount so specified.

As used in the Conditions, “**Fixed Interest Period**” means the period from (and including) an Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If interest is required to be calculated for a period other than a Fixed Interest Period, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention, or (to the extent that the 2006 ISDA Definitions apply) the amount of interest payable per Calculation Amount (as specified in the Final Terms) in respect of any Instrument for any Interest Accrual Period shall be equal to the product of the Rate of Interest, the Calculation Amount specified thereon and the Day Count Fraction for such Interest Accrual Period, unless an Interest Amount (or a formula for its calculation) is applicable to such Interest Accrual Period, in which case the amount of interest per Calculation Amount in respect of such Instrument for such Interest Accrual Period shall equal such Interest Amount (or be calculated in accordance with such formula). Where any Interest Period comprises two or more Interest Accrual Periods, the amount of interest payable per Calculation Amount in respect of such Interest Period will be the sum of the Interest Amounts of interest payable in respect of each of those Interest Accrual Periods. In respect of any other period for which interest is required to be calculated, the provisions above shall apply save that the Day Count Fraction shall be for the period for which interest is required to be calculated.

“**Interest Amount**” means in respect of the calculation of an amount of interest in accordance with this Condition 4(a):

- (i) In respect of an Interest Accrual Period, the amount of interest payable per Calculation Amount for that Interest Accrual Period and which, in the case of Fixed Rate Instruments, and unless otherwise specified hereon, shall mean the Fixed Coupon Amount or Broken Amount specified hereon as being payable on the Interest Payment Date ending the Interest Period of which such Interest Accrual Period forms part; and
- (ii) In respect of any other period, the amount of interest payable per Calculation Amount for that Period.

“**Interest Accrual Period**” means, in respect of the calculation of an amount of interest in accordance with this Condition 4(a): in respect of an Interest Period, each successive period beginning on and including an Interest Payment Date and ending on but excluding the next succeeding Interest Payment Date during that Interest Period provided always that the first Interest Accrual Period shall commence on and include the Interest Commencement Date and the final Interest Accrual Period shall end on and include the Final Maturity Date.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 4(a):

- (i) if “**Actual/Actual (ICMA)**” is specified in the applicable Final Terms:
  - (A) in the case of Covered Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the “**Accrual Period**”) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the

product of (1) the number of days in such Determination Period and (2) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or

(B) in the case of Covered Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:

(1) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and

(2) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and

(ii) if “30/360” is specified in the applicable Final Terms, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360, calculated on a formula basis as follows (to the extent that the 2006 ISDA Definitions apply):

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y<sub>1</sub>” is the year, expressed as a number, in which the first day of the Interest Period falls;

“Y<sub>2</sub>” is the year, expressed as a number, in which the day immediately following the last day included in the Interest Period falls;

“M<sub>1</sub>” is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

“M<sub>2</sub>” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Interest Period falls;

“D<sub>1</sub>” is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case D<sub>1</sub> will be 30; and

“D<sub>2</sub>” is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31 and D<sub>1</sub> is greater than 29, in which case D<sub>2</sub> will be 30.

In these Conditions:

“**Determination Period**” means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date); and

“**Principal Amount Outstanding**” means, on any date:

(a) in relation to a Covered Bond, the principal amount of that Covered Bond upon issue on the relevant Issue Date less the aggregate amount of any principal payments in respect of that Covered Bond which have been paid to the Paying Agent on or prior to that date; and

(b) in relation to the Covered Bonds outstanding at any time, the aggregate of the amount in (a) in respect of all Covered Bonds outstanding;

“**sub-unit**” means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, one cent.

(b) ***Interest on Floating Rate Covered Bonds and Index Linked Interest Covered Bonds***

(i) *Interest Payment Dates*

Each Floating Rate Covered Bond and Index Linked Interest Covered Bond bears interest on its Principal Amount Outstanding from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

- (A) the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or
- (B) if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an “**Interest Payment Date**”) which falls the number of months or other period specified as the Specified Period in the applicable Final Terms after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period. In these Conditions, the expression “**Interest Period**” shall mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

- (1) in any case where Specified Periods are specified in accordance with Condition 4(b)(i)(B) above, the “**Floating Rate Convention**”, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (B) below shall apply *mutatis mutandis* or (ii) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (A) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (B) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or
- (2) the “**Following Business Day Convention**”, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (3) the “**Modified Following Business Day Convention**”, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (4) the “**Preceding Business Day Convention**”, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In these Conditions, “**Business Day**” means a day which is both:

- (A) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and any Additional Business Centre specified in the applicable Final Terms; and
- (B) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than London and any Additional Business Centre and which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively) or (2) in relation to any sum payable in euro, a TARGET Day. “**TARGET Day**”) means (i) until such time as TARGET is permanently closed down and ceases operations, any day on which both TARGET and TARGET2 are open for the settlement of payments in euro and (ii) following such time as TARGET is permanently closed down and ceases operations, any day on which TARGET2 is open for the settlement of payments in euro. “**TARGET**” means the Trans-European Automated Real-time gross Settlement Express Transfer payment system which utilises interlinked national real time gross settlement systems and the European Central Bank’s payment mechanism and which began operations

on 4 January 1999. “**TARGET2**” means the Trans-European Automated Real-time Gross Settlement Express Transfer payment system which utilises a single shared platform and which was launched on 19 November 2007 or any successor thereto.

(ii) *Rate of Interest*

The Rate of Interest payable from time to time in respect of Floating Rate Covered Bonds and Index Linked Interest Covered Bonds will be determined in the manner specified in the applicable Final Terms.

(A) *ISDA Determination for Floating Rate Covered Bonds*

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this sub-paragraph (A), “ISDA Rate” for an Interest Period means a rate equal to the Floating Rate that would be determined by the Principal Paying Agent under an interest rate swap transaction if the Principal Paying Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. (“**ISDA**”) and as amended and updated as at the Issue Date of the first Tranche of the Covered Bonds of the relevant Series (as specified in the relevant Final Terms) or, if so specified in the relevant Final Terms, the 2006 ISDA Definitions, as published by ISDA and as amended and updated as at the Issue Date of the first Tranche of Covered Bonds of the relevant Series (as specified in the relevant Final Terms) (the “**ISDA Definitions**”) and under which:

- (1) the Floating Rate Option is as specified in the applicable Final Terms;
- (2) the Designated Maturity is a period as specified in the applicable Final Terms; and
- (3) the relevant Reset Date is either (i) if the applicable Floating Rate Option is based on the London inter-bank offered rate (“**LIBOR**”) or on the Euro-zone inter-bank offered rate (“**EURIBOR**”), the first day of that Interest Period or (ii) in any other case, as specified in the applicable Final Terms.

For the purposes of this sub-paragraph (A), “**Floating Rate**”, “**Calculation Agent**”, “**Floating Rate Option**”, “**Designated Maturity**” and “**Reset Date**” have the meanings given to those terms in the ISDA Definitions.

(B) *Screen Rate Determination for Floating Rate Covered Bonds*

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (1) the offered quotation; or
- (2) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations, (expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Principal Paying Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Principal Paying Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

The Agency Agreement contains provisions for determining the Rate of Interest in the event that the Relevant Screen Page is not available or if, in the case of (1) above, no such offered quotation appears or, in the case of (2) above, fewer than three such offered quotations appear, in each case as at the time specified in the preceding paragraph.



If the Reference Rate from time to time in respect of Floating Rate Covered Bonds is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Covered Bonds will be determined as provided in the applicable Final Terms.

(iii) *Minimum Rate of Interest and/or Maximum Rate of Interest*

If the applicable Final Terms specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

(iv) *Determination of Rate of Interest and calculation of Interest Amounts*

The Principal Paying Agent, in the case of Floating Rate Covered Bonds, and the Calculation Agent, in the case of Index Linked Interest Covered Bonds, will at or as soon as practicable after each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period. In the case of Index Linked Interest Covered Bonds, the Calculation Agent will notify the Principal Paying Agent of the Rate of Interest for the relevant Interest Period as soon as practicable after calculating the same.

The Principal Paying Agent will calculate the amount of interest payable on the Floating Rate Covered Bonds or Index Linked Interest Covered Bonds in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention, or (to the extent that the 2006 ISDA Definitions apply) the amount of interest payable per Calculation Amount (as specified in the Final Terms) in respect of any Instrument for any Interest Accrual Period shall be equal to the product of the Rate of Interest, the Calculation Amount specified thereon and the Day Count Fraction for such Interest Accrual Period, unless an Interest Amount (or a formula for its calculation) is applicable to such Interest Accrual Period, in which case the amount of interest per Calculation Amount in respect of such Instrument for such Interest Accrual Period shall equal such Interest Amount (or be calculated in accordance with such formula). Where any Interest Period comprises two or more Interest Accrual Periods, the amount of interest payable per Calculation Amount in respect of such Interest Period will be the sum of the Interest Amounts of interest payable in respect of each of those Interest Accrual Periods. In respect of any other period for which interest is required to be calculated, the provisions above shall apply save that the Day Count Fraction shall be for the period for which interest is required to be calculated.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 4(b):

- (a) if “**Actual/Actual (ISDA)**” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (b) if “**Actual/365 (Fixed)**” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;
- (c) if “**Actual/365 (Sterling)**” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;

- (d) if “**Actual/360**” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;
- (e) if “**30/360**”, “**360/360**” or “**Bond Basis**” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (a) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (b) the last day of the Interest Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month)) calculated on a formula basis as follows (to the extent that the 2006 ISDA Definitions apply):

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y<sub>1</sub>” is the year, expressed as a number, in which the first day of the Interest Period falls;

“Y<sub>2</sub>” is the year, expressed as a number, in which the day immediately following the last day included in the Interest Period falls;

“M<sub>1</sub>” is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

“M<sub>2</sub>” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Interest Period falls;

“D<sub>1</sub>” is the first calendar day, expressed as a number, of the Interest Period, unless such number would be 31, in which case D<sub>1</sub> will be 30; and

“D<sub>2</sub>” is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless such number would be 31 and D<sub>1</sub> is greater than 29, in which case D<sub>2</sub> will be 30; and

- (f) if “**30E/360**” or “**Eurobond Basis**” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360, calculated on a formula basis as follows (to the extent that the 2006 ISDA definitions apply):

$$\text{Day Count Fraction} = \frac{[360 \times (Y_2 - Y_1)] + [30 \times (M_2 - M_1)] + (D_2 - D_1)}{360}$$

where:

“Y<sub>1</sub>” is the year, expressed as a number, in which the first day of the Interest Period falls;

“Y<sub>2</sub>” is the year, expressed as a number, in which the day immediately following the last day included in the Interest Period falls;

“M<sub>1</sub>” is the calendar month, expressed as a number, in which the first day of the Interest Period falls;

“M<sub>2</sub>” is the calendar month, expressed as a number, in which the day immediately following the last day included in the Interest Period falls;

“D<sub>1</sub>” is the first calendar day, expressed as a number, of the Interest Period, unless (i) that day is the last day of February or (ii) such number would be 31, in which case D<sub>1</sub> will be 30; and

“D<sub>2</sub>” is the calendar day, expressed as a number, immediately following the last day included in the Interest Period, unless (i) that day is the last day of February but not the Final Maturity Date or (ii) such number would be 31, in which case D<sub>2</sub> will be 30.

(v) *Notification of Rate of Interest and Interest Amounts*

The Principal Paying Agent will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Issuer, the Bond Trustee and any competent listing authority, stock exchange and/or market on or by which the relevant Floating Rate Covered Bonds or Index Linked Interest Covered Bonds are for the time being listed (by no later than the first day of each Interest Period) and notice thereof to be published in accordance with Condition 13 (*Notices*) as soon as possible after their determination but in no event later than the fourth London Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to each competent listing authority, stock exchange and/or market on or by which the relevant Floating Rate Covered Bonds or Index Linked Interest Covered Bonds are for the time being listed and to the Covered Bondholders in accordance with Condition 13 (*Notices*). For the purposes of this paragraph, the expression “**London Business Day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(vi) *Determination or Calculation by Bond Trustee*

If for any reason at any relevant time the Principal Paying Agent or, as the case may be, the Calculation Agent defaults in its obligation to determine the Rate of Interest or the Principal Paying Agent defaults in its obligation to calculate any Interest Amount in accordance with sub-paragraph (ii)(A) or (B) above or as otherwise specified in the applicable Final Terms, as the case may be, and in each case in accordance with paragraph (iii) above, the Bond Trustee shall determine the Rate of Interest at such rate as, in its absolute discretion (having such regard as it shall think fit to the foregoing provisions of this Condition, but subject always to any Minimum Rate of Interest or Maximum Rate of Interest specified in the applicable Final Terms), it shall deem fair and reasonable in all the circumstances or, as the case may be, the Bond Trustee shall calculate the Interest Amount(s) in such manner as it shall deem fair and reasonable in all the circumstances and each such determination or calculation shall be deemed to have been made by the Principal Paying Agent or the Calculation Agent, as applicable.

(vii) *Certificates to be final*

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 4(b), whether by the Principal Paying Agent or, if applicable, the Calculation Agent, or the Bond Trustee shall (in the absence of wilful default, bad faith or manifest error or an error established as such to the satisfaction of the Bond Trustee) be binding on the Issuer, the Group Guarantor, the LLP, the Principal Paying Agent, the Calculation Agent (if applicable), the other Paying Agents, the Bond Trustee and all Covered Bondholders, Receiptholders and Couponholders and (in the absence of wilful default or bad faith) no liability to the Issuer, the Group Guarantor, the LLP, the Covered Bondholders, the Receiptholders or the Couponholders shall attach to the Principal Paying Agent or, (if applicable), the Calculation Agent or the Bond Trustee in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(c) *Interest on Dual Currency Interest Covered Bonds*

The rate or amount of interest payable in respect of Dual Currency Interest Covered Bonds shall be determined in the manner specified in the applicable Final Terms.

(d) *Interest on Partly Paid Covered Bonds*

In the case of Partly Paid Covered Bonds (other than Partly Paid Covered Bonds which are Zero Coupon Covered Bonds) interest will accrue as aforesaid on the paid-up nominal amount of such Covered Bonds and otherwise as specified in the applicable Final Terms.

(e) ***Accrual of interest***

Each Covered Bond (or in the case of the redemption of part only of a Covered Bond, that part only of such Covered Bond) will cease to bear interest (if any) from the date for its redemption unless, upon due presentation thereof, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue as provided in the Trust Deed.

**5. PAYMENTS**

(a) ***Method of payment***

Subject as provided below:

- (i) payments in a Specified Currency other than Sterling, euro and U.S. Dollars will be made by credit or transfer to an account in the relevant Specified Currency (which in the case of a payment in Japanese Yen to a non-resident of Japan, shall be a non-resident account) maintained by the payee with, or, at the option of the payee, by a cheque in such Specified Currency drawn on, a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively);
- (ii) payments in Sterling will be made by credit or transfer to a sterling account specified by the payee or, at the option of the payee, by a sterling cheque;
- (iii) payments in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque; and
- (iv) payments in U.S. Dollars will be made by transfer to a U.S. Dollar account maintained by the payee with a bank outside of the United States (which expression, as used in this Condition 5, means the United States of America, including the State and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction), or by cheque drawn on a United States bank.

In no event will payment be made by a cheque mailed to an address in the United States. Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment in these Conditions, the Trust Deed, the Agency Agreement and the Final Terms, but without prejudice to the provisions of Condition 7 (*Taxation*). References to Specified Currency will include any successor currency under applicable law.

(b) ***Presentation of definitive Covered Bonds, Receipts and Coupons***

Payments of principal in respect of definitive Covered Bonds will (subject as provided below) be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Covered Bonds, and payments of interest in respect of definitive Covered Bonds will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States and its possessions.

Payments of instalments of principal (if any) in respect of definitive Covered Bonds, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph (a) above against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Covered Bond in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Covered Bond to which it appertains. Receipts presented without the definitive Covered Bond to which they appertain do not constitute valid obligations of the Issuer or any Guarantor. Upon the date on which any definitive Covered Bond becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate definitive Covered Bonds (other than Dual Currency Interest Covered Bonds, Index Linked Covered Bonds or Long Maturity Covered Bonds (as defined below)) should be presented for payment together with all unmatured Coupons appertaining thereto (which

expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 7 (*Taxation*)) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 8 (*Prescription*)) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

Upon any Fixed Rate Covered Bond in definitive form becoming due and repayable prior to its Final Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Covered Bond, Dual Currency Interest Covered Bond, Index Linked Covered Bond or Long Maturity Covered Bond in definitive form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof. A “**Long Maturity Covered Bond**” is a Fixed Rate Covered Bond (other than a Fixed Rate Covered Bond which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon **provided that** such Covered Bond shall cease to be a Long Maturity Covered Bond on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the Principal Amount Outstanding of such Covered Bond.

If the due date for redemption of any definitive Covered Bond is not an Interest Payment Date, interest (if any) accrued in respect of such Covered Bond from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant definitive Covered Bond.

(c) ***Payments in respect of Global Covered Bonds***

Payments of principal and interest (if any) in respect of Covered Bonds represented by any Global Covered Bond will (subject as provided below) be made in the manner specified above in relation to definitive Covered Bonds and otherwise in the manner specified in the relevant Global Covered Bond against surrender of such Global Covered Bond at the specified office of any Paying Agent outside the United States and its possessions. On the occasion of each payment, the Paying Agent shall instruct Euroclear and Clearstream, Luxembourg to make appropriate entries in their records to reflect such payment. A record of each payment made against presentation or surrender of any Global Covered Bond, distinguishing between any payment of principal and any payment of interest, will be made on such Global Covered Bond by the Paying Agent to which it was presented and such record shall be prima facie evidence that the payment in question has been made.

(d) ***General provisions applicable to payments***

The bearer of a Global Covered Bond shall be the only person entitled to receive payments in respect of Covered Bonds represented by such Global Covered Bond and the Issuer or, as the case may be, either of the Group Guarantor or the LLP and the Bond Trustee will be discharged by payment to, or to the order of, the bearer of such Global Covered Bond in respect of each amount so paid. Each of the persons shown in the records of Euroclear or Clearstream, Luxembourg as the beneficial holder of a particular nominal amount of Covered Bonds represented by such Global Covered Bond must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for his share of each payment so made by the Issuer or, as the case may be, the Group Guarantor or the LLP or the Bond Trustee to, or to the order of, the holder of such Global Covered Bond.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Covered Bonds is payable in U.S. Dollars, such U.S. Dollar payments of principal and/or interest in respect of such Covered Bonds will be made at the specified office of a Paying Agent in the United States if:

- (i) the Issuer has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. Dollars at such specified offices outside the United States of the full amount of principal and interest on the Covered Bonds in the manner provided above when due;
- (ii) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. Dollars; and
- (iii) such payment is then permitted under United States law without involving, in the opinion of the Issuer, the Group Guarantor and the LLP, adverse tax consequences to the Issuer, the Group Guarantor or the LLP.

(e) ***Payment Day***

If the date for payment of any amount in respect of any Covered Bond, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, “**Payment Day**” means any day which (subject to Condition 8 (*Prescription*)) is:

- (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
  - (A) the relevant place of presentation;
  - (B) London;
  - (C) any Additional Financial Centre specified in the applicable Final Terms; and
- (ii) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, London and any Additional Financial Centre and which if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively) or (2) in relation to any sum payable in euro, a TARGET Day.

(f) ***Interpretation of principal and interest***

Any reference in these Conditions to principal in respect of the Covered Bonds shall be deemed to include, as applicable:

- (i) any additional amounts which may be payable with respect to principal under Condition 7 (*Taxation*) or under any undertaking or covenant given in addition thereto, or in substitution therefor, pursuant to the Trust Deed;
- (ii) the Final Redemption Amount of the Covered Bonds;
- (iii) the Early Redemption Amount of the Covered Bonds;
- (iv) the Optional Redemption Amount(s) (if any) of the Covered Bonds;
- (v) in relation to Covered Bonds redeemable in instalments, the Instalment Amounts;
- (vi) in relation to Zero Coupon Covered Bonds, the Amortised Face Amount (as defined in Condition 6(d) (*Redemption and Purchase – Early Redemption Amounts*));
- (vii) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Covered Bonds; and
- (viii) any Excess Proceeds which may be payable by the Bond Trustee under or in respect of the Covered Bonds.

Any reference in these Conditions to interest in respect of the Covered Bonds shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 7 (*Taxation*) or under any undertaking or covenant given in addition thereto, or in substitution therefor, pursuant to the Trust Deed.

(g) ***Partial payment***

Following the service of a Notice to Pay on the LLP but prior to an LLP Event of Default, if on the Original Due for Payment Date (subject to any applicable grace period) of a Series of Covered Bonds an HBOS Event of Default has occurred and the LLP has insufficient monies (after paying higher ranking amounts and taking into account amounts ranking *pari passu* and *pro rata* in the Guarantee Priority of Payments) to pay the Guaranteed Amount corresponding to the Final Redemption Amount on that Series of Covered Bonds, then the LLP shall apply the available monies (after paying higher ranking amounts in accordance with the Guarantee Priority of Payments) to redeem the relevant Series of Covered Bonds *pro rata* in part at par together with accrued interest.

**6. REDEMPTION AND PURCHASE**

(a) ***Redemption at maturity***

Unless previously redeemed or purchased and cancelled as specified below, each Covered Bond will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Final Maturity Date.

Without prejudice to Condition 9 (*Events of Default and Enforcement*), if an Extended Final Maturity Date is specified as applicable in the Final Terms for a Series of Covered Bonds and the Issuer and/or the Group Guarantor have failed to pay the Final Redemption Amount on the Final Maturity Date specified in the Final Terms (or after the expiry of the grace period set out in Condition 9(a)(i) (*Events of Default and Enforcement – HBOS Events of Default*)) and, the LLP or the Cash Manager on its behalf determines that the LLP has insufficient monies available under the Guarantee Priority of Payments to pay the Guaranteed Amounts corresponding to the Final Redemption Amount in full in respect of the relevant Series of Covered Bonds on the date falling on the earlier of (a) the date which falls two London Business Days after service of such Notice to Pay on the LLP or if later the Final Maturity Date (in each case after expiry of the grace period set out in Condition 9(b)(i) (*Events of Default and Enforcement – HBOS Events of Default*)) under the terms of the Covered Bond Guarantee and (b) the Extension Determination Date, then (subject as provided below), payment of the unpaid amount by the LLP under the Covered Bond Guarantee shall be deferred until the Extended Final Maturity Date **provided that**, any amount representing the Final Redemption Amount due and remaining unpaid on the earlier of (a) and (b) above may be paid by the LLP on any Interest Payment Date thereafter, up to (and including) the relevant Extended Final Maturity Date.

The LLP shall confirm to the Rating Agencies, any relevant Covered Bond Swap Provider, the Bond Trustee and the Principal Paying Agent as soon as reasonably practicable and in any event at least two London Business Days prior to the earlier of the dates specified in (a) and (b) of the preceding paragraph of any inability of the LLP to pay in full the Guaranteed Amounts corresponding to the Final Redemption Amount in respect of a Series of Covered Bonds pursuant to the Covered Bond Guarantee. Any failure by the LLP to notify such parties shall not affect the validity or effectiveness of the extension nor give rise to any rights in any such party.

In the circumstances outlined above, the LLP shall on the earlier of (a) the date falling two Business Days after the service of a Notice to Pay or if later the Final Maturity Date (or, in each case, after the expiry of the grace period set out in Condition 9(b)(i) (*Events of Default and Enforcement – LLP Events of Default*)) and (b) the Extension Determination Date under the Covered Bond Guarantee, apply the monies (if any) available (after paying or providing for payment of higher ranking or *pari passu* amounts in accordance with the Guarantee Priority of Payments) *pro rata* in part payment of an amount equal to the Final Redemption Amount of each Covered Bond of the relevant Series of Covered Bonds and shall pay Guaranteed Amounts constituting the Scheduled Interest in respect of each such Covered Bond on such date. The obligation of the LLP to pay any amounts in respect of the balance of the Final Redemption Amount not so paid shall be deferred as described above.

Any discharge of the Issuer's obligations in respect of the Covered Bonds as the result of the payment of Excess Proceeds to the Bond Trustee in accordance with Condition 9 (*Events of Default and Enforcement*) shall be disregarded for the purposes of determining the amounts to be paid by the LLP under the Covered Bond Guarantee in connection with this Condition 6(a) (*Redemption and Purchase*).

Such failure to pay by the LLP shall not constitute an LLP Event of Default.

For the purposes of these Conditions:

**"Extension Determination Date"** means the date falling three Business Days after the expiry of seven days from (and including) the Final Maturity Date of the relevant Series of Covered Bonds.

**"Extended Final Maturity Date"** means in relation to any Series of Covered Bonds, the date if any specified as such in the applicable Final Terms to which the payment of all or (as applicable) part of the Final Redemption Amount payable on the Final Maturity Date will be deferred in the event that the Final Redemption Amount is not paid in full on the Extension Determination Date.

(b) ***Redemption for tax reasons***

The Covered Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Covered Bond is neither a Floating Rate Covered Bond, an Index Linked Interest Covered Bond nor a Dual Currency Interest Covered Bond) or on any Interest Payment Date (if this Covered Bond is either a Floating Rate Covered Bond, an Index Linked Interest Covered Bond or a Dual Currency Interest Covered Bond), on giving not less than 30 nor more than 60 days' notice to the Bond Trustee and the Principal Paying Agent and, in accordance with Condition 13 (*Notices*), the Covered Bondholders (which notice shall be irrevocable), if the Issuer satisfies the Bond Trustee immediately before the giving of such notice that:

- (i) on the occasion of the next payment due under the Covered Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 7 (*Taxation*) or the Group Guarantor would be unable for reasons outside its control to procure payment by the Issuer and in making payment itself would be required to pay such additional amounts, in each case as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction (as defined in Condition 7 (*Taxation*)) or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Covered Bonds; and
- (ii) such obligation cannot be avoided by the Issuer or, as the case may be, the Group Guarantor taking reasonable measures available to it,

**provided that** no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer or, as the case may be, the Group Guarantor would be obliged to pay such additional amounts were a payment in respect of the Covered Bonds then due.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Bond Trustee a certificate signed by two directors of the Issuer or, as the case may be, two directors of the Group Guarantor stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the Bond Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Covered Bondholders, the Receiptholders and the Couponholders.

Covered Bonds redeemed pursuant to this Condition 6(b) will be redeemed at their Early Redemption Amount referred to in paragraph (d) below together (if appropriate) with interest accrued to (but excluding) the date of redemption.

(c) ***Redemption at the option of the Issuer (Issuer Call)***

If Issuer Call is specified in the applicable Final Terms, the Issuer may, having given:

- (i) not less than 15 nor more than 30 days' notice to the Covered Bondholders in accordance with Condition 13 (*Notices*); and



- (ii) not less than 15 days before the giving of the notice referred to in (i), notice to the Bond Trustee and to the Principal Paying Agent;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Covered Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such partial redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Covered Bonds, the Covered Bonds to be redeemed (the “**Redeemed Covered Bonds**”) will be selected individually by lot, in the case of Redeemed Covered Bonds represented by definitive Covered Bonds, and in accordance with the rules of Euroclear and/or Clearstream, Luxembourg (to be reflected in the records of Euroclear and Clearstream, Luxembourg as either a pool factor or a reduction in nominal amount, at their discretion), in the case of Redeemed Covered Bonds represented by a Global Covered Bond, in each case, not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the “**Selection Date**”). In the case of Redeemed Covered Bonds represented by definitive Covered Bonds, a list of the serial numbers of such Redeemed Covered Bonds will be published in accordance with Condition 13 (*Notices*) not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Covered Bonds represented by definitive Covered Bonds shall bear the same proportion to the aggregate nominal amount of all Redeemed Covered Bonds as the aggregate nominal amount of definitive Covered Bonds outstanding bears to the aggregate nominal amount of the Covered Bonds outstanding, in each case on the Selection Date, **provided that** such first mentioned nominal amount shall, if necessary, be rounded downwards to the nearest integral multiple of the Specified Denomination, and the aggregate nominal amount of Redeemed Covered Bonds represented by a Global Covered Bond shall be equal to the balance of the Redeemed Covered Bonds. No exchange of the relevant Global Covered Bond will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this paragraph (c) and notice to that effect shall be given by the Issuer to the Covered Bondholders in accordance with Condition 13 (*Notices*) at least five days prior to the Selection Date.

(d) **Early Redemption Amounts**

For the purpose of paragraph (b) above and Condition 9 (*Events of Default and Enforcement*), each Covered Bond will be redeemed at its “**Early Redemption Amount**” calculated as follows:

- (i) in the case of a Covered Bond with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;
- (ii) in the case of a Covered Bond (other than a Zero Coupon Covered Bond but including an Instalment Covered Bond) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Covered Bond is denominated, at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its nominal amount; or
- (iii) in the case of a Zero Coupon Covered Bond, at an amount (the “**Amortised Face Amount**”) calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})^y$$

where:

“**RP**” means the Reference Price;

“**AY**” means the Accrual Yield expressed as a decimal; and

“**y**” is a fraction, the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Covered Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Covered Bond becomes due and repayable, and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Final Terms.

(e) **Instalments**

Instalment Covered Bonds will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to paragraph (d) above.

(f) **Partly Paid Covered Bonds**

Partly Paid Covered Bonds will be redeemed, whether at maturity, early redemption or otherwise, in accordance with the provisions of this Condition and the applicable Final Terms.

(g) **Purchases**

The Issuer, the Group Guarantor or any of the Group Guarantor's Subsidiaries may at any time purchase Covered Bonds (**provided that**, in the case of definitive Covered Bonds, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Covered Bondholders alike. Such Covered Bonds may be held, reissued, resold or, at the option of the Issuer, the Group Guarantor or the LLP, surrendered to any Paying Agent for cancellation.

(h) **Cancellation**

All Covered Bonds which are redeemed will forthwith be cancelled (together with all unmatured Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Covered Bonds so cancelled and any Covered Bonds purchased and cancelled pursuant to paragraph (f) above (together with all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Principal Paying Agent and cannot be reissued or resold.

(i) **Late payment on Zero Coupon Covered Bonds**

If the amount payable in respect of any Zero Coupon Covered Bond upon redemption of such Zero Coupon Covered Bond pursuant to paragraph (a), (b) or (c) above or upon its becoming due and repayable as provided in Condition 9 (*Events of Default and Enforcement*) is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Covered Bond shall be the amount calculated as provided in paragraph (d)(iii) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Covered Bond becomes due and payable were replaced by references to the date which is the earlier of:

- (i) the date on which all amounts due in respect of such Zero Coupon Covered Bond have been paid; and
- (ii) five days after the date on which the full amount of the monies payable in respect of such Zero Coupon Covered Bonds has been received by the Principal Paying Agent or the Bond Trustee and notice to that effect has been given to the Covered Bondholders in accordance with Condition 13 (*Notices*).

(j) **Legislative Exchange**

Following the coming into force in the United Kingdom of the RCB Regulations on 6 March 2008 the Issuer may, at its option and without the consent of the Bond Trustee, the Security Trustee or the Covered Bondholders, apply to have the Issuer's Covered Bonds issued under the Programme registered under the RCB Regulations and, if accepted, exchange all (but not some only) of the Covered Bonds of all Series then outstanding (the "**Existing Covered Bonds**") for new Covered Bonds which qualify as covered bonds under the RCB Regulations (the "**New Covered Bonds**") in identical form, amounts and denominations as the Existing Covered Bonds and on the same economic terms and conditions as the Existing Covered Bonds (the "**Legislative Exchange**") if not more than 60 nor less than 30 days' notice to the Covered Bondholders (in accordance with Condition 13 (*Notices*)) and the Bond Trustee is given and **provided that**:

- (i) on the date on which such notice expires the Issuer delivers to the Bond Trustee a certificate signed by two directors of each of the Issuer and the Group Guarantor and a certificate signed by a Designated Member of the LLP confirming that, in the case of the Issuer and the Group Guarantor, no HBOS Event of Default or Potential HBOS Event of Default and, in the case of the LLP, no LLP Event of Default or Potential LLP Event of Default, shall have occurred and be continuing;

- (ii) each of the Rating Agencies then rating the Existing Covered Bonds has confirmed in writing that the New Covered Bonds will be assigned the same ratings as are then applicable to the Existing Covered Bonds; and
- (iii) if the Existing Covered Bonds are listed, quoted and/or traded on or by a competent and/or relevant listing authority, stock exchange and/or quotation system on or before the date on which such notice expires the Issuer delivers to the Bond Trustee a certificate signed by two directors of the Issuer confirming that all applicable rules of such competent and/or relevant listing authority, stock exchange and/or quotation system have been or will be complied with.

The Existing Covered Bonds will be cancelled concurrently with the issue of the New Covered Bonds and with effect on and from the date of issue thereof all references herein to Covered Bonds shall be deemed to be references to the New Covered Bonds.

(k) ***Redemption due to illegality***

The Covered Bonds of all Series may be redeemed at the option of the Issuer in whole, but not in part, at any time, on giving not less than 30 nor more than 60 days' notice to the Bond Trustee and the Principal Paying Agent and, in accordance with Condition 13 (*Notices*), all Covered Bondholders (which notice shall be irrevocable), if the Issuer satisfies the Bond Trustee immediately before the giving of such notice that it has, or will, before the next Interest Payment Date of any Covered Bond of any Series, become unlawful for the Issuer to make, fund or allow to remain outstanding any Term Advance made by it to the LLP under the Intercompany Loan Agreement, as a result of any change in, or amendment to, the applicable laws or regulations or any change in the application or official interpretation of such laws or regulations, which change or amendment has become or will become effective before the next such Interest Payment Date.

Prior to the publication of any notice of redemption pursuant to this Condition 6(k), the Issuer shall deliver to the Bond Trustee a certificate signed by two directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred and the Bond Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on all Covered Bondholders, Receiptholders and Couponholders.

Covered Bonds redeemed pursuant to this Condition 6(k) will be redeemed at their Early Redemption Amount referred to in paragraph 6(d) above together (if appropriate) with interest accrued to (but excluding) the date of redemption.

## **7. TAXATION**

All payments of principal and interest in respect of the Covered Bonds, Receipts and Coupons by the Issuer, the LLP or the Group Guarantor, as the case may be, will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In the event of a withholding or deduction being made by either the Issuer or the Group Guarantor in respect of a payment made by any of them, the Issuer or, as the case may be, the Group Guarantor will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Covered Bonds, Receipts or Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Covered Bonds, Receipts or Coupons, as the case may be, in the absence of such withholding or deduction, except that no such additional amounts shall be payable with respect to any Covered Bond, Receipt or Coupon:

- (a) presented for payment in the United Kingdom; or
- (b) presented for payment by or on behalf of a holder who is liable for such taxes or duties in respect of such Covered Bond, Receipt or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Covered Bond, Receipt or Coupon; or

- (c) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined in Condition 5(e) (*Payments – Payment Date*)); or
- (d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to EU Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (e) presented for payment by or on behalf of a holder who would be able to avoid such withholding or deduction by presenting the relevant Covered Bond, Receipt or Coupon to another Paying Agent in a member state of the EU.

As used herein:

- (i) “**Tax Jurisdiction**” means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax; and
- (ii) the “**Relevant Date**” means the date on which such payment first becomes due, except that, if the full amount of the monies payable has not been duly received by the Bond Trustee or the Principal Paying Agent on or prior to such due date, it means the date on which, the full amount of such monies having been so received, notice to that effect is duly given to the Covered Bondholders in accordance with Condition 13.

Should any payments made by the LLP under the Covered Bond Guarantee be made subject to any withholding or deduction on account of taxes or duties of whatever nature imposed or levied by or on account of any Tax Jurisdiction the LLP will not be obliged to pay any additional amounts as a consequence.

## 8. PRESCRIPTION

The Covered Bonds, Receipts and Coupons will become void unless presented for payment within a period of ten years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 7 (*Taxation*)) therefor, subject in each case to the provisions of Conditions 3 (*Redenomination*) and 5(b) (*Payments – Presentation of definitive Covered Bonds, Receipts and Coupons*).

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon, the claim for payment in respect of which would be void pursuant to this Condition or Condition 5(b) (*Payments – Presentation of definitive Covered Bonds, Receipts and Coupons*), or any Talon which would be void pursuant to Condition 5(b) (*Payments – Presentation of definitive Covered Bonds, Receipts and Coupons*).

## 9. EVENTS OF DEFAULT AND ENFORCEMENT

### (a) *HBOS Events of Default*

An “**HBOS Acceleration Notice**” means a notice from the Bond Trustee in writing to the Issuer and the Group Guarantor that as against the Issuer and the Group Guarantor (but not against the LLP) each Covered Bond of each Series is, and each such Covered Bond shall thereupon immediately become, due and repayable at its Early Redemption Amount together with accrued interest as provided in the Trust Deed.

The Bond Trustee at its discretion may, and:

- (1) in relation to the defaults set out in sub-paragraphs (i) and (vii) below; or
- (2) if so requested in writing by the holders of not less than twenty-five per cent. of the Principal Amount Outstanding of the Covered Bonds (which means the Covered Bonds of all Series then outstanding taken together as if they were a single Series) then outstanding; or
- (3) if so directed by an Extraordinary Resolution of the holders of Covered Bonds

shall give an HBOS Acceleration Notice, (subject in each case to being indemnified and/or secured to its satisfaction), but in the cases of (a) and (b) below, only if the Bond Trustee shall have certified in writing to the Issuer and the Group Guarantor that such event is, in its opinion, materially prejudicial to the interests of the Covered Bondholders of any Series:

- (a) any event described in paragraph (ii) below; or,
- (b) any event described in relation to the Group Guarantor only, paragraphs (iii) to (vi) (inclusive);

if any of the following events (each an “**HBOS Event of Default**”) shall occur and be continuing:

- (i) default is made by the Issuer and (following the delivery of a written demand on the Group Guarantor by the Bond Trustee for payment under the terms of the Group Guarantee) the Group Guarantor for a period of 7 days or more in the payment of any principal or redemption amount, or for a period of 14 days or more in the payment of any interest on the Covered Bonds of any Series when due; or
- (ii) a default is made in the performance by the Issuer or the Group Guarantor of the obligation (other than any obligation for the payment of principal, redemption amount or interest in respect of the Covered Bonds of any Series) under the provisions of the Covered Bonds of any Series or the Trust Deed or any other Transaction Document to which the Issuer or the Group Guarantor is a party which (unless certified by the Bond Trustee, in its opinion, to be incapable of remedy) shall continue for more than thirty days after written notification requiring such default to be remedied and indicating that this provision may be invoked if it is not so remedied, shall have been given to the Issuer and the Group Guarantor by the Bond Trustee in accordance with the Trust Deed; or
- (iii) an order is made or an effective resolution passed for the bankruptcy or liquidation or winding up of the Issuer or the Group Guarantor (except a bankruptcy, liquidation or winding up for the purpose of a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution (as defined in the Trust Deed) of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 14) (*Meetings of Covered Bondholders, Modification, Waiver and Substitution*); or
- (iv) the Issuer or the Group Guarantor ceases to carry on its business or substantially all its business (except a cessation for the purpose of a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 14); or
- (v) proceedings shall be initiated against the Issuer or the Group Guarantor under any applicable liquidation, winding-up, insolvency, bankruptcy, composition, reorganisation or other similar laws (except in connection with a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 14 (*Meetings of Covered Bondholders, Modification, Waiver and Substitution*)); or a administrator, trustee or other similar official, shall be appointed in relation to the Issuer or the Group Guarantor or in relation to the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets or a distress, diligence or execution or other process shall be levied or enforced upon or sued out against the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets and, in any of the foregoing cases, it shall not be discharged within thirty days; or if the Issuer or the Group Guarantor shall initiate or consent to judicial proceedings relating to itself under any applicable liquidation, winding up, insolvency, bankruptcy, composition, reorganisation or other similar laws (except in connection with a reconstruction, amalgamation, merger or following the transfer of all or substantially all of the assets of the Issuer or the Group Guarantor, the terms of which have previously been approved by an Extraordinary Resolution of the holders of the Covered Bonds or which has been effected in compliance with the terms of Condition 14 (*Meetings of Covered Bondholders, Modification, Waiver and Substitution*)) or shall make a conveyance, assignment or assignation for the benefit of, or shall enter into any composition with, its creditors generally; or

- (vi) the Issuer or the Group Guarantor shall be unable to pay its debts as they fall due (within the meaning of section 123(1)(b) to (e) and section 123(2) of the Insolvency Act 1986 (as that section may be amended)) or shall admit inability to pay its debts as they fall due or shall stop payment in respect of any debts that are due (save, in the case of stopping payments, in each case in respect of any obligation for the payment of principal, redemption amount or interest in respect of the Covered Bonds of any Series) or shall be adjudged or found bankrupt or insolvent; or
- (vii) except as provided by the terms of the Group Guarantee, the Group Guarantee is not, or is claimed by the Group Guarantor not to be, in full force and effect.

Upon the Covered Bonds becoming immediately due and repayable against the Issuer and the Group Guarantor pursuant to this Condition 9(a), the Bond Trustee shall forthwith serve a notice to pay (the “**Notice to Pay**”) on the LLP pursuant to the Covered Bond Guarantee and the LLP shall be required to make payments of Guaranteed Amounts when the same shall become Due for Payment in accordance with the terms of the Covered Bond Guarantee.

Following the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice, the Bond Trustee may or shall take such proceedings against the Issuer and/or the Group Guarantor in accordance with the first paragraph of Condition 9(c) (*Events of Default and Enforcement – Enforcement*).

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

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

(b) **LLP Events of Default**

An “**LLP Acceleration Notice**” means a notice in writing to the Issuer, copied to the LLP, that each Covered Bond of each Series is, and each Covered Bond of each Series shall as against the Issuer and the Group Guarantor (if not already due and repayable against them following an HBOS Event of Default) and as against the LLP, thereupon immediately become, due and repayable at its Early Redemption Amount together with accrued interest as provided in the Trust Deed and thereafter the Security shall become enforceable.

The Bond Trustee at its discretion may, and:

- (1) if so requested in writing by the holders of not less than twenty-five per cent. of the Principal Amount Outstanding of the Covered Bonds (which means the Covered Bonds of all Series then outstanding taken together as if they were a single Series) then outstanding; or
- (2) if so directed by an Extraordinary Resolution of the holders of Covered Bonds;

shall give an LLP Acceleration Notice, (subject in each case to being indemnified and/or secured to its satisfaction), but in the cases of (ii) below, only if the Bond Trustee shall have certified in writing to the Issuer and the LLP that such event is, in its opinion, materially prejudicial to the interests of the Covered Bondholders of any Series, if any of the following events (each an “**LLP Event of Default**”) shall occur and be continuing:

- (i) default is made by the LLP in the payment of any Guaranteed Amount when Due for Payment in respect of the Covered Bonds of any Series for a period of seven days or more in the payment of any principal or redemption amount, or for a period of fourteen days or more in the payment of any interest; or
- (ii) a default is made in the performance or observance by the LLP of any obligation binding upon it (other than any obligation for the payment of Guaranteed Amounts in respect of the Covered Bonds of any Series) under the Trust Deed, the Deed of Charge or any other Transaction Document to which the LLP is a party which (unless certified by the Bond Trustee, in its opinion, to be incapable of remedy) shall continue for more than 30 days after written notification requiring such default to be remedied and indicating that this provision may be invoked if it is not so remedied shall have been given to the LLP by the Bond Trustee in accordance with the Trust Deed; or
- (iii) an order is made or an effective resolution passed for the liquidation or winding up of the LLP; or
- (iv) the LLP ceases to carry on its business or substantially all its business; or
- (v) proceedings shall be initiated against the LLP under any applicable liquidation, winding up, insolvency, bankruptcy, composition, reorganisation or other similar laws (including, but not limited to, presentation of a petition for an administration order); or a receiver, administrator or other similar official shall be appointed in relation to the LLP or in relation to the whole or any part of its assets, or a distress, diligence or execution or other process shall be levied or enforced upon or sued out against the whole or any part of its assets, or if the LLP shall initiate or consent to judicial proceedings relating to itself under any applicable liquidation, winding up, insolvency, bankruptcy, composition, reorganisation or other similar laws or shall make a conveyance, assignment or assignment for the benefit of, or shall enter into any composition with, its creditors generally; or
- (vi) the LLP shall stop payment or shall be unable, or shall admit inability, to pay its debts generally as they fall due or shall be adjudicated or found bankrupt or insolvent; or
- (vii) the Covered Bond Guarantee is not, or is claimed by the LLP not to be, in full force and effect; or
- (viii) a failure to satisfy the Amortisation Test (as set out in the LLP Deed) on any Calculation Date following the service of a Notice to Pay on the LLP.

For the purposes hereof:

“**Amortisation Test**” means the Amortisation Test Aggregate Loan Amount (as defined in the Master Definitions and Construction Agreement) which shall be an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on each Calculation Date following the service of a Notice to Pay on the LLP.

Following the occurrence of an LLP Event of Default and service of an LLP Acceleration Notice, each of the Bond Trustee and the Security Trustee may or shall take such proceedings or steps in accordance with the first and second paragraphs, respectively, of Condition 9(c) (*Events of Default and Enforcement – Enforcement*) and the Covered Bondholders shall have a claim against the LLP, under the Covered Bond Guarantee, for the Early Redemption Amount together with accrued interest as provided in the Trust Deed in respect of each Covered Bond.

(c) **Enforcement**

The Bond Trustee may at any time after service of an HBOS Acceleration Notice (in the case of the Issuer and the Group Guarantor) or an LLP Acceleration Notice (in the case of the LLP), at its discretion and without further notice, take such proceedings against the Issuer and/or the Group Guarantor or the LLP, as the case may be, and/or any other person as it may think fit to enforce the provisions of the Trust Deed, the Covered Bonds, the Receipts, and the Coupons, but it shall not be bound to take any such enforcement proceedings in relation to the Trust Deed, the Covered Bonds, the Receipts or the Coupons or any other Transaction Document unless (i) it shall have been so requested in writing by the holders of not less than 25 per cent. of the Principal Amount Outstanding of the Covered Bonds or so directed by an Extraordinary Resolution of the Covered Bonds and (ii) it shall have been indemnified and/or secured to its satisfaction.

The Security Trustee may at any time, at its discretion and without further notice, take such proceedings against the LLP and/or any other person as it may think fit to enforce the provisions of the Deed of Charge and may, at any time after the Security has become enforceable, take such steps as it may think fit to enforce the Security, but it shall not be bound to take any such steps unless (i) it shall have been so directed by an Extraordinary Resolution of the Covered Bonds or a request in writing by the holders of not less than twenty-five per cent. of the Covered Bonds; and (ii) it shall have been directed in writing to do so by the Priority Secured Creditor; and (iii) it shall have been indemnified and/or secured to its satisfaction.

For the purposes hereof:

“**Priority Secured Creditor**” means the Swap Providers.

No Covered Bondholder, Receiptholder or Couponholder shall be entitled to proceed directly against the Issuer, the Group Guarantor or the LLP or to take any action with respect to the Trust Deed, the Receipts, the Coupons, or the Security unless the Bond Trustee or the Security Trustee, as applicable, having become bound so to proceed, fails so to do for a period of 30 days and the failure shall be continuing.

#### **10. REPLACEMENT OF COVERED BONDS, RECEIPTS, COUPONS AND TALONS**

Should any Covered Bond, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Principal Paying Agent upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Covered Bonds, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

#### **11. PAYING AGENTS**

The names of the initial Paying Agents and their initial specified offices are set out below.

The Issuer is entitled, with the prior written approval of the Bond Trustee (such approval not to be unreasonably withheld or delayed), to vary or terminate the appointment of any Paying Agent and/or appoint additional or other Paying Agents and/ or approve any change in the specified office through which any Paying Agent acts, **provided that:**

- (a) there will at all times be a Principal Paying Agent;
- (b) so long as the Covered Bonds are listed and/or admitted to trading on or by any competent listing authority, on any stock exchange or market, there will at all times be a Paying Agent with a specified office in such place as may be required by the rules and regulations of the relevant competent listing authority, stock exchange or market; and
- (c) it will ensure that it maintains a Paying Agent in a member state of the EU that is not obliged to withhold or deduct tax pursuant to the EU Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 5(d) (*General Provisions applicable to payments*). Any variation, termination, appointment or change shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Covered Bondholders in accordance with Condition 13 (*Notices*).

In acting under the Agency Agreement, the Paying Agents act solely as agents of the Issuer, the Group Guarantor and the LLP and, in certain circumstances specified therein, of the Bond Trustee and do not assume any obligation to, or relationship of agency or trust with, any Covered Bondholders, Receiptholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.



## **12. EXCHANGE OF TALONS**

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Principal Paying Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Covered Bond to which it appertains) a further Talon, subject to the provisions of Condition 8.

## **13. NOTICES**

All notices regarding the Covered Bonds will be deemed to be validly given if published in a leading English language daily newspaper of general circulation in London. It is expected that such publication will be made in the *Financial Times* in London and (in relation to Covered Bonds listed on the Luxembourg Stock Exchange) in *Luxemburger Wort* and/or the *Tageblatt* in Luxembourg. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules of any competent listing authority, stock exchange or market on or by which the Covered Bonds are for the time being listed and/or admitted to trading or by which they have been admitted to listing and/or trading. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. If publication as provided above is not practicable, a notice will be given in such other manner, and will be deemed to have been given on such date, as the Bond Trustee shall approve.

So long as the Covered Bonds are represented in their entirety by any Global Covered Bonds held on behalf of Euroclear and/or Clearstream, Luxembourg, there may be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg for communication by them to the holders of the Covered Bonds and, in addition, for so long as any Covered Bonds are listed and/or admitted to trading on or by any competent listing authority, stock exchange or market and the rules of that competent listing authority, stock exchange or market so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules. Any such notice shall be deemed to have been given to the holders of the Covered Bonds on the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

Notices to be given by any Covered Bondholder shall be in writing and given by lodging the same, together (in the case of any Covered Bond in definitive form) with the relative Covered Bond or Covered Bonds, with the Principal Paying Agent. Whilst any of the Covered Bonds are represented by a Global Covered Bond, such notice may be given by any holder of a Covered Bond to the Principal Paying Agent through Euroclear and/or Clearstream, Luxembourg, as the case may be, in such manner as the Principal Paying Agent and Euroclear and/or Clearstream, Luxembourg, as the case may be, may approve for this purpose.

## **14. MEETINGS OF COVERED BONDHOLDERS, MODIFICATION, WAIVER AND SUBSTITUTION**

The Trust Deed contains provisions for convening meetings of the Covered Bondholders of any Series to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Covered Bonds of such Series or the related Receipts and/or Coupons or of any of the Transaction Documents (subject as provided below and in the Trust Deed). Such a meeting may be convened by the Issuer, the Group Guarantor, the LLP or the Bond Trustee and shall be convened by the Issuer if required in writing by Covered Bondholders of a Series of Covered Bonds holding not less than five per cent. of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being remaining outstanding. The quorum at any such meeting in respect of any Series of Covered Bonds for passing an Extraordinary Resolution is one or more persons holding or representing not less than 50 per cent. of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being outstanding, or at any adjourned meeting one or more persons being or representing Covered Bondholders of such Series whatever the nominal amount of the Covered Bonds of such Series so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Covered Bonds of a Series, the related Receipts or the Coupons or the Trust Deed (including a reduction or cancellation of the amount payable in respect of such Covered Bonds, the alteration of the currency in which payments

under such Covered Bonds are to be made, the alteration of the majority required to pass an Extraordinary Resolution, any amendment to any of the Guarantees or the Deed of Charge (except in a manner determined by the Bond Trustee not to be materially prejudicial to the interests of the Covered Bondholders of any Series) or the sanction of any scheme or proposal for the exchange of such Covered Bonds in respect of such Series of Covered Bonds (each, a “**Series Reserved Matter**” all as more particularly set out in the Trust Deed)), the quorum shall be one or more persons holding or representing not less than two-thirds of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third of the Principal Amount Outstanding of the Covered Bonds of such Series for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Covered Bondholders of a Series shall, subject as provided below, be binding on all the Covered Bondholders of such Series, whether or not they are present at the meeting, and on all Receiptholders and Couponholders in respect of such Series of Covered Bonds. Pursuant to the Trust Deed, the Bond Trustee may convene a single meeting of the holders of Covered Bonds of more than one Series if in the opinion of the Bond Trustee there is no conflict between the holders of such Covered Bonds, in which event the provisions of this paragraph shall apply thereto *mutatis mutandis*.

Notwithstanding the provisions of the immediately preceding paragraph, any Extraordinary Resolution to direct the Bond Trustee to accelerate the Covered Bonds pursuant to Condition 9 (*Events of Default and Enforcement*) or to direct the Bond Trustee or the Security Trustee to take any enforcement action (each a “**Programme Resolution**”) shall only be capable of being passed at a single meeting of the holders of the Covered Bonds of all Series then outstanding. Any such meeting to consider a Programme Resolution may be convened by the Issuer, the Group Guarantor, the LLP or the Bond Trustee or by Covered Bondholders of any Series. The quorum at any such meeting for passing a Programme Resolution is one or more persons holding or representing more than fifty per cent. in aggregate of the Principal Amount Outstanding of the Covered Bonds of all Series for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing Covered Bonds whatever the nominal amount of the Covered Bonds of any Series so held or represented. A Programme Resolution passed at any meeting of the Covered Bondholders of all Series shall be binding on all Covered Bondholders of all Series, whether or not they are present at the meeting, and on all related Receiptholders and Couponholders in respect of such Series of Covered Bonds.

In connection with any meeting of the holders of Covered Bonds of more than one Series where such Covered Bonds are not denominated in Sterling, the nominal amount of the Covered Bonds of any Series not denominated in Sterling shall be converted into Sterling at the relevant Covered Bond Swap Rate.

Each of the Bond Trustee and the Security Trustee may also agree with the Issuer, but without the consent of the other Secured Creditors (and for this purpose the Bond Trustee and the Security Trustee may disregard whether any such modification relates to a Series Reserved Matter), to:

- (a) any modification of the Covered Bonds of one or more Series, the related Receipts and/or Coupons or any Transaction Document to which either of them is a party or, in the case of the Security Trustee, over which it has Security **provided that** (i) in the opinion of the Bond Trustee and/or, as the case may be, the Security Trustee such modification is not materially prejudicial to the interests of any of the Covered Bondholders of any Series or any of the other Secured Creditors (other than the LLP and the Sellers) (in which respect the Bond Trustee and the Security Trustee may rely upon the consent in writing of any other Secured Creditor (other than any Covered Bondholders) as to the absence of material prejudice to the interests of such Secured Creditor) and (ii) it has not been informed in writing by any Secured Creditor (other than any Covered Bondholder(s)) that such Secured Creditor will be materially prejudiced thereby (other than a Secured Creditor who has given his/her written consent as aforesaid); or
- (b) any modification of the Covered Bonds of any one or more Series, the related Receipts and/or Coupons or any Transaction Document to which either of them is a party or, in the case of the Security Trustee, over which it has Security which is of a formal, minor or technical nature or is made to correct a manifest error or an error established as such to the satisfaction of the Bond Trustee or to comply with mandatory provisions of law.

The Bond Trustee may also agree, without the consent of the Covered Bondholders of any Series, the related Receiptholders and/or Couponholders or any other Secured Creditor, to the waiver or authorisation of any breach or proposed breach of any of the provisions of the Covered Bonds of any Series, or determine, without any such consent as aforesaid, that any HBOS Event of Default or LLP Event of Default or Potential HBOS Event of Default or Potential LLP Event of Default shall not be treated as such, where, in any such case, it is not, in the opinion of the Bond Trustee, materially prejudicial to the interests of any of the Secured Creditors (in which respect the Bond Trustee may (without further enquiry) rely upon the consent in writing of any other Secured Creditor as to the absence of material prejudice to the interests of such Secured Creditor) **provided that** the Bond Trustee has not been informed by any Secured Creditor (other than any Covered Bondholder(s)) that such Secured Creditor will be materially prejudiced thereby (other than a Secured Creditor who has given its written consent as aforesaid).

Any such modification, waiver, authorisation or determination shall be binding on all Covered Bondholders of all Series of Covered Bonds for the time being outstanding, the related Receiptholders and the Couponholders and the other Secured Creditors, and unless the Security Trustee and the Bond Trustee otherwise agree, any such modification shall be notified by the Issuer to the Covered Bondholders of all Series of Covered Bonds for the time being outstanding and the other Secured Creditors in accordance with the relevant terms and conditions as soon as practicable thereafter.

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation, determination or substitution), the Bond Trustee and the Security Trustee shall have regard to the general interests of the Covered Bondholders of each Series as a class (but shall not have regard to any interests arising from circumstances particular to individual Covered Bondholders, Receiptholders or Couponholders whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Covered Bondholders, the related Receiptholders, Couponholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Bond Trustee and the Security Trustee shall not be entitled to require, nor shall any Covered Bondholder, Receiptholder or Couponholder be entitled to claim, from the Issuer, the Group Guarantor, the LLP, the Bond Trustee, the Security Trustee or any other person any indemnification or payment in respect of any tax consequences of any such exercise upon individual Covered Bondholders, Receiptholders and/or Couponholders, except to the extent already provided for in Condition 7 (*Taxation*) and/or in any undertaking or covenant given in addition to, or in substitution for, Condition 7 (*Taxation*) pursuant to the Trust Deed.

**Provided that** the Bond Trustee and the Security Trustee shall have received a certificate of two directors of the Issuer and the Group Guarantor and a certificate of a Designated Member of the LLP stating that immediately after giving effect to such transaction no HBOS Event of Default (in respect of the Issuer or the Group Guarantor) or LLP Event of Default in respect of the LLP, respectively and no Potential HBOS Event of Default (in respect of the Issuer or the Group Guarantor) or Potential LLP Event of Default in respect of the LLP, respectively, shall have happened and be continuing and certain other conditions as are specified in the Trust Deed are satisfied, but without the consent of the Covered Bondholders of any Series of Covered Bonds for the time being outstanding or of the holders of the Coupons and Receipts appertaining thereto, or of any other Secured Creditor: (a) the Group Guarantor may assume the obligations of the Issuer as principal obligor under the Trust Deed and all other Transaction Documents in respect of all Series of Covered Bonds subject to the Covered Bonds of all Series being or remaining unconditionally guaranteed by the Group Guarantor on the same basis (save for such Group Guarantor to become the principal obligor) or (b) another Subsidiary (as defined in the Master Definitions and Construction Agreement) of the Group Guarantor may assume the obligations of the Issuer as principal obligor under the Trust Deed and the other Transaction Documents in respect of all Series of Covered Bonds subject to the Covered Bonds of all Series being or remaining unconditionally guaranteed by the Group Guarantor on the same basis. The Trust Deed provides that any such assumption shall be notified to the holders of all Series of Covered Bonds (in accordance with the relevant terms and conditions of such Covered Bonds).

**Provided that** the Bond Trustee and the Security Trustee shall have received a certificate of two directors of the Issuer and the Group Guarantor and a certificate of a Designated Member of the LLP stating that immediately after giving effect to such resignation or assumption no HBOS Event of Default (in respect of the Issuer or the Guarantor) and no LLP Event of Default, respectively, and no Potential HBOS Event of Default (in respect of the Issuer or the Guarantor) and no Potential LLP Event of Default, respectively, shall have happened and be continuing and certain other conditions as are specified in the Trust Deed are satisfied, but without the consent of the Covered Bondholders of any Series of Covered Bonds for the time being outstanding or of the holders of the Coupons and the Receipts appertaining thereto or any other Secured Creditor, HBOS (in its capacity as Group Guarantor) may resign as the Group Guarantor **provided that** the long-term unsecured, unsubordinated and unguaranteed debt ratings of the Issuer (if independently rated) or any Replacement Guarantor are at least equal to the ratings (at the time of the resignation) of the highest rated Group Guarantor and for such purpose “**Replacement Guarantor**” means any other member of the HBOS Group (as defined in the Master Definitions and Construction Agreement) who assumes the obligations of the resigning Group Guarantor under the Trust Deed in respect of such Covered Bonds. The Trust Deed provides that any such resignation or assumption shall be notified to the holders of such Covered Bonds (in accordance with the relevant terms and conditions of such Covered Bonds).

The Issuer and the Group Guarantor may each, without the consent of the holders of the Covered Bonds of any Series or any Receipts or Coupons relating thereto, or any other Secured Creditor consolidate with, merge or amalgamate into or transfer their respective assets substantially as an entirety to, any corporation organised under the laws of the United Kingdom, or any political subdivision thereof, **provided that** (i) a certificate of two Directors of the Issuer and the Group Guarantor and a certificate of a Designated Member of the LLP is delivered to the Bond Trustee and the Security Trustee to the effect that immediately after giving effect to such transaction no HBOS Event of Default in respect of the Issuer or the Group Guarantor and no LLP Event of Default in respect of the LLP, respectively, and no Potential HBOS Event of Default in respect of the Issuer or the Group Guarantor and no Potential LLP Event of Default in respect of the LLP, respectively, will have happened and be continuing and (ii) unless the Issuer or the Group Guarantor, as the case may be, is the surviving entity, the Issuer or, as the case may be, the Group Guarantor shall procure that the surviving or transferee company assumes its obligations as Issuer or, as the case may be, Group Guarantor under the Trust Deed, each other relevant Transaction Document and all of the outstanding Covered Bonds of all Series, in place of the Issuer or, as the case may be, the Group Guarantor and (iii) in the case of an assumption of the obligations of the Issuer by a successor or transferee company, the guarantee of the Group Guarantor and the guarantee of the LLP are fully effective on the same basis in relation to the obligations of such successor or transferee company and (iv) certain other conditions set out in the Trust Deed are met. Upon the assumption of the obligations of the Issuer or the Group Guarantor by such surviving or transferee company, the predecessor Issuer or Group Guarantor, as the case may be, shall (subject to the provisions of the Trust Deed) have no further liabilities under or in respect of the Trust Deed or the outstanding Covered Bonds of each Series then outstanding or any Coupons or Receipts appertaining thereto and the other Transaction Documents. Any such assumption shall be subject to the relevant provisions of the Trust Deed. The Trust Deed provides that any such assumption shall be notified to the holders of all Series of Covered Bonds in accordance with the relevant terms and conditions of such Covered Bonds and the other Secured Creditors.

In these Conditions, in any circumstance where it is necessary to calculate the Principal Amount Outstanding of the Covered Bonds, Covered Bonds not denominated in Sterling shall be converted into Sterling at the relevant Covered Bond Swap Rate for the purposes of such calculation.

For the purposes hereof:

“**Potential HBOS Event of Default**” means any condition, event or act which, with the lapse of time and/or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition, would constitute an HBOS Event of Default.

“**Potential LLP Event of Default**” means any condition, event or act which, with the lapse of time and/or the issue, making or giving of any notice, certification, declaration, demand, determination and/or request and/or the taking of any similar action and/or the fulfilment of any similar condition, would constitute an LLP Event of Default.

“**Rating Agency Confirmation**” means a confirmation in writing by the Rating Agencies that the then current ratings of the Covered Bonds will not be adversely affected by or withdrawn as a result of the relevant event or matter.

**15. INDEMNIFICATION OF THE BOND TRUSTEE AND/OR SECURITY TRUSTEE AND BOND TRUSTEE AND/OR SECURITY TRUSTEE CONTRACTING WITH THE ISSUER AND/OR BANK OF SCOTLAND AND/OR HBOS AND/OR THE LLP**

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

The Trust Deed and the Deed of Charge contain provisions for the indemnification of the Bond Trustee and the Security Trustee and for their relief from responsibility, including provisions relieving them from taking any action unless indemnified and/or secured to their satisfaction.

The Trust Deed and the Deed of Charge also contain provisions pursuant to which each of the Bond Trustee and Security Trustee, respectively, is entitled, *inter alia*, (i) to enter into business transactions with the Issuer, either of the Group Guarantor, the LLP and/or any of their respective Subsidiaries and affiliates and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer, the Group Guarantor, the LLP and/or any of their respective Subsidiaries and affiliates, (ii) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Covered Bondholders, Receiptholders or Couponholders or the other Secured Creditors and (iii) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

Neither the Bond Trustee nor the Security Trustee will be responsible for any loss, expense or liability, which may be suffered as a result of any Loans or Related Security, or any deeds or documents of title thereto, being uninsured or inadequately insured or being held by clearing organisations or their operators or by intermediaries such as banks, brokers or other similar persons on behalf of the Bond Trustee and/or the Security Trustee. Neither the Bond Trustee nor the Security Trustee will be responsible for (i) supervising the performance by the Issuer or any other party to the Transaction Documents of their respective obligations under the Transaction Documents and the Bond Trustee and the Security Trustee will be entitled to assume, until they each have written notice to the contrary, that all such persons are properly performing their duties; (ii) considering the basis on which approvals or consents are granted by the Issuer or any other party to the Transaction Documents under the Transaction Documents; (iii) monitoring the Portfolio, including, without limitation, whether the Portfolio is in compliance with the Asset Coverage Test, the Pre-Maturity Liquidity Test or the Amortisation Test; or (iv) monitoring whether Loans and Related Security satisfy the Eligibility Criteria. Neither the Bond Trustee nor the Security Trustee will be liable to any Covered Bondholder or other Secured Creditor for any failure to make or to cause to be made on their behalf the searches, investigations and enquiries which would normally be made by a prudent chargee in relation to the Security and have no responsibility in relation to the legality, validity, sufficiency and enforceability of the Security and the Transaction Documents.

**16. FURTHER ISSUES**

The Issuer shall be at liberty from time to time without the consent of the Covered Bondholders, the Receiptholders or the Couponholders to create and issue further bonds having terms and conditions the same as the Covered Bonds of any Series or the same in all respects

save for the amount and date of the first payment of interest thereon, issue date and/or purchase price and so that the same shall be consolidated and form a single Series with the outstanding Covered Bonds of such Series.

**17. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

No person shall have any right to enforce any term or condition of this Covered Bond under the Contracts (Rights of Third Parties) Act 1999, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

**18. GOVERNING LAW AND SUBMISSION TO JURISDICTION**

(a) ***Governing law***

The Trust Deed, the Agency Agreement, the Covered Bonds, the Receipts, the Coupons and the other Transaction Documents (other than the Jersey Corporate Services Agreement) are governed by, and shall be construed in accordance with, English law unless specifically stated to the contrary.

(b) ***Submission to jurisdiction***

The Group Guarantor agrees, for the exclusive benefit of the Bond Trustee, the Covered Bondholders, the Receiptholders, the Couponholders and the other Secured Creditors, that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Trust Deed, the Covered Bonds, the Receipts, the Coupons and/or the other Transaction Documents and that accordingly any suit, action or proceedings (together referred to as “**Proceedings**”) arising out of or in connection with the Trust Deed, the Covered Bonds, the Receipts, the Coupons and the other Transaction Documents may be brought in such courts.

The Group Guarantor hereby irrevocably waives any objection which it may have now or hereafter to the laying of the venue of any such Proceedings in any such court and any claim that any such Proceedings have been brought in an inconvenient forum and hereby further irrevocably agrees that a judgment in any such Proceedings brought in the English courts shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction.

Nothing contained in this Condition shall limit any right to take Proceedings against the Group Guarantor in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

(c) ***Service of Process***

Each of the Issuer and the Group Guarantor have agreed in the Trust Deed that the process by which any proceedings in England in connection with the Trust Deed, the Covered Bonds, the Receipts, the Coupons and/or the other Transaction Documents are begun may be served on it by being delivered to Bank of Scotland, Treasury Division, 33 Old Broad Street, London EC2N 1HZ attention: Legal Department and undertakes that, in the event of Bank of Scotland ceasing to have a place of business in England, it will appoint a person having a place of business in England to act in Bank of Scotland’s place.

## USE OF PROCEEDS

The Sterling Equivalent of the gross proceeds from each issue of Covered Bonds will be used by the Issuer to make available Term Advances to the LLP pursuant to the terms of the Intercompany Loan Agreement, which in turn shall be used by the LLP:

- (i) to acquire Loans and their Related Security or to invest the same in Substitution Assets up to the prescribed limit; and/or
- (ii) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced; and/or
- (iii) to deposit all or part of the proceeds into the Principal GIC Sub-Account; and/or
- (iv) subject to written confirmation from the LLP that the Asset Coverage Test is met on the relevant Issue Date (both before and immediately following the making of the relevant Term Advance), to make a Capital Distribution to any Seller (in its capacity as a Member) by way of distribution of that Member's equity in the LLP in an amount equal to the Term Advance or any part thereof, which is to be paid to the Member on the relevant Issue Date by telegraphic transfer or as otherwise directed by the Member.

## THE ISSUER AND ORIGINAL SELLER

### *Introduction*

Bank of Scotland plc (“**Bank of Scotland**”) plc was originally established in 1695 as The Governor and Company of the Bank of Scotland by an Act of the Parliament of Scotland. On the Consolidation Date, in accordance with the provisions of the HBOS Group Reorganisation Act, the Governor and Company of the Bank of Scotland became incorporated and registered in Scotland as a public limited company under the Companies Act and changed its name to Bank of Scotland plc, registered number SC327000. On the same day, under the HBOS Group Reorganisation 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. Bank of Scotland together with its subsidiaries and subsidiary undertakings (as defined in the Companies Act) are collectively referred to as the “Bank of Scotland Group”. The registered head office of Bank of Scotland is located at The Mound, Edinburgh EH1 1YZ, Scotland, telephone number +44 (0) 870 600 500.

Bank of Scotland is a United Kingdom clearing bank with its headquarters in Edinburgh and an “authorised person” under FSMA. The Bank of Scotland Group is engaged in a range of banking, insurance broking, financial services and finance-related activities throughout the UK and internationally. As at 31 December 2007, it operated from branch outlets in Scotland and England, overseas branches in Amsterdam, Frankfurt, Grand Cayman, Hong Kong, Madrid, New York City, Paris, Stockholm and Sydney and representative offices in Boston, Chicago, Dallas, Houston, Los Angeles, Miami, Minneapolis and Seattle. It is a member of the British Bankers’ Association and the Committee of Scottish Clearing Bankers. The Bank Notes (Scotland) Act 1845 confirmed Bank of Scotland’s right to issue bank notes in Scotland. At 31 December 2007, circulation of such notes was approximately £881 million.

### *Business*

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

The Bank of Scotland Group’s products and services can be categorised into the following business divisions:

- Retail;
- Corporate;
- International; and
- Treasury.

### *Retail*

The Retail division of the Bank of Scotland Group provides financial services to 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.

Mortgages are provided by Bank of Scotland under the Halifax, Intelligent Finance, Birmingham Midshires and Bank of Scotland brands and mortgages provided under The Mortgage Business brand name will be provided by The Mortgage Business plc, a subsidiary of Bank of Scotland.

Bank of Scotland offers savings products through the Halifax, Bank of Scotland, Birmingham, Midshires and Intelligent Finance brands catering for all segments of the savings market, including children’s accounts, tax free, fixed rate and regular savings accounts. Bank accounts range from full facilities current accounts to basic social banking facilities.

Bank of Scotland offers personal loans and credit cards through the Halifax and Bank of Scotland 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 of Bank of Scotland also distributes HBOS Group’s insurance and investment products on behalf of the HBOS Group’s Insurance & Investment division and participates in a number of joint ventures, such as Sainsbury’s Bank.



### ***Corporate***

The Bank of Scotland Group provides a range of banking services to the corporate business sector. Its principal market is UK and European based businesses with an annual 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 an annual 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 airplanes 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 deliver 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.

### ***International***

The International operations division of the Bank of Scotland Group consists of three operating divisions in Ireland, Australia and ENA. Bank of Scotland (Ireland) Limited focuses on providing banking solutions to small and medium sized enterprises in Ireland and has recently begun to roll out its full service retail offering. HBOS Australia Pty Limited operates in Australia under the four separate brands of BankWest, Capital Finance, St Andrew's and BOS International, to offer a full range of financial solutions to retail and corporate customers.

ENA encompasses the group's interests in North America and covers a range of financial services. The division operates through a range of businesses, which include: EUBOS (Netherlands), an online and intermediary mortgage business; and retail activities consisting of Banco Halifax Hispania, an expanding branch network in Spain.

The Bank of Scotland Group operates principally within the United Kingdom, Ireland and Australia.

### ***Treasury***

The Treasury division provides centralised wholesale multi-currency funding, liquidity management and treasury services to HBOS and its subsidiary undertakings in the United Kingdom, Australia, Ireland, and the United States. It manages the market risk arising from the HBOS Group's Retail and Corporate Divisions. It operates in the world's foreign exchange and money markets and also provides a range of treasury services to certain of the HBOS Group's customers from its office in London and its branches in Glasgow, Grand Cayman, New York and Sydney.

Treasury division's Grand Cayman branch operates under licence from the Cayman Islands Monetary Authority. Treasury division's New York branch operates under the supervision of the Office of the Comptroller of the Currency and oversight of the Board of Governors of the Federal Reserve System. Bank of Scotland is registered as a foreign company in Australia and carries on banking business in Australia pursuant to an authority issued the Australian Prudential Regulation Authority. In addition, the Australia branch also holds an Australian Financial Services License which enables the Australia branch to conduct its treasury activities within the Australian jurisdiction.

Trading transactions are undertaken to accommodate customer and HBOS Group requirements, whilst proprietary activity is maintained within approved limits. The Treasury division manages the treasury investment portfolio for the HBOS Group and leads the debt capital issuance and asset securitisation activities of the HBOS Group.

### **Major Shareholder**

Bank of Scotland is a wholly owned subsidiary of HBOS. For further details of HBOS, see *The Group Guarantor and the HBOS Group* below.

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

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

<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly or indirectly by Bank of Scotland)</b>	<b>Country of incorporation or registration</b>	<b>Registered office/head office</b>
HBOS Australia Pty Limited and subsidiaries including Bank of Western Australia Limited .....	Retail and commercial banking	100	Australia	Bank West Tower 108 St Georges Terrace Perth, Australia WA6000
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 Loans	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
Banco Halifax Hispania SA .....	Retail and commercial banking	100	Spain	PO Box: Ps de la Castellana 86, P1.5 Dcha. Madrid-28046 Spain
Halifax Estate Agencies Ltd.....	Estate agency and financial services	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 LRG
Uberior Investments plc .....	Investment Holding	100	England and Wales	Level 1 Citymark 150 Fountainbridge Edinburgh EH3 9PC

## MANAGEMENT OF BANK OF SCOTLAND

### Board of Directors of Bank of Scotland

<u>Name</u>	<u>Position in Bank of Scotland</u>	<u>Principal outside activities (if any) of significance to Bank of Scotland</u>
Lord Stevenson of Coddenham ....	Chairman	Chairman of HBOS plc
Andy Hornby .....	Chief Executive	Chief Executive, HBOS plc
Peter Cummings .....	Executive Director	Chief Executive Corporate, HBOS plc
Jo Dawson.....	Executive Director	Chief Executive Insurance & Investment and Retail Distribution, HBOS plc
Mike Ellis .....	Executive Director	Group Finance Director, HBOS plc
Philip Gore-Randall .....	Executive Director	Chief Operating Officer, HBOS plc
Colin Matthew .....	Executive Director	Chief Executive Strategy & International and Treasury & Asset Management, HBOS plc
Dan Watkins .....	Executive Director	Chief Executive Retail Products, HBOS plc
Sir Ronald Garrick .....	Non-executive Director and Deputy Chairman	Non-executive Director and Deputy Chairman of HBOS plc
Richard Cousins.....	Non-executive Director	Non-executive Director of HBOS plc
Anthony Hobson.....	Non-executive Director	Non-executive Director of HBOS plc
Karen Jones.....	Non-executive Director	Non-executive Director of HBOS plc
John E. Mack.....	Non-executive Director	Non-executive Director of HBOS plc
Coline McConville .....	Non-executive Director	Non-executive Director of HBOS plc
Kate Nealon.....	Non-executive Director	Non-executive Director of HBOS plc

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

#### ***Conflicts of Interest***

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

The Issuer and its subsidiaries are hereafter referred to as the “**Issuer Group**”.

## THE LLP

### **Introduction**

The LLP was incorporated in England and Wales on 6 December 2004 as a limited liability partnership (registered number OC310386) with limited liability under the LLPA 2000 by The Governor and Company of the Bank of Scotland, Halifax plc, HBOS Treasury Services plc and Addison Social Housing Limited as its original members. As of the Consolidation Date, its Members were Bank of Scotland plc and Addison Social Housing Limited. The principal place of business of the LLP is at Charterhall House, City Road, Chester, CH88 3AN and its telephone number is 01244 693 328. The LLP has no subsidiaries.

### **Principal Activities**

The principal objects of the LLP are set out in the LLP Deed and include, *inter alia*, the ability to carry on the business of acquiring the Loans and their Related Security pursuant to the terms of the Loan Sale Agreement with a view to profit and to do all such things as are incidental or conducive to the carrying on of that business and to borrow money.

The LLP has not engaged since its incorporation, and will not engage whilst the Covered Bonds or any Term Advance remains outstanding, in any material activities other than activities incidental to its incorporation under the LLPA 2000, activities contemplated under the Transaction Documents to which it is or will be a party and other matters which are incidental or ancillary to the foregoing.

### **Members**

The members of the LLP as of the Consolidation Date were, and their registered offices are:

<b>Name</b>	<b>Registered Office</b>
Bank of Scotland plc .....	The Mound Edinburgh EH1 1YZ
Addison Social Housing Limited.....	35 Great St Helen's London EC3A 6AP

The LLP has no employees.

### **Management Committee**

The members of the LLP Management Committee are, and their business addresses are:

	<b>Bank of Scotland Appointee:</b>
Ian W.G. McDonald .....	C/o Bank of Scotland, Citymark – Level 4, 150 Fountainbridge, Edinburgh, EH3 9PE
	<b>Liquidation Member Appointee</b>
Craig Vandeppear .....	C/o Bank of Scotland, Citymark – Level 4, 150 Fountainbridge, Edinburgh, EH3 9PE

## Directors of the Members

The following table sets out the directors of Addison Social Housing Limited and their respective business addresses and occupations.

<u>Name</u>	<u>Business</u>	<u>Business Occupation</u>
SFM Directors Limited .....	35 Great St Helen's London EC3A 6AP	Director company
<i>Directors of SFM Directors Limited: ...</i>	<i>Jonathan Keighley James Macdonald Robert Berry James France</i>	
SFM Directors (No.2) Limited.....	35 Great St Helen's London EC3A 6AP	Director company
<i>Directors of SFM Directors (No.2) Limited: .....</i>	<i>Jonathan Keighley James Macdonald Robert Berry James France</i>	
Ian William Gibb McDonald .....	Citymark Level 4150 Fountainbridge Edinburgh EH3 9PE	Head of Corporate, Portfolio Management and Securitisation

The directors of Bank of Scotland are set out under *The Issuer and Original Seller* above.

## Conflicts of Interest

No potential conflicts of interest exist at the date of this Base Prospectus between the duties of the directors of the LLP and their private duties or other duties.

## Capitalisation and Indebtedness Statement

The following table shows the capitalisation and indebtedness of the LLP as at the date set forth below:

	<b>As at 31 December 2007</b>
	<b>£ millions</b>
Capital Contributions.....	857
Term Advances.....	1,503
Reserves .....	—
Total capitalisation and indebtedness .....	<b>2,360</b>

The LLP had no Loan capital, term Loans, other borrowings or indebtedness or contingent liabilities or guarantees as at 31 December 2007 other than the Covered Bond Guarantee.

## THE GROUP GUARANTOR AND THE HBOS GROUP

### *Introduction*

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. HBOS together with its subsidiaries and subsidiary undertakings (as defined in the Companies Act) are 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. 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, The Governor and Company of the Bank of Scotland became incorporated and was registered in Scotland as a public limited company under the Companies Act and changed its name to Bank of Scotland plc, with registered number SC327000. On the same day, under the HBOS Group Reorganisation Act, the business activities, assets (including investments in subsidiaries) and liabilities of Capital Bank plc, Halifax plc and HBOS Treasury Services plc were transferred to Bank of Scotland. HBOS has three principal directly held subsidiaries remaining: 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:

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

### *Growing the U.K 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% range and consolidate our leadership positions in residential mortgages and in savings. 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 pursuing measured and selective high value growth by concentrating 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 specialization 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 applying 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 U.S. 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 recent dislocation in financial markets has shown, capital strength is also required to cushion against the shocks that are a periodic feature of banking.

During 2007, the FSA approved the HBOS Group's "Advanced Measurement Approach" to operational risk and the "Advanced Internal Ratings Based Approach" to credit risk and, as from 1 January 2008, the HBOS Group is now operating under the Basel Accord 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.

On April 29, 2008, the HBOS Group announced a rights issue to strengthen the Group's capital base. See "*Recent Developments*".

#### *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 consistently deliver 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 HBOS Group's 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 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 HBOS Group's 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 to maintaining long-term relationships with customers and thereby meeting a greater share of their financial needs. This will be achieved through providing excellent service, offering additional products that are more effectively targeted to meet customer's 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 keep tight control of costs.

### *Corporate*

The HBOS Group's 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 airplanes 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 deliver 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 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 and 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, Sheila's 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 HBOS Group's significant 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 retail 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 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 HBOS Group's 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 brands, with a 100 year old presence in Western Australia and a rapidly growing presence nationally. The division's insurance and investment businesses operate under the St. Andrew's and Whittaker Macnaught brands and the corporate banking businesses, based in Sydney, operate under the BOS International brand. Principally, this division provides mergers and acquisition finance, real estate lending and infrastructure/project finance. 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 the 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 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 approximately £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 approximately £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.

### ***Recent Developments***

#### *Rights Issue*

On 29 April 2008, HBOS announced a fully underwritten rights issue of ordinary shares to raise £4.0 billion on the basis of two new ordinary shares for every five existing ordinary shares held at a subscription price of 275p per share. The rights issue is conditional, amongst other things, upon the passing of necessary shareholder resolutions at an Extraordinary General Meeting of HBOS proposed to be held in late June 2008, the final day for acceptance and payment of the rights issue being no later than 7 August 2008 and the underwriting arrangements in respect of the rights issue becoming unconditional and not having been terminated in accordance with their terms. The Directors have established a new target Tier 1 capital ratio of between 8.0% and 9.0% and a new target core Tier 1 capital ratio of between 6.0% and 7.0%.

#### *Trading Update Announcement*

HBOS also made a trading update announcement in accordance with the rules of the London Stock Exchange on 29 April 2008. HBOS maintains a portfolio of debt securities as part of its treasury operations and in respect of which there have been no credit impairments to date. In accordance with its valuation procedures for these treasury assets HBOS has taken additional mark-downs for certain parts of its portfolio reflecting the illiquidity of relevant markets. Accordingly, the Group has made a number of fair value adjustments, relating primarily to its holdings of asset backed securities and floating rate notes. These adjustments are £970,000,000 in respect of its trading book and £1,874,000,000 post tax in respect of its banking book. The fair value adjustments in the banking book have no impact on reported profits or regulatory capital strength.

The above-referenced steps were announced by HBOS in a trading update made in accordance with the rules of the London Stock Exchange on April 29, 2008. However, the trading update is not included or incorporated by reference in this Base Prospectus.

#### *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 ("OFT") 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 the HBOS Group 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 charges 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 Group (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.

The first step in the Test Case was a trial of certain 'preliminary' issues concerning the legal status and enforceability of contractual terms relating to unarranged overdraft charges.

This preliminary trial concluded on 8 February 2008 and the judgment was handed down on 24 April 2008. The judgment held that the contractual terms relating to unarranged overdraft charges used by HBOS Group (i) are not unenforceable as penalties, but (ii) are not exempt from assessment for fairness under the Unfair Terms in Consumer Contract Regulations 1999.

HBOS Group is considering whether to appeal any of the rulings contained in the judgment. A court hearing has been arranged for 22 May 2008 at which the OFT, HBOS Group and the other Test Case banks are expected to make submissions to the Court in relation to whether they wish to appeal the judgment, the implications of the judgment in the Test Case and arrangements for any remaining issues relevant to the customer claims and complaints to be determined in the Test Case in due course.

A definitive outcome of the Test Case is unlikely to be known for at least 12 months.

Given the early stage of these proceedings and the uncertainty as to their outcome, it is not practicable at this time to estimate any potential financial effect. Consistent with HBOS' obligations as a company with securities admitted to the Official List, HBOS will give further details in relation to the OFT litigation, if material, when they become available, including its potential impact on the HBOS Group.

### ***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 HBOS Group Reorganisation Act (and with effect from the Consolidation Date), all assets and liabilities in respect of three former subsidiaries or HBOS (HBOS Treasury Services plc, Capital Bank plc and Halifax plc) were assumed by Bank of Scotland.

<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly by HBOS)</b>	<b>Country of incorporation or registration</b>	<b>Registered office/head office</b>
Bank of Scotland plc.....	Banking, financial and related services	100	Scotland	P.O. Box No. 5 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
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	Bank West Tower 108 St Georges Terrace Perth Australia WA 6000
Bank of Western Australia Limited .....	Banking	100	Australia	Bank West 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	Trinity Road Halifax

<u>Company</u>	<u>Activity</u>	<u>Total % of ordinary share capital held (directly by HBOS)</u>	<u>Country of incorporation or registration</u>	<u>Registered office/head office</u>
				West Yorkshire HX1 2RG
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
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 Andrews Life Assurance plc	Pensions	100	England and Wales	St Andrews House Portsmouth Road Esher Surrey KT10 9SA
St James's Place plc.....	Financial services	60	England and Wales	St James's Place House Dollar Street Cirencester GL7 2AQ

### ***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, 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 which has increased competition in recent years from a variety of sources, including merged banks, demutualised life

insurers and building societies and diversified consumer services companies. Increased regulatory intervention has also influenced the UK banking market.

As at 31 December 2007, the HBOS Group had 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 Corporate 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 metropolitan 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 retail and wholesale business 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 and Investment businesses in the more populous eastern states via cost-effective distribution, both direct-to-customer 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.

## Management of HBOS

### Board of Directors of HBOS

Name	Position in HBOS	Principal outside activity (if any) of significance to HBOS
Lord Stevenson of Coddendam	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	—
Dan Watkins	Chief Executive – Retail Products	
Colin Matthew	Chief Executive – Strategy & International and Treasury & Asset Management	—
Richard Cousins	Non-executive Director	Compass Group plc
Anthony 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 as at the date of this Base Prospectus between the duties of the Directors to HBOS and their private interests or other duties.

#### *Audit Committee*

##### *Membership*

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.

The members of the audit committee of HBOS are Anthony Hobson (Chair), Coline McConville, 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. Mr Ormerod brings industry specific expertise and additional experience, resource and perspective to its deliberations

##### *Attendance at meetings*

In 2007 the Committee met on seven occasions. The Committee invites the Chief Executive, senior executives from the Finance and Risk functions, the Head of Group Internal Audit and the external to attend all of its meetings. Other senior management attend as requested by the 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 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 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 HBOS Group Risk Director, the HBOS Group Finance Director and other key members of senior management as part of the 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 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 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 Omerod, who is neither an HBOS Director nor an employee of the HBOS Group. Mr Omerod 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 its plans. 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' 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 CONSOLIDATED FINANCIAL INFORMATION OF HBOS**

The selected consolidated financial information set forth below has been derived from the audited consolidated annual financial statements and notes thereto of the HBOS Group for the year ended 31 December 2007, which have been prepared in accordance with International Financial Reporting Standards. The consolidated annual financial statements have been audited by KPMG Audit plc, independent auditor.

The following information includes unaudited “underlying” data that management believes assists in assessing the HBOS Group’s financial performance in addition to the “statutory” data considered alone.

The consolidated annual financial statements should not be viewed as a likely indicator of future financial performance.

## SUMMARY CONSOLIDATED INCOME STATEMENT 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 losses 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 associates.....		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
Basic earnings per share – continuing operations .....	106.2p	100.5p
Basic earnings per share – disposal group.....	—p	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.....	—p	0.1p
Diluted earnings per share – total.....	105.5p	99.5p

## SUMMARY CONSOLIDATED BALANCE SHEET DATA OF HBOS

	Year ended 31 December	
	2007	2006
	(in £ millions, except per share)	
Shareholders' Equity		
Issued share capital and share premium.....	4,128	3,995
Reserves .....	17,721	16,690
	21,849	20,685
Shareholders' equity (excluding minority interests).....		
Minority interests (equity) .....	385	486
	22,234	21,171
Shareholders' equity (including minority interests).....		
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)(2)</sup> .....	1.63%	1.72%
Underlying cost: income ratio (underlying operating expenses to underlying net operating income <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 Accord II)</i>		
Tier 1 capital.....	7.7%	
Total capital.....	11.0%	
Total impairment provisions as a percentage of closing advances.....	0.78%	0.82%

(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 components of the underlying cost: income ratio are as follows:

	Year ended 31 December	
	2007	2006
	<b>(in £ millions)</b>	
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 Drive .....	10	(253)
	21,398	22,322
Impairment losses 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
	(£ millions)
<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
	4,685

	As at 31 December 2007
	(€ millions)
Euro Preference Shares (of €1 each) .....	3,000
	3,000

	As at 31 December 2007
	(U.S.\$ millions)
U.S.\$ Preference Shares (of U.S.\$1 each) .....	4,998
6.413% preference shares series "A" (of U.S.\$1 each) .....	1
5.92% preference shares series "B" (of U.S.\$1 each) .....	1
6.657% preference shares (of U.S.\$1 each) .....	1
	5,001

	As at 31 December 2007
	(Aus \$ millions)
Aus \$ Preference Shares (of Aus \$1 each) .....	1,000
	1,000

	<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>
6.475% 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).....	385
Minority interests .....	22,234
Total Shareholders' Equity.....	<u>41,513</u>
Deposits by banks .....	243,221
Customer account.....	22,705
Financial liabilities held for trading .....	12,311
Derivative liabilities.....	881
Notes in circulation .....	26,864
Insurance contract liabilities.....	52,828
Investment contract liabilities.....	1,493
Unallocated surplus.....	347
Net post retirement liabilities .....	2,900
Current tax and deferred tax liabilities .....	5,072
Other liabilities .....	3,630
Accruals and deferred income .....	175
Other provisions .....	206,520
Debt securities in issue .....	24,253
Other borrowed funds <sup>(1)</sup> .....	<u>644,713</u>
Total Indebtedness .....	<u><u>666,947</u></u>
<b>Total Capitalisation and Indebtedness</b> .....	<b>666,947</b>

Note:

(1) Other borrowed funds also include those preference shares which are defined as liabilities: £300 million of 9¼ per cent. Non-cumulative Irredeemable Preference Shares, £100 million of 9¼ per cent. Non-cumulative Irredeemable Preference Shares U.S.\$750 million of 6.413 per cent. Fixed to Floating Rate US\$ Preference Shares Series "A", U.S. \$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. As at 31 December 2007, the HBOS Group had contingent liabilities (including guarantees) of £6,934 million. No account has been taken of intra group guarantees.

On 19 March 2008 HBOS Capital Funding No. 4 L.P. issued £750,000,000 of Fixed to Floating Rate Non-voting Non-cumulative Perpetual Preferred Securities which are guaranteed on a subordinated basis by HBOS plc.

There have been no material changes in the capitalisation, indebtedness and contingent liabilities (including guarantees) of HBOS Group since 31 December 2007, other than those described in the previous two paragraphs and in *Recent Developments*.

## SUMMARY OF THE PRINCIPAL DOCUMENTS

### Trust Deed

The Trust Deed, made between the Issuer, the Guarantor, the Bond Trustee and the Security Trustee on the Programme Date, is the principal agreement governing the Covered Bonds. The Trust Deed contains provisions relating to, *inter alia*:

- the constitution of the Covered Bonds and the terms and conditions of the Covered Bonds (as more fully set out under *Terms and Conditions of the Covered Bonds* above);
- the covenants of the Issuer and the Guarantor;
- the terms of the Group Guarantee and the Covered Bond Guarantee (as described below);
- the enforcement procedures relating to the Covered Bonds and the Guarantees; and
- the appointment, powers and responsibilities of the Bond Trustee and the circumstances in which the Bond Trustee may resign, retire or be removed.

### Group Guarantee

Under the terms of the Group Guarantee, if the Issuer defaults in the payment on the due date of any monies due and payable under or pursuant to the Trust Deed or the Covered Bonds or any Receipts or Coupons, the Group Guarantor has agreed to pay or procure to be paid upon demand the amount in respect of which such default has been made.

The Group Guarantor agrees that its obligations under the Group Guarantee shall be as principal debtor and not merely as surety and shall be absolute and unconditional, irrespective of, and unaffected by, any invalidity, irregularity or unenforceability of, or defect in, any provisions of the Trust Deed or the Covered Bonds or Receipts or Coupons or the absence of any action to enforce the same or the waiver, modification or consent by the Bond Trustee or any of the Covered Bondholders, Receiptholders or Couponholders in respect of any provisions of the same or the obtaining of any judgment or decree against the Issuer or any action to enforce the same or any other circumstances which might otherwise constitute a legal or equitable discharge or defence of a Guarantor.

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

In addition, one Group Guarantor may withdraw its Group Guarantee if the Issuer or any member of the HBOS Group who provides a replacement Group Guarantee as described in the previous paragraph has the Requisite Ratings.

Subject as provided above or in the Transaction Documents, the Group Guarantee will remain in force in relation to each Series of Covered Bonds until all monies payable by the Issuer under or pursuant to the Trust Deed and the Covered Bonds of the relevant Series have been paid.

The Trust Deed also provides that all Excess Proceeds shall be paid by the Bond Trustee on behalf of the Covered Bondholders of the relevant Series to the LLP for its own account, as soon as practicable, and shall be held by the LLP in the relevant GIC Sub-Account and the Excess Proceeds shall thereafter form part of the Security and shall be used by the LLP in the same manner as all other money from time to time standing to the credit of the relevant GIC Sub-Account in accordance with the Guarantee Priority of Payments. Any Excess Proceeds received by the Bond Trustee shall discharge the obligations of the Issuer in respect of the Covered Bonds, Receipts and Coupons and the obligations of the Group Guarantor under the Group Guarantee. However, the obligations of the LLP under the Covered Bond Guarantee are unconditional and irrevocable and the receipt by the Bond Trustee of any Excess Proceeds shall not reduce or discharge any of such obligations.

Each Covered Bondholder shall be deemed to have directed the Bond Trustee to pay the Excess Proceeds to the LLP in the manner as described above.



### ***Covered Bond Guarantee***

Under the terms of the Covered Bond Guarantee, if the Issuer and the Group Guarantor default in the payment on the due date subject to any grace periods of any monies due and payable under or pursuant to the Trust Deed or the Covered Bonds or any Receipts or Coupons or if an LLP Event of Default occurs, the LLP has agreed (subject as described below) on a several basis (as between the Group Guarantor on the one hand and the LLP on the other) to pay or procure to be paid (following the service of a Notice to Pay on the LLP, or, if earlier, the service on the Issuer and the LLP of an LLP Acceleration Notice) unconditionally and irrevocably to or to the order of the Bond Trustee (for the benefit of the Covered Bondholders), an amount equal to that portion of the Guaranteed Amounts which shall become Due for Payment but would otherwise be unpaid, as of any Scheduled Payment Date, by the Issuer or the Group Guarantor.

Service of a Notice to Pay by the Bond Trustee on the LLP will follow (i) the occurrence of an HBOS Event of Default and service of an HBOS Acceleration Notice on the Issuer and the Group Guarantor or (ii) the breach of the Pre-Maturity Liquidity Test if certain actions are not taken within a specified period or the breach of the Asset Coverage Test. However, service of a Notice to Pay under (ii) above will not require the LLP to pay under the Covered Bond Guarantee until an HBOS Event of Default and the service of an HBOS Acceleration Notice have also occurred. Payment by the LLP of the Guaranteed Amounts pursuant to the Covered Bond Guarantee will be made on the later of (a) the day which is two London Business Days following service of a Notice to Pay on the LLP if an HBOS Event of Default has also occurred or (b) the day on which the Guaranteed Amounts are otherwise Due for Payment.

All payments of Guaranteed Amounts by or on behalf of the LLP will be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or other governmental charges of whatever nature, unless the withholding or deduction of such taxes, assessments or other governmental charges are required by law or regulation or administrative practice of any jurisdiction. If any such withholding or deduction is required, the LLP will pay the Guaranteed Amounts net of such withholding or deduction and shall account to the appropriate tax authority for the amount required to be withheld or deducted. The LLP will not be obliged to pay any amount to the Bond Trustee or any holder of Covered Bonds in respect of the amount of such withholding or deduction.

Under the terms of the Covered Bond Guarantee, the LLP has agreed that its obligations under the Covered Bond Guarantee shall be as principal debtor and not merely as surety and shall be absolute and (following the service of a Notice to Pay on the LLP, the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice or, if earlier, service on the Issuer and the LLP of an LLP Acceleration Notice) unconditional, irrespective of, and unaffected by, any invalidity, irregularity or unenforceability of, or defect in, any provisions of the Trust Deed or the Covered Bonds or Receipts or Coupons or the absence of any action to enforce the same or the waiver, modification or consent by the Bond Trustee or any of the Covered Bondholders, Receiptholders or Couponholders in respect of any provisions of the same or the obtaining of any judgment or decree against the Issuer or any action to enforce the same or any other circumstances which might otherwise constitute a legal or equitable discharge or defence of a Guarantor.

Subject to the grace periods in Condition 9(b) of the Conditions failure by the LLP to pay the Guaranteed Amounts when Due for Payment will result in an LLP Event of Default.

For the purposes hereof:

“**Due for Payment**” means the requirements by the LLP to pay any Guaranteed Amounts:

- (a) prior to the occurrence of an LLP Event of Default following the service of a Notice to Pay on the LLP, the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice: on the later of:
  - (i) the date on which the Scheduled Payment Date in respect of such Guaranteed Amounts is reached, or, if later, the day which is two Business Days following service of the Notice to Pay on the LLP in respect of such Guaranteed Amounts or if the applicable Final Terms specified that an Extended Final Maturity Date is applicable to the relevant Series of Covered Bonds, the Interest Payment Date that would have applied if the Final Maturity Date of such Series of Covered Bonds had been the Extended Final Maturity Date or such other Interest Payment Date(s) as specified in the relevant Final Terms (the “**Original Due for Payment Date**”); and

- (ii) in relation to any Guaranteed Amounts in respect of the Final Redemption Amount payable on the Final Maturity Date for a Series of Covered Bonds only, the Extended Final Maturity Date, but only (i) if in respect of the relevant Series of Covered Bonds the Covered Bond Guarantee is subject to an Extended Final Maturity Date pursuant to the terms of the applicable Final Terms and (ii) to the extent that the LLP, having received a Notice to Pay no later than the date falling two Business Days prior to the Extension Determination Date, does not pay Guaranteed Amounts equal to the Final Redemption Amount in respect of such Series of Covered Bonds by the Extension Determination Date, as the LLP has insufficient monies available under the Guarantee Priority of Payments to pay such Guaranteed Amounts in full on the earlier of (a) the date which falls two Business Days after service of such Notice to Pay on the LLP or, if later, the Final Maturity Date (in each case, after the expiry of the grace period set out in Condition 9(b)(i)) under the terms of the Covered Bond Guarantee and (b) the Extension Determination Date,

or if, in either case, such day is not a Business Day, the next following Business Day. For the avoidance of doubt, Due for Payment does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the guaranteed obligations, by reason of prepayment, acceleration of maturity, mandatory or optional redemption or otherwise; or

- (b) following the occurrence of an LLP Event of Default, the date on which the LLP Acceleration Notice is served on the Issuer and the LLP.

“**Guaranteed Amounts**” means, prior to the service of an LLP Acceleration Notice, with respect to any Original Due for Payment Date or, if applicable the Extended Final Maturity Date, the sum of amounts equal to Scheduled Interest and Scheduled Principal, in each case, payable on that Original Due for Payment Date, or, if applicable, the Extended Final Maturity Date or after the service of an LLP Acceleration Notice, an amount equal to the relevant Early Redemption Amount as specified in the Conditions plus all accrued and unpaid interest and all other amounts due and payable in respect of the Covered Bonds, including all Excluded Scheduled Interest Amounts and all Excluded Scheduled Principal Amounts (whenever the same arose) and all amounts payable by the LLP under the Trust Deed **provided that** any Guaranteed Amounts representing interest paid after the Final Maturity Date shall be paid on such dates and at such rates as specified in the relevant Final Terms.

“**London Business Day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

“**Scheduled Interest**” means an amount equal to the amount in respect of interest which would be due and payable under the Covered Bonds on each Interest Payment Date as specified in Condition 4 (*Interest*) falling on or after service of a Notice to Pay on the LLP (but excluding any additional amounts relating to premiums, default interest or interest upon interest (“**Excluded Scheduled Interest Amounts**”) payable by the Issuer following an HBOS Event of Default but including such amounts (whenever the same arose) following an LLP Acceleration Notice) in circumstances where the Covered Bonds had not become due and payable prior to their Final Maturity Date and (if the Final Terms specified that an Extended Final Maturity Date is applicable to the relevant Covered Bonds) if the maturity date of the Covered Bonds had been the Extended Final Maturity Date (but taking into account any principal repaid in respect of such Covered Bonds or any Guaranteed Amounts paid in respect of such principal prior to the Extended Final Maturity Date) or, where applicable, after the Final Maturity Date, such other amount of interest as may be specified in the relevant Final Terms less any additional amounts the Issuer would be obliged to pay as a result of any gross-up in respect of any withholding or deduction made under the circumstances set out in Condition 7 (*Taxation*).

“**Scheduled Payment Date**” means each Interest Payment Date or Final Maturity Date (as applicable) on which Scheduled Interest or Scheduled Principal is due and payable.

“**Scheduled Principal**” means an amount equal to the amount in respect of principal which would be due and payable under the Covered Bonds on each Interest Payment Date or the Final Maturity Date (as the case may be) as specified in Condition 6(a) (*Redemption at Maturity*) and Condition 6(e) (*Instalments*) (but excluding any additional amounts relating to prepayments, early redemption, broken funding indemnities, penalties, premiums or default interest (“**Excluded Scheduled Principal Amounts**”) payable by the Issuer following an HBOS Event of Default but including such amounts (whenever the same arose) following service of an LLP Acceleration Notice) in circumstances where the Covered Bonds had not become due and repayable prior to their Final Maturity Date and, if the

Final Terms specifies that an Extended Final Maturity Date is applicable to the relevant Covered Bonds, if the maturity date of the Covered Bonds had been the Extended Final Maturity Date.

The Trust Deed is governed by English law.

### **Intercompany Loan Agreement**

On each Issue Date, the Issuer will use the proceeds of the Covered Bonds issued under the Programme to lend an amount equal to the Sterling Equivalent of the gross proceeds of the issue of the Covered Bonds to the LLP by way of a term advance (each such term advance, a “**Term Advance**”) pursuant to a term loan agreement dated the Programme Date between the Issuer, the LLP and the Security Trustee (as amended and/or restated from time to time the “**Intercompany Loan Agreement**”). Each Term Advance will be used by the LLP (i) as consideration in part for the acquisition of Loans and their Related Security from a Seller or Sellers pursuant to the terms of the Loan Sale Agreement, as described under – *Loan Sale Agreement – Sale by Sellers of Loans and their Related Security* and/or (ii) to invest in Substitution Assets in an amount not exceeding the prescribed limit and/or (iii) if an existing Series, or part of an existing Series, of Covered Bonds is being refinanced by such issue of Covered Bonds, to repay the Term Advance(s) corresponding to the Covered Bonds being so refinanced and/or (iv) to make a deposit in the Principal GIC Sub-Account and/or (v) subject to written confirmation from the LLP that the Asset Coverage Test is met on the relevant Issue Date (both before and immediately following the making of the relevant Term Advance), to make a Capital Distribution to any Seller (in its capacity as a Member) by way of distribution of that Member’s equity in the LLP in an amount equal to the Term Advance or any part thereof, which is to be paid to the Member on the relevant Issue Date by telegraphic transfer or as otherwise directed by the Member. Each Term Advance will bear interest at a rate of interest equal to LIBOR for three-month Sterling deposits.

The Issuer will not be relying on repayment of any Term Advance in order to meet its repayment obligations under the Covered Bonds. Following payment in full of all amounts outstanding under a Series of Covered Bonds, the LLP will repay the corresponding Term Advances(s) in accordance with the relevant Priorities of Payments. Interest on each Term Advance will be paid by the LLP over the term of that Term Advance. However, the Issuer will not be relying on payment of such interest in order to meet its interest obligations under the Covered Bonds.

The amounts owed by the LLP to the Issuer under the Intercompany Loan Agreement will be reduced by the Sterling Equivalent of any amounts paid by the LLP under the terms of the Covered Bond Guarantee.

The Intercompany Loan Agreement is governed by English law.

### **Loan Sale Agreement**

#### ***Original Seller and New Sellers***

Loans and their Related Security will be sold to the LLP from time to time pursuant to the terms of a Loan sale agreement entered into on the Programme Date between the Original Seller, the LLP and the Security Trustee (as amended and/or restated from time to time, the “**Loan Sale Agreement**”). In addition, any other member of the HBOS Group that wishes to sell Loans and their Related Security (each a “**New Seller**” and, together with the Original Seller, the “**Sellers**”) to the LLP will accede to, *inter alia*, the Loan Sale Agreement. The sale of New Loans and their Related Security by New Sellers to the LLP will be subject to certain conditions, including the following:

- each New Seller acceding to the LLP Deed as a Member (with such subsequent amendments as may be agreed by the parties thereto) so that it has, in relation to those New Loans and their Related Security to be sold by the relevant New Seller, substantially the same rights and obligations as the Original Seller had in relation to those Loans and their Related Security comprised in the Initial Portfolio under the LLP Deed;
- each New Seller acceding to the Loan Sale Agreement (with such subsequent amendments as may be agreed by the parties thereto) so that it has, in relation to those New Loans and their Related Security to be sold by the relevant New Seller, substantially the same rights and obligations as the Original Seller had in relation to those Loans and their Related Security comprised in the Initial Portfolio under the Loan Sale Agreement;
- each New Seller acceding to the Programme Agreement and entering into such other documents as may be required by the Security Trustee and/or the LLP (acting reasonably) to give effect to the addition of a New Seller to the transactions contemplated under the Programme;

- any Loans and their Related Security sold by a New Seller to the LLP complying with the Eligibility Criteria set out in the Loan Sale Agreement;
- the Security Trustee being satisfied that any accession of a New Seller to the Programme will not prejudice the Asset Coverage Test; and
- the Security Trustee being satisfied that the accession of a New Seller to the Programme is not materially prejudicial to Covered Bondholders.

If the above conditions are met, the consent of Covered Bondholders will not be obtained to the accession of a New Seller to the Programme.

For the purposes hereof:

“**Arrears of Interest**” means, in respect of a Loan on a given date, interest which is due and payable and unpaid on that date.

“**Borrower**” means, in relation to a Loan, the housing association or other registered social landlord (which may be a company limited by guarantee or industrial and provident society or trust) specified as such in the relevant Loan Agreement together with any other entity (if any) from time to time assuming an obligation to repay such Loan or any part of it.

“**Current Balance**” means in relation to a Loan at any given date, the aggregate (without double counting) of the Outstanding Principal Balance, Accrued Interest and Arrears of Interest relating to that Loan as at that date.

“**Deferred Consideration**” means the consideration payable to the Sellers in respect of the Loans sold to the LLP from time to time, which is payable after making payments of a higher order of priority as set out in the relevant Priorities of Payments.

“**First Transfer Date**” means the date on which the Initial Portfolio was transferred to the LLP pursuant to the Loan Sale Agreement.

“**Legal Charge**” means a first fixed charge by way of legal mortgage granted by a Borrower pursuant to the terms of a Loan Agreement to or for the benefit of the relevant Seller, and sold by the relevant Seller to the LLP pursuant to the Loan Sale Agreement, which secures the repayment of the relevant Loan.

“**Loan**” means the relevant Seller’s interest (whether as sole lender or as a syndicated lender) in the aggregate of all principal sums and interest and other monies due or owing from time to time (including any Further Advance) to, or for the benefit of, the Seller with respect to that Loan under the terms of the relevant Loan Agreement by a Borrower on the security of a Legal Charge or, as the context may require, the Borrower’s obligations in respect of the same;

“**Loan Agreement**” means, in relation to a Loan, the facility agreement entered into between the relevant Borrower and a Seller, whether syndicated or bilateral, as amended and/or restated from time to time.

“**Related Security**” means, in relation to a Loan, the relevant Seller’s interest (whether as sole lender or as beneficiary of a security trust in relation to a syndicated Loan) in the security created by a Borrower to or for the benefit of the relevant Seller for the repayment of that Loan including the relevant Legal Charge and all other security created by the relevant Borrower over any of its property, rights, title and benefit thereto and all other matters applicable thereto, which can include, but may not be limited to, *inter alia*, (i) a charge over benefits, claims and returns in respect of contracts and policies of insurance relating to the Property, (ii) an assignment of the rights under any contracts and agreements entered into by the Borrower relating thereto and (iii) an assignment of rental income relating thereto;

“**Secured Borrower Property**” means all the assets, rights and property of the Borrower mortgaged or charged in favour of, or assigned to, the security trustee pursuant to the Mortgage Deed, the Debenture or the Supplemental Debenture.

“**Transfer Date**” means the First Transfer Date and the date of transfer of any New Portfolio to the LLP in accordance with the Loan Sale Agreement.

#### ***Sale by Sellers of Loans and Related Security***

The Portfolio consists of Loans and their Related Security sold from time to time by Sellers to the LLP in accordance with the terms of the Loan Sale Agreement. The types of Loans forming part of the Portfolio will vary over time **provided that**, at the time the relevant Loans are sold to the LLP,

the Eligibility Criteria (as described below) in respect of such Loans are met on the relevant Transfer Date.

Prior to the occurrence of an HBOS Event of Default, the LLP will acquire Loans and their Related Security from the Sellers in the three circumstances described below:

- (a) first, in relation to the issue of Covered Bonds from time to time in accordance with the Programme, the Issuer will make Term Advances to the LLP, the proceeds of which may be applied in whole or in part by the LLP to acquire Loans and their Related Security from the Sellers. In exchange for the sale of the Loans and their Related Security to the LLP, the relevant Seller will receive an amount equal to the aggregate of the Current Balance of those Loans sold by it as at the Transfer Date, which will be satisfied by a combination of:
  - (i) a cash payment to be made by the LLP from the proceeds of the relevant Term Advance and/or from Available Principal Receipts; or
  - (ii) a combination of a cash payment and the relevant Seller being treated as having made a Capital Contribution in an amount equal to the difference between the aggregate of the Current Balance of the Loans sold by such Seller as at the relevant Transfer Date and the cash payment (if any) made by the LLP; and/or
  - (iii) Deferred Consideration;
- (b) secondly, the LLP will use the Available Principal Receipts that are specifically attributable to Loans and their Related Security sold by a specific Seller to acquire New Loans and their Related Security from that Seller or any other Seller nominated by that Seller and/or Substitution Assets (in respect of any Substitution Assets up to the prescribed limit) on each LLP Payment Date; and
- (c) thirdly, the LLP and the Sellers are required to ensure that the Portfolio is maintained at all times in compliance with the Asset Coverage Test (as determined by the Cash Manager on each Calculation Date). If on any Calculation Date there is a breach of the Asset Coverage Test, the Sellers will use all reasonable efforts to offer to sell sufficient New Loans and their Related Security to the LLP on or before the next Calculation Date in consideration of the relevant Sellers being treated as having made a Capital Contribution (in an amount equal to the aggregate of the Current Balance of the New Loans) sold by the relevant Seller as at the relevant Transfer Date and in consideration of the right to receive the Deferred Consideration.

If Selected Loans and their Related Security are sold by or on behalf of the LLP as described below under *LLP Deed – Sale or Refinancing of Selected Loans and their Related Security of the Pre-Maturity Liquidity Test or Asset Coverage Test is breached* and *Sale or Refinancing of Selected Loans and their Related Security following service of a Notice to Pay for reasons other than a breach of the Pre-Maturity Liquidity Test or the Asset Coverage Test*, the obligations of the Sellers insofar as they relate to those Selected Loans and their Related Security will cease to apply.

Sellers will also be required to repurchase Loans and their Related Security sold to the LLP in the circumstances described below under – *Repurchase of Loans*.

“**Initial Advance**” means, in respect of any Loan, the original principal amount advanced by the relevant Seller to the relevant Borrower.

“**New Loans**” means Loans, other than the Loans comprised in the Initial Portfolio, which a Seller may assign or transfer to the LLP after the First Transfer Date pursuant to the Loan Sale Agreement.

“**New Portfolio Notice**” means a notice in the form set out in the Loan Sale Agreement served in accordance with the terms of the Loan Sale Agreement.

“**Outstanding Principal Balance**” in relation to a Loan at any date (the “**determination date**”), means the aggregate principal balance of the Loan at such date (but avoiding double counting) including:

- (a) the Initial Advance; and
- (b) any increase in the principal amount due under that Loan due to any form of Further Advance, in each case relating to such Loan less any prepayment, repayment or payment of the foregoing made on or prior to the determination date.

### ***Eligibility Criteria***

The sale of Loans and their Related Security to the LLP will be subject to the following conditions (the “**Eligibility Criteria**”) being satisfied on the relevant Transfer Date or in respect of Further Advances on the next Calculation Date:

- (a) no HBOS Event of Default or LLP Event of Default under the Transaction Documents shall have occurred which is continuing;
- (b) the LLP, acting on the advice of the Cash Manager, is not aware, and could not reasonably be expected to be aware, that the purchase of the Loans and their Related Security, would adversely affect the then current ratings by Moody’s or S&P of the Covered Bonds;
- (c) each of the Borrowers is either (a) registered with the Housing Corporation (or in the case of Borrowers in Wales, with the National Assembly for Wales) as a RSL under the Housing Act or (b) an entity that will lend directly to an entity which is registered as described in (a);
- (d) each Loan is senior, secured and ranks at least *pari passu* and with other debt obligations of the Borrower;
- (e) each Borrower has agreed in its Loan Agreement and in any related hedging agreements entered into with the relevant Seller to waive its right to any set-off or counterclaim against such Seller;
- (f) the Loan Agreement in respect of a Loan does not contain terms which would lead to a termination of such Loan Agreement in the event of the termination of any related hedging agreements;
- (g) the Loan contains a minimum Loan asset cover covenant of 100 per cent. whether the valuation is based on existing use value social housing, assuming continuous re-letting by a social landlord (“**Basis I**”) or on existing use value assuming vacant units are sold to a commercial landlord (“**Basis II – OMV-STT**”) subject to the weighted average Loan Asset Cover Covenant for the Portfolio for both Basis I and Basis II – OMV-STT not being less than 110 per cent. as a result of the acquisition by the LLP of the New Loans;
- (h) the weighted average margin on the Portfolio is not less than 20 basis points as a result of the acquisition by the LLP of the New Loans; and
- (i) the weighted average credit estimates by S&P of the Portfolio as a result of the acquisition by the LLP of the New Loans does not fall below the lower of (i) BBB and (ii) the weighted average credit estimates by S&P of the Portfolio on such date prior to any acquisition.

On the relevant Transfer Date, the Representations and Warranties (described below in – *Representations and Warranties*) will be given by the relevant Seller in respect of the Loans and their Related Security sold by that Seller to the LLP.

The vast majority of Borrowers are not publicly rated by rating agencies. Therefore, in respect of paragraph (i) above, for the purposes of calculating the weighted average credit estimates of the Portfolio on the acquisition by the LLP of each New Loan, such New Loan will be deemed to be assigned an equivalent of the lower of (i) BBB and (ii) the weighted average credit estimates by S&P of the Portfolio on such date prior to any acquisition, unless the Borrower under such Loan has been assigned a specific credit estimates by S&P in which case the relevant specific credit estimates will be used in respect of such Loan. The relevant Original Seller will use reasonable endeavours to provide desk-top data to S&P to enable the assignment of a credit estimates in relation to a Borrower within 60 days of the sale of such Borrower’s New Loan into the Portfolio.

If a Seller accepts an application from or makes an offer (which is accepted) to a Borrower for a Loan Amendment or Further Advance, then if the Eligibility Criteria referred to in paragraphs (g) and (h) above relating to the Loan subject to that Loan Amendment is not satisfied on the next following Calculation Date, the LLP will be entitled to rectify the relevant breach of those Eligibility Criteria by (in the event of a breach of the Eligibility Criteria in paragraphs (g) and (h) above) requiring the relevant Seller to repurchase the Loans subject to any Loan Amendment or Further Advance.

For the purposes hereof:

“**Loan Amendment**” means an amendment to the terms of a Loan as set out in the relevant Loan Agreement.

### ***Transfer of Title to the Loans to the LLP***

Loans have been, and in future will be sold by the relevant Seller to the LLP by way of equitable assignment without notice to the relevant Borrower. As a result, in relation to Loans which are bilateral, legal title to Loans and their Related Security will remain with the relevant Seller until a notice of the sale is given by the relevant Seller to the relevant Borrower. In relation to Loans which are syndicated where an agent or security trustee holds the Related Security for the benefit of the relevant Seller and other lenders, legal title to the Loan will remain with the relevant Seller until a notice of the sale is given by the relevant Seller to the relevant Borrower but notwithstanding any such notice, legal title to the Related Security will remain with such agent or security trustee. The giving of a notice of sale to the relevant Borrower of the Loans and their Related Security (including, where appropriate, in relation to bilateral loans, the registration or recording in the relevant property register of the transfer of the Related Security to the LLP) to the LLP will be deferred and will only take place in the limited circumstances described below.

The giving of a notice of sale which will assign the legal title of the Loans and their Related Security (or, where specified, the Selected Loans and their Related Security) to the LLP will be completed as soon as reasonably practicable and to the extent possible after the earliest of the following:

- (a) the occurrence of an HBOS Event of Default, the service of an HBOS Acceleration Notice and the service on the LLP of a Notice to Pay (unless the relevant Seller or Sellers has or have notified the LLP that it/they will accept the offer set out in the Selected Offer Notice within the prescribed time);
- (b) in respect of Selected Loans only, at the request of the LLP following the acceptance of any offer to sell the Selected Loans and their Related Security to any person who is not a Seller;
- (c) a Seller and/or the LLP being required, by an order of a court of competent jurisdiction, or by a regulatory authority of which the Seller is a member or any organisation whose members comprise, but are not necessarily limited to, lenders to housing associations and other registered social landlords with whose instructions it is customary for the Seller to comply, to perfect legal title to the Legal Charges;
- (d) such actions being rendered necessary by law;
- (e) the Security under the Deed of Charge or any material part of that Security being in jeopardy and the Security Trustee determining or being required by the Bond Trustee (on behalf of the Covered Bondholders) or the other Secured Creditors to take that action to reduce that jeopardy;
- (f) a Seller requesting a transfer by way of assignment by giving notice to the LLP and the Security Trustee;
- (g) the date on which any Seller ceases to be assigned a long-term unsecured, unsubordinated unguaranteed debt obligation rating by Moody's of at least Baa3 or by S&P of at least BBB-; and
- (h) the occurrence of an Insolvency Event in relation to a Seller.

Pending the giving of notice to the relevant Borrower of the sale of the Loan and its Related Security to the LLP, the right of the LLP to give notice to the relevant Borrower of the sale, and, in the case of bilateral Loans, to exercise the powers of the legal owner of the Legal Charges or, in the case of syndicated Loans, in common with the other lenders thereunder to direct the agent thereunder to exercise certain powers in relation to such syndicated Loan and its Related Security, will be secured by an irrevocable power of attorney granted by each Seller in favour of the LLP and the Security Trustee.

The Borrower Files relating to the Loans in the Portfolio will be held by or to the order of the relevant Seller or relevant Servicer, as the case may be, or by solicitors acting for the relevant Seller in connection with the creation of the Loans and their Related Security. The Sellers or relevant Servicer, as the case may be, will undertake that all the Borrower Files relating to the Loans in the Portfolio which are at any time in their possession or under their control or held to their order will be held to the order of the Security Trustee or as the Security Trustee may direct.

For the purposes hereof:

“**Borrower Files**” means the file or files relating to each Loan containing, *inter alia*:

- (a) all material correspondence relating to that Loan; and

- (b) the completed Loan documentation applicable to the Loan including the Valuation Report (if applicable) whether original documentation, electronic form or otherwise or information provided by such documentation stored on an electronic data base.

“**Insolvency Event**” means, in respect of a relevant entity:

- (a) an order is made or an effective resolution passed for the bankruptcy or liquidation or winding up of the relevant entity; or
- (b) the relevant entity ceases to carry on its business or substantially all its business; or
- (c) proceedings shall be initiated against the relevant entity under any applicable liquidation, winding up, insolvency, bankruptcy, composition, reorganisation or other similar laws; or a liquidator, provisional liquidator, administrator, administrative receiver, receiver, receiver or manager, compulsory or interim manager, nominee, supervisor, trustee, conservator, guardian or other similar official shall be appointed in relation to the relevant entity or in relation to the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets or a distress, diligence or execution or other process shall be levied or enforced upon or sued out against the whole or a substantial part (having an aggregate book value in excess of £50,000,000) of its assets and, in any of the foregoing cases, it shall not be discharged within thirty days; or if the relevant entity shall initiate or consent to judicial proceedings relating to itself under any applicable liquidation, winding up, insolvency, bankruptcy, composition, reorganisation or other similar laws or shall make a conveyance, assignment or assignation for the benefit of, or shall enter into any composition with, its creditors generally; or
- (d) the relevant entity shall be unable to pay its debts as they fall due (within the meaning of section 123(1)(b) to (e) and section 123(2) of the Insolvency Act 1986 (as those sections may be amended)) or shall admit inability to pay its debts as they fall due or shall stop payment or shall be adjudged or found bankrupt or insolvent.

“**Lending Criteria**” means the criteria applicable to the granting of an offer of a Loan to a Borrower from time to time, or such other criteria as would be acceptable to a Reasonable Prudent Lender.

“**Property**” means a freehold or leasehold property which is subject to a Legal Charge.

“**Reasonable Prudent Lender**” means the Sellers and/or the Servicers, as applicable, acting in accordance with the standards of a reasonable prudent lender lending to Borrowers in England and/or Wales.

“**Valuation Report**” means the valuation report or reports for lending purposes obtained by a Seller from a Valuer in respect of each Borrower Property or a valuation report in respect of a valuation made using a methodology which would be acceptable to a Reasonable Prudent Lender and which has been approved by the relevant officers of the relevant Seller.

“**Valuer**” means an Associate or Fellow of the Royal Institute of Chartered Surveyors who was at the relevant time either a member of a firm which was on the list of Valuers approved by or on behalf of the relevant Seller from time to time or an Associate or Fellow of the Royal Institute of Chartered Surveyors employed in-house by the relevant Seller acting for the relevant Seller in respect of the valuation of a Property.

### ***Representations and warranties***

Neither the Group Guarantor, the LLP, the Security Trustee, the Bond Trustee nor the Issuer has made or has caused to be made on its behalf any enquiries, searches or investigations in respect of the Loans and their Related Security to be sold to the LLP. Instead, each is relying entirely on the Representations and Warranties by the relevant Seller contained in the Loan Sale Agreement relating to the Loans and the Related Security. The parties to the Loan Sale Agreement may, with the prior written consent of the Security Trustee and if agreed with the Rating Agencies, amend the Representations and Warranties in the Loan Sale Agreement. The material Representations and Warranties are as follows and are given on the relevant Transfer Date in respect of the Loans and Related Security to be sold to the LLP only on that date and on the Calculation Date following the making of any Further Advance or Loan Amendment in respect of the Loan to which the Further Advance or Loan Amendment relates only:

- each Loan was originated or purchased by the relevant Seller;
- since originating or purchasing each relevant Loan, the relevant Seller has administered the relevant Loan, the relevant Loan Agreement and its Related Security acting as a Reasonable Prudent Lender;



- the Relevant Seller has good title to, and is the absolute unencumbered legal and beneficial owner of all property, interests, rights and benefits agreed to be sold and/or assigned by the relevant Seller to the LLP in relation to each Loan and its Related Security;
- the Relevant Seller has not in whole or in part assigned (whether outright or by way of security), transferred, sold, conveyed, discounted, novated, charged, disposed of or dealt with the Loans or their Related Security in any way whatsoever and has not permitted any of the same to be seized, attached or subrogated;
- prior to the making of the initial advance under each Loan, each Seller received from solicitors acting for or approved by it a report on title or a certificate of title or received from a transaction party warranties regarding title relating to the relevant Property comprised in the Initial Portfolio comprising the security for the repayment of the relevant Loan which either initially or after further investigation disclosed nothing concerning such title which would have caused a Reasonable Prudent Lender acting reasonably to decline to proceed with the initial advance on the proposed terms and the relevant Borrower had a good and marketable title to the relevant property free from any Security Interest (other than the Related Security);
- prior to the sale of the Loans and Related Security to the LLP pursuant to the Loan Sale Agreement, each Seller made those enquiries and carried out those procedures so as to satisfy itself as a Reasonable Prudent Lender that there is no restriction against assignment to the LLP pursuant to the Loan Sale Agreement of each Loan and its Related Security or if the relevant Loan Agreement contains any such restriction, the relevant Seller has obtained the written consent of the relevant Borrower and any other persons whose consent is required to such assignment of that Loan Agreement and its Related Security;
- the assignment of the Loans and their Related Security on the relevant Transfer Date pursuant to the Loan Sale Agreement will be effective to transfer full, unencumbered beneficial title to the Loans and their Related Security and the Loan Agreements to the LLP and (other than in the case of certain syndicated Loans) no further act, condition or thing will be required to be done in connection with such assignment in order to enable the LLP to require payment of the amounts due under the Loans to the LLP, to determine the applicable Loan Rates of Interest or to enforce any such right in court, other than the delivery to each relevant Borrower of a Loan Sale Notification Event Notice;
- prior to the sale of the Loans and Related Security to the LLP pursuant to the Loan Sale Agreement, each Seller made those enquiries and carried out those procedures so as to satisfy itself as a Reasonable Prudent Lender that the Current Balance due under each Loan is secured by a first ranking Legal Charge over the relevant Property or Properties;
- the consent, licence, approval or authorisation of any person (other than the Borrowers which was necessary to permit the creation of the security interests in favour of the relevant Seller under the terms of each of the Legal Charges) were obtained including the consent of the Housing Corporation under section 9 of the Housing Act;
- prior to the sale of the Loans and Related Security to the LLP pursuant to the Loan Sale Agreement, each Seller made those enquiries and carried out those procedures so as to satisfy itself as a Reasonable Prudent Lender that each of the Legal Charges in relation to Property which is registered land is registered in accordance with all applicable legal and regulatory requirements;
- prior to the sale of the Loans and Related Security to the LLP pursuant to the Loan Sale Agreement, each Seller made those enquiries and carried out those procedures so as to satisfy itself as a Reasonable Prudent Lender that each Legal Charge made in respect of the Related Security granted by the relevant Borrower constituted a valid and subsisting first charge by way of legal mortgage over the relevant Property;
- interest on each Loan is payable without any deduction or withholding on account of all present taxes, levies, duties (other than stamp duty), imposts, fees, deductions, withholdings or charges of any nature whatsoever and wheresoever imposed, including, without limitation, income tax, corporation tax, VAT or other tax in respect of added value and any franchise, transfer, sales, gross receipts, use, business, occupation, excise, personal property, real property or other tax imposed by any national, local or supranational taxing or fiscal authority or agency together with any penalties, fines or interest thereon;

- the relevant Seller has in all material respects performed all its obligations which have fallen due under or in connection with the relevant Loan Agreements and so far as the relevant Seller is aware, no Borrower has threatened or commenced any legal action which has not been resolved against the relevant Seller for any failure on the part of the relevant Seller to perform any such obligation;
- no proceedings have been taken by the relevant Seller against any Borrower in respect of any Loan Agreement or its Related Security and no judgement debt has been obtained in respect of any Borrower;
- the relevant Seller has not received written notice of any litigation, dispute or complaint subsisting, threatened or pending which affects or might affect any Borrower or any Loan Agreement or its Related Security which may have an adverse effect on the ability of a Borrower to perform its obligations under any Loan Agreement and its Related Security;
- each of the Borrowers is established in England and Wales as either an IPS under the IPS Act or as a company limited by guarantee under the Companies Act or as the incorporated board of trustees of a registered charitable trust and accordingly each of such Borrowers is a “body corporate” for the purposes of Section 78 Finance Act 1986;
- each of the Borrowers is either (a) registered with the Housing Corporation or with the National Assembly for Wales as a RSL under the Housing Act (as the case may be) or (b) an entity that will lend directly to an entity which is registered as described in (a);
- the relevant Seller has not received written notice in relation to each Borrower which is a RSL, that any person has been appointed by the Housing Corporation or the National Assembly for Wales under Schedule 1 paragraph 20 of the Housing Act to conduct an inquiry into the affairs of any of such Borrowers;
- in relation to any Borrower which is an RSL, the relevant Seller has not received written notice in relation to such Borrower that any matters referred to in Section 40 of the Housing Act have occurred and remain subsisting; and
- in relation to any Borrower which is an RSL, the relevant Seller has not received written notice that any Insolvency Event has occurred in relation to such Borrower or the assets or undertaking of such Borrower.

For the purposes hereof:

“**Accrued Interest**” means in relation to any Loan and as at any date (the “**determination date**”) on or after the relevant Transfer Date, interest on such Loan (not being interest which is currently payable on the determination date) which has accrued from and including the Loan Interest Payment Date immediately prior to the determination date and including the determination date.

“**Further Advance**” means, in relation to a Loan, any advance of further money under the relevant Loan Agreement to the relevant Borrower following the making of the Initial Advance.

“**Housing Act**” means the Housing Act 1996 (as amended from time to time).

“**Housing Corporation**” means the statutory body so named established pursuant to the Housing Act 1964.

“**IPS**” means an Industrial and Provident Society established under the IPS Act.

“**IPS Act**” means the Industrial and Provident Societies Act 1965.

“**Loan Interest Payment Date**” means the date on which interest is due to be paid by a Borrower on a Loan or, if any such day is not a business day, the next following business day.

“**Loan Sale Notification Event Notice**” means a notice given by the LLP or the Security Trustee to Borrowers in relation to perfection of the sale of the Loans to the LLP pursuant to the Loan Sale Agreement.

“**Representations and Warranties**” means the representations and warranties set out in Part 3 (*Loan Representations and Warranties of the Sellers*) and Part 4 (*Borrower Representations and Warranties of the Sellers*) of Schedule 1 of the Loan Sale Agreement.

“**RSL**” means a Registered Social Landlord pursuant to the Housing Act;

“**Security Interest**” means any mortgage, sub mortgage, standard security charge, sub-charge, pledge, lien (other than a lien arising in the ordinary course of business or by operation of law), assignation in security or other encumbrance or security interest howsoever created or arising.

“**Tenancy Agreements**” means the agreement or agreements entered into between a Borrower and the tenant or tenants of a Property owned by such Borrower.

#### ***Repurchase of Loans***

If the Seller receives a notice from the Cash Manager identifying a Loan or its Related Security in the Portfolio which does not, as at the relevant Transfer Date or relevant Calculation Date, materially comply with the Representations and Warranties set out in the Loan Sale Agreement, then the Seller will be required to repurchase any such Loan. The repurchase price payable on the repurchase of any Loan is an amount (not less than zero) equal to the Current Balance thereof as at the relevant repurchase date. The repurchase proceeds received by the LLP will be applied (other than Accrued Interest and Arrears of Interest) in accordance with the relevant Pre-Acceleration Principal Priority of Payments (see *Cashflows* below).

If the Seller does not repurchase these Loans and their Related Security which are in breach of the Representations and Warranties within 60 days of receiving notification from the Cash Manager then the aggregate of the Current Balance of those Loans will be excluded from any calculation of the Asset Coverage Test.

#### ***Defaulted Loans***

If a Seller receives a notice from the Cash Manager (the “**Defaulted Loans Notice**”) identifying a Loan or its Related Security in the Portfolio which (each a “**Defaulted Loan**”) is more than 60 days in arrears, then that Defaulted Loan will be excluded from any calculation of the Asset Coverage Test and the Amortisation Test as at the relevant Calculation Date. In addition, the Seller may, at its option, repurchase a Defaulted Loan for an amount equal to the aggregate of the Current Balance as at the date of repurchase.

#### ***Right of Pre-emption***

Under the terms of the Loan Sale Agreement, each Seller has a right of pre-emption in respect of any sale, in whole or in part, of Selected Loans and their Related Security.

The LLP will serve on the Sellers a notice offering to sell those Selected Loans and their Related Security which each Seller has previously sold to the LLP (or, to such other Seller nominated by the relevant Seller) for an offer price equal to the greater of the aggregate of the Current Balance on the then Selected Loans and the Adjusted Required Redemption Amount (as defined below under *Method of Sale or Refinancing of Selected Loans and their Related Security*), subject to the offer being accepted by the Sellers within ten London Business Days (a “**Selected Offer Notice**”). If all of the Sellers reject or fail to accept the LLP’s offer, the LLP will offer to sell the Selected Loans and their Related Security to Purchasers (as described under – *LLP Deed – Sale of Selected Loans and their Related Security if the Pre-Maturity Liquidity Test or Asset Coverage Test is breached and, Sale or refinancing of Selected Loans in the Portfolio following Service of a Notice to Pay for reasons other than for a breach of the Pre-Maturity Liquidity Test or the Asset Coverage Test*, below).

If any of the Sellers validly accepts the LLP’s offer to sell the Selected Loans and their Related Security, the LLP will, within three London Business Days of such acceptance, serve a further notice on the relevant Seller or Sellers (a “**Selected Loan Repurchase Notice**”). The relevant Seller or Sellers will sign and return a duplicate copy of the Selected Loan Repurchase Notice and will repurchase from the LLP free from the Security created by and pursuant to the Deed of Charge the relevant Selected Loans and their Related Security (and any other Loan secured or intended to be secured by that Related Security or any part of it) referred to in the relevant Selected Loan Repurchase Notice. Completion of the purchase of the Selected Loans and their Related Security by a Seller will take place on the LLP Payment Date after receipt of the Selected Loans Repurchase Notice(s) or such date as the LLP may direct in the Selected Loans Repurchase Notice (**provided that** such date is not later than the earlier to occur of the date which is (a) 10 London Business Days after returning the Selected Loan Repurchase Notice to the LLP and (b) (prior to the occurrence of an LLP Event of Default) the Final Maturity Date or, as applicable, the Extended Final Maturity Date, of the Earliest Maturing Covered Bonds).

“**Purchaser**” means any third party or any Seller to whom the LLP offers to sell Selected Loans.

“**Required Redemption Amount**” means in respect of any relevant Series of Covered Bonds, the amount calculated as follows:

the Principal Amount Outstanding of the relevant Series of Covered Bonds	$1 + (((0.25 \text{ per cent. plus the Weighted Average Swap Margin}) 98 \text{ per cent.}) (\text{days to maturity of the relevant Series of Covered Bonds} / 365.25))$
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“**Selected Loans**” means Loans and their Related Security to be sold by the LLP pursuant to the terms of the LLP Deed.

#### ***Governing law***

The Loan Sale Agreement is governed by English law.

#### ***Servicing Agreements***

Pursuant to the terms of the servicing agreements entered into on the Programme Date between the LLP, the Security Trustee and (i) Bank of Scotland (in its capacity as servicer, the “**Original Servicer**”) (the “**Original Servicing Agreement**”), the Original Servicer has agreed to service on behalf of the LLP the Loans and their Related Security sold by Bank of Scotland in its capacity as Original Seller to the LLP and certain of the New Loans and their Related Security sold by New Sellers to the LLP, unless any New Seller and each Original Servicer agree that such New Seller shall act as servicer in relation to Loans and their Related Security sold by such New Seller to the LLP (as described below).

If it is agreed that the New Seller will service, on behalf of the LLP, the New Loans and their Related Security sold by such New Seller to the LLP then a servicing agreement will be entered into between such New Seller (in its capacity as servicer, the “**New Servicer**” and, together with the Original Servicer and any other New Servicer, a “**Servicer**”), the LLP and the Security Trustee on substantially the same terms as the Original Servicing Agreement so that each New Servicer has substantially the same rights and obligations as the Original Servicer (each a “**New Servicing Agreement**” and, together with the Original Servicing Agreement, a “**Servicing Agreement**”).

Each Servicer will be required to administer the Loans in accordance with the relevant Servicing Agreement and:

- (i) in the case of the Original Servicer, as if it were the beneficial owner of the Loans and their Related Security sold by the Original Seller to the LLP or, in relation to New Loans and their Related Security sold by New Sellers (where the Original Servicer has agreed to service such New Loans and their Related Security), as if it were the beneficial owner of such New Loans and their Related Security sold by such New Seller to the LLP;
- (ii) in the case of any New Servicer, as if the New Loans and their Related Security sold by the relevant New Sellers to the LLP (where the New Servicer has agreed to service such New Loans and their Related Security) had not been sold to the LLP but remained with the relevant New Seller; and
- (iii) in the case of each Servicer, in accordance with the relevant Seller’s procedures and administration and enforcement policies as they apply to those Loans.

Each Servicer’s actions in servicing the Loans in accordance with its procedures will be binding on the LLP and the Secured Creditors.

Each Servicer will have the power to exercise the rights, powers and discretions and to perform the duties of the LLP in relation to the Loans and their Related Security that it is servicing pursuant to the terms of the relevant Servicing Agreement, and to do anything which it reasonably considers necessary or convenient or incidental to the administration of those Loans and their Related Security.

#### ***Undertakings of the Servicer***

Pursuant to the terms of the relevant Servicing Agreement, the relevant Servicer has undertaken in relation to those Loans and their Related Security that it is servicing, *inter alia*, to:

- keep records and accounts on behalf of the LLP in relation to the Loans;
- keep the Borrower Files in its possession in safe custody and maintain records necessary to enforce each Legal Charge and to provide the LLP and the Security Trustee with access to the Title Deeds and other records relating to the administration of the Loans and their Related Security;
- maintain a register in respect of the Portfolio;
- make available to the LLP and the Security Trustee a report on a quarterly basis containing information about the Loans and their Related Security comprised in the Portfolio;
- if the long-term credit rating of a Seller falls below A by S&P or A2 by Moody’s ensure that the obligations to value the Property under each Loan Agreement in respect of Loans sold by such Seller are satisfied;

- assist the Cash Manager in the preparation of a quarterly asset coverage report in accordance with the Cash Management Agreement;
- provide on a timely basis to the Rating Agencies all information on the Borrowers and the Loan Agreements which is reasonably required in order for the Rating Agencies to be able to establish their credit estimates on Borrowers;
- take all reasonable steps, in accordance with the usual procedures undertaken by a Reasonable Prudent Lender, to recover all sums due to the LLP, including instituting proceedings and enforcing any relevant Loan or Legal Charge; and

to enforce any Loan which is in default in accordance with the relevant Seller's enforcement procedures for bilateral or syndicated Loans or, to the extent that such enforcement procedures are not applicable having regard to the nature of the default in question, or the requirements of the relevant Loan Agreement, with the usual procedures undertaken by a Reasonable Prudent Lender acting on behalf of the LLP.

The Servicer has also undertaken that, on the Servicer ceasing to be assigned a long-term unsecured, unguaranteed and unsubordinated debt obligation rating by Moody's of at least Baa3 or by S&P of at least BBB-, it will use reasonable efforts to enter into a master servicing agreement with a third party within 60 days.

#### *Compensation*

The LLP will pay to the Original Servicer a nominal servicing fee per annum (inclusive of VAT) in accordance with the Original Servicing Agreement. Fees payable to New Servicers and/or the Original Servicer acting as Servicer in respect of Loans sold by New Sellers to the LLP will be determined on the date that they accede to the Programme.

#### *Removal or resignation of the Servicer*

The LLP and the Security Trustee may, upon written notice to the relevant Servicer, terminate the relevant Servicer's rights and obligations immediately if any of the following events (each a "**Servicer Termination Event**") and, in relation to the first three events set out below, a "**Servicer Event of Default**") occurs:

- the relevant Servicer defaults in the payment of any amount due to the LLP under the relevant Servicing Agreement and fails to remedy that default for a period of three London Business Days after the earlier of the Servicer becoming aware of such default and receipt by the Servicer of written notice from the LLP and the Security Trustee requiring the same to be remedied;
- the relevant Servicer fails to comply with any of its other obligations under the Servicing Agreement which failure in the opinion of the Security Trustee is materially prejudicial to Covered Bondholders and does not remedy that failure within 20 London Business Days after the earlier of the Servicer becoming aware of such default and receipt by the Servicer of written notice from the LLP and the Security Trustee requiring the same to be remedied;
- an Insolvency Event occurs in relation to the relevant Servicer; or
- the LLP resolves that the appointment of the relevant Servicer should be terminated.

Subject to the fulfilment of a number of conditions, a Servicer may voluntarily resign by giving not less than 12 months' notice to the Security Trustee and the LLP **provided that** a substitute servicer with a management team with experience of administering Loans to housing associations or other registered social landlords in the United Kingdom has been appointed and enters into a servicing agreement with the LLP substantially on the same terms as the Original Servicing Agreement. The resignation of a Servicer is conditional on the resignation having no adverse effect on the then current ratings of the Covered Bonds unless the Covered Bondholders agree otherwise by Extraordinary Resolution.

If the appointment of a Servicer is terminated, the relevant Servicer must deliver the Borrower Files relating to the Loans administered by it to, or at the direction of, the LLP.

The relevant Servicing Agreement will terminate at such time as the LLP has no further interest in any of the Loans or their Related Security sold to the LLP and serviced under the relevant Servicing Agreement that have been comprised in the Portfolio.

A Servicer may sub-contract or delegate the performance of its duties under the Servicing Agreement **provided that** it meets conditions as set out in the relevant Servicing Agreement.

Neither the Bond Trustee nor the Security Trustee are obliged to act as Servicer in any circumstances.

#### *Governing Law*

The Servicing Agreement is governed by English law.

#### **Asset Monitor Agreement**

Under the terms of an asset monitor agreement entered into on the Programme Date between KPMG Audit Plc (the “**Asset Monitor**”), the LLP, the Cash Manager and the Security Trustee (the “**Asset Monitor Agreement**”), the Asset Monitor has agreed, subject to due receipt of the information to be provided by the Cash Manager to the Asset Monitor, to conduct tests in respect of the calculations performed by the Cash Manager on the Calculation Date immediately preceding each anniversary of the Programme Date with a view to confirmation of compliance by the LLP with the Asset Coverage Test on that Calculation Date if such date falls prior to the service of a Notice to Pay on the LLP. Following service of such notice, the Asset Monitor will be required to test the calculations performed by the Cash Manager in respect of the Amortisation Test on each Calculation Date.

If the long-term ratings of the Cash Manager or the Issuer (or for such time as the Issuer is not, as of the date thereof, independently rated, the higher of the ratings of each Group Guarantor (such higher ratings, the “**Deemed Ratings**”)) fall below BBB- and Baa3 (by S&P and Moody’s, respectively) the Asset Monitor will be required to conduct such tests following each Calculation Date and, following a determination by the Asset Monitor of any material errors in the calculations performed by the Cash Manager such that the Asset Coverage Test has been failed on the applicable Calculation Date (where the Cash Manager had recorded it as being satisfied) or the Adjusted Aggregate Loan Amount or the Amortisation Test Aggregate Loan Amount is misstated by an amount exceeding 1 per cent. of the Adjusted Aggregate Loan Amount or the Amortisation Test Aggregate Loan Amount, as applicable, (as at the date of the relevant Asset Coverage Test or the relevant Amortisation Test), the Asset Monitor will be required to conduct the tests in respect of the calculations performed by the Cash Manager following each Calculation Date over four successive Calculation Dates.

The Asset Monitor is entitled, in the absence of manifest error, to assume that all information provided to it by the Cash Manager for the purpose of conducting such tests is true and correct and not misleading, and is not required to conduct a test or otherwise take steps to verify the accuracy of any such information. The results of the tests conducted by the Asset Monitor will be delivered to the Cash Manager, the LLP, the Issuer, the Bond Trustee, the Security Trustee and the Rating Agencies (the “**Asset Monitor Report**”).

Under the terms of the Asset Monitor Agreement the LLP pays to the Asset Monitor a maximum annual fee including any expenses or outlays of £2,850 per test (inclusive of VAT) for the tests performed by the Asset Monitor.

The LLP may, at any time, but subject to the prior written consent of the Security Trustee, terminate the appointment of the Asset Monitor by providing at least 30 days’ prior written notice to the Asset Monitor, **provided that** such termination may not be effected unless and until a replacement asset monitor has been found by the LLP (such replacement to be approved by the Security Trustee if the replacement is an accountancy firm of national standing) which agrees to perform the duties (or substantially similar duties) of the Asset Monitor set out in the Asset Monitor Agreement.

The Asset Monitor may, at any time, resign by giving at least 60 days’ prior written notice to the LLP and the Security Trustee (with a copy to the Rating Agencies), **provided that** such resignation will not take effect unless and until a replacement has been found by the LLP (such replacement to be approved by the Security Trustee if the replacement is an accountancy firm of national standing) which agrees to perform the duties (or substantially similar duties) of the Asset Monitor set out in the Asset Monitor Agreement.

If a replacement asset monitor has not been found by the LLP within 60 days of notice of termination by the LLP or notice of resignation by the Asset Monitor, the Asset Monitor may identify a replacement (such replacement to be approved by the Security Trustee, if the replacement is an accountancy firm of national standing) which agrees to perform the duties of the Asset Monitor set out in the Asset Monitor Agreement.

Neither the Bond Trustee nor the Security Trustee will be obliged to act as Asset Monitor in any circumstances.

The Asset Monitor Agreement contains a cap of £1,000,000 on liability of the Asset Monitor to either the LLP or the Security Trustee in relation to claims against the Asset Monitor in respect of the duties undertaken by the Asset Monitor in the Asset Monitor Agreement.

The Asset Monitor Agreement is governed by English law.

### **LLP Deed**

The Members of the limited liability partnership incorporated under the name HBOS Social Housing Covered Bonds LLP (the “**LLP**”) have agreed to operate the business of the LLP in accordance with the terms of a limited liability partnership deed to be entered into on the Programme Date between the LLP, the Original Seller, the Issuer, the Liquidation Member, the Bond Trustee and the Security Trustee (as amended and/or restated from time to time, the “**LLP Deed**”).

### **Members**

As of the Consolidation Date, Bank of Scotland and the Liquidation Member were members (each a “**Member**”, and together with any other members from time to time, the “**Members**”) of the LLP. Bank of Scotland and the Liquidation Member are also the designated members (each a “**Designated Member**”, and together with any other designated members from time to time, the “**Designated Members**”) of the LLP. The Designated Members have such duties as are specified in the LLPA 2000 or otherwise at law and in the LLP Deed. The LLP Deed requires there will at all times be at least two Designated Members of the LLP.

Save as set out below, any Member admitted to the LLP after the Programme Date (a “**New Member**”) must be a Seller and accede to the Loan Sale Agreement. In the event that an administrator or a liquidator is appointed in respect of Bank of Scotland and for so long as Covered Bonds are outstanding, if an administrator or a liquidator is appointed to Bank of Scotland, the Liquidation Member may, by written notice to the LLP, appoint another Member as a Designated Member or may, at its sole discretion (acting on behalf of itself and the other Members), admit a New Member to the LLP (in each case with the prior written consent of the Security Trustee). A New Member admitted in these circumstances will not be required to be a Seller or to accede to the terms of the Loan Sale Agreement.

### **Capital Contributions**

A sale of Loans and their Related Security by a Seller to the LLP will constitute a Capital Contribution in Kind by the relevant Seller of those Loans in an amount equal to (a) the aggregate of the Current Balance of those Loans as at the relevant Transfer Date minus (b) any cash payment paid by or on behalf of the LLP for the Loans and their Related Security on that Transfer Date. Any increase in the Outstanding Principal Balance of a Loan due to a Seller making a Further Advance to a Borrower will constitute a Capital Contribution in Kind by the relevant Seller (in its capacity as a Member) in respect of that Loan in an amount equal to the relevant increase minus any cash payment paid by or on behalf of the LLP for such Further Advance and its Related Security on that Transfer Date.

If so requested by the Management Committee, the Members may from time to time make cash contributions to the LLP which will constitute Cash Capital Contributions.

The Liquidation Member will not make any Capital Contributions to the LLP.

### **Calculation of Capital Contributions**

The Capital Contributions made or deemed to be made by each Member (the “**relevant Member**”) from time to time will be credited to that Member’s Capital Account Ledger and Capital Distributions will be debited to the relevant Member’s Capital Account Ledger. The Capital Contribution Balance of each Member shall represent that Member’s interest in the capital of the LLP. Any increase or decrease in the Capital Contribution Balance of a Member shall be recorded to that Member’s Capital Account Ledger on each Calculation Date.

On each Calculation Date (the “**relevant Calculation Date**”) or the date that the LLP is wound up, the Capital Contribution Balance of each Member in respect of the immediately preceding Calculation Period will be recalculated. The Capital Contribution Balance of each Member will be an amount calculated in Sterling (and to the extent that any amount is denominated in a currency other than Sterling, converted into Sterling at the relevant Covered Bond Swap Rate) as follows:

$$A - B - C + D$$

Where,

A = the Capital Contribution Balance of the relevant Member on the immediately preceding Calculation Date (or in the case of the first Calculation Date in relation to that Member, the Opening Capital Contribution Balance of that Member);

B = the amount of any Capital Distribution to be paid to the relevant Member on the next following LLP Payment Date;

C = the amount of any Losses on the Loans in the immediately preceding Calculation Period that are attributable to Loans sold in return for a Capital Contribution in Kind by the relevant Member to the LLP and which have not been or will not be repurchased by the relevant Member on or before the next following LLP Payment Date; and

D = any Capital Contribution made by the relevant Member to the LLP in the immediately preceding Calculation Period.

For the purposes hereof:

“**Calculation Date**” means the 15th day of each of March, June, September and December (or, if such day is not a London Business Day, then the immediately preceding London Business Day).

“**Calculation Period**” means each period (i) from and including 1 December to and including 28 February (or 29 February in a leap year) **provided that** the first Calculation Period shall be from and including the Issue Date to and including 28 February 2005; (ii) from and including 1 March to and including 31 May; (iii) from and including 1 June to and including 31 August and (iv) from and including 1 September to and including 30 November.

“**Capital Account Ledger**” means the ledger maintained by the Cash Manager on behalf of the LLP in respect of each Member to record the balance of each Member’s Capital Contributions from time to time.

“**Capital Contribution**” means in relation to each Member, the aggregate of the capital contributed by that Member to the LLP from time to time by way of Cash Capital Contributions and Capital Contributions in Kind as determined on each Calculation Date in accordance with the formula set out in the LLP Deed.

“**Capital Contribution Balance**” means the balance of each Member’s Capital Contributions as recorded from time to time in the relevant Member’s Capital Account.

“**Capital Contribution in Kind**” means a contribution of Loans and their Related Security to the LLP in an amount equal to (a) the aggregate Current Balance of those Loans as at the relevant Transfer Date minus (b) any cash payment paid by or on behalf of the LLP for the Loans and their Related Security on that Transfer Date.

“**Capital Distribution**” means any return on a Member’s Capital Contribution in accordance with the terms of the LLP Deed (and excluding, for the avoidance of doubt, any Deferred Consideration).

“**Cash Capital Contributions**” means a Capital Contribution made in cash.

“**LLP Payment Date**” means the 20th day of each of March, June, September and December or if not a Business Day the next following Business Day.

“**Opening Capital Contribution Balance**” means the Capital Contribution Balance of each Member on the Programme Date and, in the case of New Members, on the date any such New Member is admitted to the LLP in accordance with the LLP Deed.

The Original Seller and each other Member have agreed that they will amend the calculation above if Capital Contributions are made or deemed made by Members other than the Original Seller.

#### ***Asset Coverage Test***

Under the terms of the LLP Deed, the LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date, the Adjusted Aggregate Loan Amount is in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date (the “**Asset Coverage Test**”).

If on any Calculation Date the Adjusted Aggregate Loan Amount is less than the aggregate Principal Amount Outstanding of all Covered Bonds as calculated on the relevant Calculation Date, then the LLP (or the Cash Manager on its behalf) will notify the Members thereof and the Members (other than the Liquidation Member) will use all reasonable endeavours to sell sufficient further Loans and



their Related Security to the LLP in accordance with the Loan Sale Agreement (see *Summary of the Principal Documents – Loan Sale Agreement – Sale by Sellers of Loans and their Related Security*) or provide Cash Capital Contributions to ensure that the Asset Coverage Test is met on the next following Calculation Date. If the Adjusted Aggregate Loan Amount is less than the aggregate Principal Amount Outstanding of all Covered Bonds on the next following Calculation Date, the Asset Coverage Test will be breached and the Bond Trustee will serve a Notice to Pay on the LLP. Following service of a Notice to Pay in these circumstances, the LLP will be required to sell or refinance Selected Loans, see further – *Summary of Principal Documents – LLP Deed – Sale or Refinancing of Selected Loans and their Related Security if the Pre-Maturity Test or Asset Coverage Test is breached*.

For the purposes hereof:

“**Adjusted Aggregate Loan Amount**” means the amount calculated on each Calculation Date as follows:

$$A + B + C + D + E - X$$

where,

A = the aggregate of the Current Balance of the Loans in the Portfolio as at the relevant Calculation Date

*minus*

the aggregate sum of the following deemed reductions to the aggregate of the Current Balance of the Loans in the Portfolio if any of the following occurred during the previous Calculation Period:

- (1) a Loan or its Related Security is, in the immediately preceding Calculation Period, in breach of the Representations and Warranties contained in the Loan Sale Agreement or subject to any other obligation of a Seller to repurchase the relevant Loan and its Related Security, and in each case the relevant Seller has not repurchased the Loan or Loans and their Related Security to the extent required by the terms of the Loan Sale Agreement. In this event, the aggregate of the Current Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the aggregate of the Current Balance of the relevant Loan or Loans (as calculated on the relevant Calculation Date); and/or
- (2) a Seller, in any preceding Calculation Period, was in breach of any other material warranty under the Loan Sale Agreement and/or a Servicer was, in the immediately preceding Calculation Period, in breach of a material term of a Servicing Agreement. In this event, the aggregate of the Current Balance of the Loans in the Portfolio (as calculated on the relevant Calculation Date) will be deemed to be reduced by an amount equal to the resulting financial loss incurred by the LLP in the immediately preceding Calculation Period (such financial loss to be calculated without double counting); and/or
- (3) a Loan is a Defaulted Loan on such Calculation Date;

*the result of which is multiplied by* the Asset Percentage (as defined below);

B = the amount of any Principal Receipts on the Loans in the Portfolio up to the end of the immediately preceding Calculation Period (as recorded in the Principal Ledger) which have not been applied as at the relevant Calculation Date to acquire further Loans and their Related Security or otherwise applied in accordance with the LLP Deed and/or the other Transaction Documents;

C = the amount of any Cash Capital Contributions made by the Members (as recorded in the Capital Account Ledger of each Member) or proceeds of Term Advances which have not been applied as at the relevant Calculation Date to acquire further Loans and their Related Security or otherwise applied in accordance with the LLP Deed and/or the other Transaction Documents;

D = the outstanding principal balance of any Substitution Assets or, if any Substitution Assets have a maturity greater than one year, the mark-to-market value of such Substitution Assets on that date;

E = the amount of any Sale Proceeds standing to the credit of the Liquidation GIC Sub-Accounts as at the relevant Calculation Date; and

X = the weighted average remaining maturity of all Covered Bonds then outstanding *multiplied by* the Sterling Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds *multiplied by* (0.25 per cent. plus the then Weighted Average Swap Margin) *multiplied by* 98 per cent.

“**Asset Percentage**” means a percentage figure as determined from time to time in accordance with the terms of the LLP Deed and will be equal to 100 per cent. less the level of credit enhancement (“**Credit Enhancement**”) required for the Loans in the Portfolio on the Calculation Date falling in March, June, September and December of each year. Such calculations will be made by the LLP (or the Cash Manager on its behalf) on the same basis throughout unless agreed otherwise by the Rating Agencies.

Save where otherwise agreed with the Rating Agencies, the Asset Percentage will be adjusted in accordance with the model’s process to ensure that sufficient Credit Enhancement is maintained.

“**Weighted Average Swap Margin**” means the swap margin, if any, that the LLP will pay in relation to each Series above LIBOR for three-month Sterling deposits to the Covered Bond Swap Provider.

#### ***Amortisation Test***

The LLP and the Members (other than the Liquidation Member) must ensure that on each Calculation Date following service of a Notice to Pay on the LLP (but prior to service of an LLP Acceleration Notice) the Amortisation Test Aggregate Loan Amount will be in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date (the “**Amortisation Test**”).

Following the service of a Notice to Pay on the LLP, if on any Calculation Date the Amortisation Test Aggregate Loan Amount is less than the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date, then the Amortisation Test will be breached and an LLP Event of Default will occur. The LLP or the Cash Manager, as the case may be, will immediately notify the Members, the Security Trustee and (whilst Covered Bonds are outstanding) the Bond Trustee of any breach of the Amortisation Test.

The “**Amortisation Test Aggregate Loan Amount**” will be calculated on each Calculation Date as follows:

$$A + B + C - X$$

where,

A = the aggregate “**Amortisation Test Balance**” of each Loan, which shall be the aggregate of the Current Balance of the relevant Loan as calculated on the relevant Calculation Date multiplied by M,

where for all the Loans that are less than 60 days in arrears M = 1 or for all the Loans that are 60 days or more in arrears M = 0.3

B = the amount of any cash standing to the credit of the GIC Sub-Accounts and the principal amount of any Authorised Investments (excluding any Revenue Receipts received in the immediately preceding Calculation Period);

C = the outstanding principal balance of any Substitution Assets or, if any Substitution Assets have a maturity of greater than one year, the mark-to-market value of such Substitution Assets on that date; and

X = the weighted average remaining maturity of all Covered Bonds then outstanding *multiplied by* the Sterling Equivalent of the aggregate Principal Amount Outstanding of the Covered Bonds *multiplied by* (0.25 per cent. plus the then Weighted Average Swap Margin) *multiplied by* 98 per cent.

#### ***Sale or Refinancing of Selected Loans and their Related Security if the Pre-Maturity Liquidity Test or Asset Coverage Test is breached***

The LLP Deed provides for the sale or refinancing of Selected Loans and their Related Security in circumstances where the Pre-Maturity Liquidity Test or the Asset Coverage Test has been breached. The Pre-Maturity Liquidity Test will be breached if the ratings or Deemed Ratings, as applicable, of the Issuer fall below a specified level and a Series of Covered Bonds is due for repayment within a specified period of time thereafter (see further *Credit Structure – Pre-Maturity Liquidity below*). The Asset Coverage Test will be breached if the Adjusted Aggregate Loan Amount is less than the aggregate Principal Amount Outstanding of all Covered Bonds on two consecutive Calculation Dates.

In each case the LLP will be obliged to sell or refinance the Selected Loans and their Related Security to Purchasers, subject to the rights of pre-emption enjoyed by the Sellers to buy the Selected Loans and their Related Security pursuant to the terms of the Loan Sale Agreement, in accordance with the procedure summarised in – *Method of Sale or Refinancing of Selected Loans and their Related Security* below and subject to any Cash Capital Contribution made by the Members. If the Issuer and the Group Guarantor fail to repay any Series of Covered Bonds on the Final Maturity Date thereof, then the proceeds from any sale or refinancing of Selected Loans or the Cash Capital Contributions standing to the credit of the relevant ledger of the Liquidation GIC Sub-Account will be applied to repay the relevant Series of Covered Bonds. Otherwise, the proceeds will be applied as set out in Credit Structure below.

***Sale or refinancing of Selected Loans and their Related Security following service of a Notice to Pay for reasons other than a breach of the Pre-Maturity Liquidity Test or the Asset Coverage Test***

After a Notice to Pay has been served on the LLP following the occurrence of an HBOS Event of Default, but prior to service of an LLP Acceleration Notice, the LLP will be obliged to sell or refinance Selected Loans and their Related Security in the Portfolio in accordance with the LLP Deed (as described below), subject to the rights of pre-emption enjoyed by the Sellers to buy the Selected Loans and their Related Security pursuant to the Loan Sale Agreement. The proceeds from any such sale or refinancing will be credited to the relevant GIC Sub-Account and applied as set out in the Guarantee Priority of Payments.

***Method of Sale or Refinancing of Selected Loans and their Related Security***

If the LLP is required to sell or refinance Selected Loans and their Related Security to Purchasers following a breach of the Pre-Maturity Liquidity Test or a breach of the Asset Coverage Test or the occurrence of an HBOS Event of Default (but prior to the service of an LLP Acceleration Notice), the LLP will be required to ensure that before offering Selected Loans for sale the Selected Loans from the Portfolio have an aggregate Current Balance in an amount (the “**Required Current Balance Account**”) which is at least equal to the amount calculated as follows:

$$N \times \frac{\text{Aggregate of the Current Balance of all the Loans in the Portfolio}}{\text{of the Adjusted Required Redemption Amount in respect of each Series of Covered Bonds then outstanding}}$$

where N is an amount equal to the Sterling Equivalent of:

- (i) in respect of Selected Loans being sold following a breach of the Pre-Maturity Liquidity Test or the Asset Coverage Test, the Required Redemption Amount of the relevant Series of Covered Bonds less amounts standing to the credit of the relevant Liquidation GIC Sub-Account that are not otherwise required to provide liquidity for any Series of Covered Bonds which mature prior to or on the same date as the relevant series of Covered Bonds; or
- (ii) in respect of Selected Loans being sold following service of a Notice to Pay for any other reason, the Required Redemption Amount of the Earliest Maturing Covered Bonds less amounts standing to the credit of the relevant GIC Sub-Accounts and the principal amount of any Authorised Investments (excluding all amounts to be applied on the next following LLP Payment Date to repay higher ranking amounts in the Guarantee Priority of Payments and those amounts that are required to repay any Series of Covered Bonds which mature prior to or on the same date as the relevant Series of Covered Bonds).

The LLP will (i) offer the Selected Loans and their Related Security for sale to Purchasers for the best price reasonably available or (ii) seek to refinance the Selected Loans on the best terms reasonably available, but, in each case, in any event for an amount not less than the Adjusted Required Redemption Amount. The “**Adjusted Required Redemption Amount**” means, the Required Redemption Amount, plus or minus any swap termination amounts payable to or by the LLP in respect of the relevant Series of Covered Bonds less (where applicable):

- (i) amounts standing to the credit of the relevant Liquidation GIC Sub-Accounts; or
- (ii) amounts standing to the credit of the relevant GIC Sub-Accounts and the principal balance of any Authorised Investments (excluding all amounts to be applied on the next following LLP Payment Date to repay higher ranking amounts in the Guarantee Priority of Payments).

If the Selected Loans have not been sold or refinanced (in whole or in part) in an amount equal to the Adjusted Required Redemption Amount by the date which is six months prior to (where the

Covered Bonds are not subject to an Extended Final Maturity Date) the Final Maturity Date or (where the Covered Bonds are subject to an Extended Final Maturity Date) the Extended Final Maturity Date as applicable, of the Earliest Maturing Covered Bonds (after taking into account all payments, provisions and credits to be made in priority thereto), then the LLP will (i) offer the Selected Loans and their Related Security for sale for the best price reasonably available or (ii) seek to refinance the Selected Loans on the best terms reasonably available, notwithstanding that such amount may be less than the Adjusted Required Redemption Amount. The proceeds of any such sale shall be allocated *pro rata* and *pari passu* to each Series of Covered Bonds in proportion to the Principal Amount Outstanding of each such Series, in accordance with the description set out in *Cashflows* below.

The LLP is also permitted to offer for sale to Purchasers or to seek to refinance part of any portfolio of Selected Loans (a “**Partial Portfolio**”). Except in circumstances where the portfolio of Selected Loans is being sold or refinanced within six months of the Final Maturity Date of the Series of Covered Bonds to be repaid from such proceeds, the sale price or amount raised in respect of the Partial Portfolio (as a proportion of the Adjusted Required Redemption Amount), shall be at least equal to the proportion that the Partial Portfolio bears to the relevant portfolio of Selected Loans.

In respect of the sale or refinancing of Selected Loans following service of a Notice to Pay on the LLP, in addition to offering Selected Loans for sale to Purchasers or seeking to refinance such Selected Loans in respect of the Earliest Maturing Covered Bonds, the LLP (subject to the rights of pre-emption enjoyed by the Sellers pursuant to the Loan Sale Agreement) is permitted to offer for sale to Purchasers or refinance further portfolios of Selected Loans, in accordance with the provisions summarised above, in respect of other or all Series of Covered Bonds.

The LLP will through a tender process appoint a portfolio manager or arranger of the refinancing of recognised standing on a basis intended to incentivise the portfolio manager or arranger of the refinancing to achieve the best price for the sale or refinancing of the Selected Loans (if such terms are commercially available in the market) to advise it in relation to the sale or refinancing of the Selected Loans to Purchasers (except where the Sellers are buying the Selected Loans in accordance with their right of pre-emption in the Loan Sale Agreement). The terms of the agreement giving effect to the appointment in accordance with such tender shall be approved by the Security Trustee.

In respect of any sale or refinancing of Selected Loans and their Related Security following service of a Notice to Pay, the LLP will instruct the portfolio manager to use all reasonable endeavours to procure that Selected Loans are sold as quickly as reasonably practicable (in accordance with the recommendations of the portfolio manager), taking into account the market conditions at that time and the scheduled repayment dates of the Covered Bonds and the terms of the LLP Deed.

The terms of any sale and purchase agreement with respect to the sale of Selected Loans or the terms of any refinancing (which shall give effect to the recommendations of the portfolio manager or arranger of such re-financing) will be subject to the prior written approval of the Security Trustee. The Security Trustee will not be required to release the Selected Loans from the Security unless the conditions relating to the release of the Security (as described under *Deed of Charge – Release of Security*, below) are satisfied.

If Purchasers accept the offer or offers from the LLP so that some or all of the Selected Loans shall be sold prior to the next following Final Maturity Date or, as applicable, Extended Final Maturity Date of the Earliest Maturing Covered Bonds or at any time following the occurrence of an LLP Event of Default, then the LLP will, subject to the foregoing paragraph, enter into a sale and purchase agreement with the relevant Purchasers, which will require, *inter alia*, a cash payment from the relevant Purchasers. Any such sale or any refinancing is unlikely to include any Representations and Warranties from the LLP in respect of the Loans and the Related Security.

#### ***Covenants of the LLP and the Members***

Each of the Members has covenanted that, subject to the terms of the Transaction Documents, it will not sell, transfer or otherwise dispose of its interest in the LLP without the prior written consent of the LLP and, whilst the Covered Bonds are outstanding, the Security Trustee. Whilst any amounts are outstanding in respect of the Covered Bonds, each of the Members undertakes not to terminate or purport to terminate the LLP or institute any winding-up, administration, insolvency or similar proceedings against the LLP.

The LLP has covenanted that it will not, save with the prior written consent of the Management Committee (and, for so long as any Covered Bonds are outstanding, the consent of the Security Trustee), or as envisaged by the Transaction Documents:

- (a) create or permit to subsist any security interest over the whole or any part of its assets or undertakings, present or future;
- (b) dispose of, deal with or grant any option or present or future right to acquire any of its assets or undertakings or any interest therein or thereto;
- (c) have an interest in a bank account other than as set out in the Transaction Documents;
- (d) incur any indebtedness or give any guarantee or indemnity in respect of any such indebtedness;
- (e) consolidate or merge with or transfer any of its property or assets to another person;
- (f) have any employees, premises or subsidiaries;
- (g) acquire assets other than pursuant to the Loan Sale Agreement, the Cash Management Agreement and the LLP Deed; or
- (h) engage in any activities or derive income from any activities within the United States or hold any property if doing so would cause it to be engaged or deemed to be engaged in a trade or business within the United States;
- (i) enter into any contracts, agreements or other undertakings;
- (j) compromise, compound or release any debt due to it; or
- (k) commence, defend, settle or compromise any litigation or other claims relating to it or any of its assets.

***Limit on Investing in Substitution Assets and Authorised Investments***

Prior to the service of a Notice to Pay on the LLP, the LLP will be permitted to invest Available Revenue Receipts, Available Principal Receipts and the proceeds of Term Advances in Substitution Assets, **provided that** such investments are made in accordance with the terms of the Cash Management Agreement.

Following service of a Notice to Pay on the LLP, all Substitution Assets must be sold by the LLP (or the Cash Manager on its behalf) as quickly as reasonably practicable and the proceeds credited to the relevant GIC Sub-Account and the LLP will be permitted to invest all available monies in Authorised Investments, **provided that** such investments are made in accordance with the terms of the Cash Management Agreement.

For the purposes hereof:

“**Authorised Investments**” means:

- (a) Sterling gilt-edged securities; and
- (b) Sterling demand or time deposits, certificates of deposit and short-term debt obligations (including commercial paper) **provided that** in all cases such investments have a remaining maturity date of 60 days or less and mature on or before the next following LLP Payment Date and the short-term unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the demand or time deposits are made (being an authorised person under FSMA) are rated at least A-1 by Standard & Poor’s and P-1 by Moody’s or their equivalents by two internationally recognised rating agencies.

“**Substitution Assets**” means:

- (a) Sterling gilt-edged securities;
- (b) Sterling demand or time deposits, certificates of deposit, long-term debt obligations and short-term debt obligations (including asset backed commercial paper) and the short-term unsecured, unguaranteed and unsubordinated debt obligations or, as applicable, the long-term unsecured, unguaranteed and unsubordinated debt obligations of the issuing or guaranteeing entity or the entity with which the demand or time deposits are made (being an authorised person under the FSMA) are rated at least P-1/Aa3 by Moody’s and A-1+/AA- by S&P or their equivalents by two other internationally recognised rating agencies;
- (c) Sterling denominated government and public securities, as defined from time to time by the FSA, and which are rated at least Aaa by Moody’s and AAA by S&P or their equivalents by two other internationally recognised rating agencies;

- (d) Sterling denominated covered bonds or structured covered bond securities, which are actively traded in a continuous, liquid market on a recognised stock exchange, are held widely across the financial system, are available in an adequate supply and which are rated at least Aaa by Moody's and AAA by S&P or their equivalents by two other internationally recognised rating agencies; and/or
- (e) Sterling denominated covered bonds or structured covered bonds issued by HBOS Treasury Services plc, which are rated at least Aaa by Moody's and AAA by S&P, with maturities and interest payment provisions matching the Covered Bonds then outstanding,

**provided that:**

- (i) the aggregate value of Substitution Assets of the types described in paragraphs (a) to (d) above shall not exceed in any circumstances in aggregate an amount equal to 25 per cent. of the total assets of the LLP and provided further that all Substitution Assets of the types described in paragraphs (a) to (d) above shall have a remaining period to maturity of one year or less unless the Cash Manager has, at that time, a short-term debt rating of at least A1+/P-1 in which case Substitution Assets of the type described in paragraphs (a) to (d) above with an aggregate value (calculated on a mark-to-market basis) of up to 10 per cent. of the total assets of the LLP may consist of investments with a remaining period to maturity of greater than one year **provided that** such investments generate a floating rate of interest (taking into account any related hedging agreement, as applicable); and
- (ii) the aggregate value of Substitution Assets of the types described in paragraph (e) above shall not exceed 100 per cent. of the total assets of the LLP.

To the extent that the Cash Manager loses its A1+/P-1 rating then it will dispose of Substitution Assets with maturities greater than one year as soon as reasonably practicable.

***Other provisions***

The allocation and distribution of Revenue Receipts, Principal Receipts and all other amounts received by the LLP is described under *Cashflows* below.

A committee comprised as at the Programme Date of the representatives of each of the Members (the "**Management Committee**") will act on behalf of the LLP to which (other than any decision to approve the audited accounts of the LLP or to make a resolution for the voluntary winding up of the LLP, which require a unanimous decision of the Members) the Members delegate all matters. Any decision by the Management Committee relating to *inter alia* the admission of a New Member, any change in the LLP's business, and any material amendment to the LLP Deed will be made, (whilst any Covered Bonds are outstanding,) with the consent of the Security Trustee.

For so long as any Covered Bonds are outstanding, each Member has agreed that it will not terminate or purport to terminate the LLP or institute any winding-up, administration, insolvency or other similar proceedings against the LLP. Furthermore, the Members have agreed *inter alia* not to demand or receive payment of any amounts payable by the LLP (or the Cash Manager on its behalf) or the Security Trustee unless all amounts then due and payable by the LLP to all other creditors ranking higher in the relevant Priorities of Payments have been paid in full.

Each Member will be responsible for the payment of its own tax liabilities and will be required to indemnify the LLP and the other Members from any liabilities which they incur as a result of the relevant Member's non-payment.

Following the appointment of a liquidator to any Member (other than the Liquidation Member), any decisions of the LLP that are reserved to the Members in the LLP Deed shall be made by the Liquidation Member only.

***Governing Law***

The LLP Deed is governed by English law.

***Cash Management Agreement***

The Cash Manager provides certain cash management services to the LLP pursuant to the terms of a cash management agreement entered into on the Programme Date between the LLP, Bank of Scotland in its capacity as the Cash Manager (the "**Cash Manager**") and the Security Trustee (as amended and/or restated from time to time, the "**Cash Management Agreement**").

The Cash Manager's services include but are not limited to:

- (a) maintaining the Ledgers on behalf of the LLP;

- (b) distributing the Revenue Receipts and the Principal Receipts in accordance with the Priorities of Payment described under *Cashflows*, below;
- (c) determining whether the Asset Coverage Test is satisfied on each Calculation Date in accordance with the LLP Deed, as more fully described under *Credit Structure – Asset Coverage Test*, below;
- (d) determining whether the Amortisation Test is satisfied on each Calculation Date following the service of a Notice to Pay on the LLP in accordance with the LLP Deed, as more fully described under *Credit Structure – Amortisation Test*, below;
- (e) on each London Business Day, determining whether the Pre-Maturity Liquidity Test for each Series of Covered Bonds is satisfied as more fully described under *Credit Structure – Pre-Maturity Liquidity Test*, below; and
- (f) the preparation of an asset coverage report on a quarterly basis, with the co-operation of the Servicer.

For purposes hereof:

“**Capital Account Ledgers**” means the ledgers maintained by the LLP to record the Capital Contributions of each of the Members.

“**Liquidation GIC Sub-Account**” means each account in the name of the LLP maintained by the Cash Manager pursuant to the Cash Management Agreement to receive and make payments of monies available to repay any Series of Covered Bonds on the Final Maturity Date (or, as applicable, the Extended Final Maturity Date) thereof if the Pre-Maturity Liquidity Test or Asset Coverage Test has been breached.

“**Losses**” mean all realised losses on the Loans.

“**Principal GIC Sub-Account**” means the so named account in the name of the LLP maintained by the Cash Manager pursuant to the Cash Management Agreement to receive payments and make payments of Principal Receipts in accordance with the terms of the LLP Deed.

“**Reserve GIC Sub-Account**” means the so named account in the name of the LLP maintained by the Cash Manager pursuant to the Cash Management Agreement to receive payments of Revenue Receipts which are to be credited to the Reserve Fund and make payments which are to be debited from the Reserve Fund in accordance with the terms in the LLP Deed.

“**Revenue GIC Sub-Account**” means the so named account in the name of the LLP maintained by the Cash Manager pursuant to the Cash Management Agreement to receive payments and make payments of Revenue Receipts in accordance with the terms of the LLP Deed.

The Cash Management Agreement is governed by English law.

### **Interest Rate Swap Agreements**

Loans in the Portfolio pay interest at a variable rate for a period of time based on LIBOR (as determined in accordance with the relevant Loan Agreement), at a fixed rate, a rate linked to RPI or other indexed linked rate. However, the interest rate payable by the LLP with respect to the Term Advances is calculated based on LIBOR for three-month Sterling deposits. The LLP may also hold Substitution Assets and/or Authorised Investments which generate a rate of interest. To provide a hedge against the possible variance between:

- (1) the rates of interest payable by the Borrowers (the “**Loan Rates of Interest**”) in respect of those Loans sold by the Original Seller to the LLP and the rates of interest on the Substitution Assets and/or Authorised Investments; and
- (2) LIBOR for three-month Sterling deposits,

the LLP and Bank of Scotland (in its capacity as interest rate swap provider, the “**Original Interest Rate Swap Provider**”) and the Security Trustee have entered into interest rate swaps (the “**Original Interest Rate Swaps**”) each governed by an ISDA master agreement, including a schedule and confirmation thereto (the “**Original Interest Rate Swap Agreements**”) on the Programme Date.

Each New Seller (in its capacity as interest rate swap provider, a “**New Interest Rate Swap Provider**” and, together with the Original Interest Rate Swap Provider and any other New Interest Rate Swap Provider, the “**Interest Rate Swap Providers**”) will also enter into an interest rate swap (the “**New Interest Rate Swap**” and, together with the Original Interest Rate Swap, the “**Interest Rate Swaps**”) with the LLP and the Security Trustee in respect of those Loans sold by the relevant New Seller on

substantially the same terms as the Original Interest Rate Swap Agreements (each, a “**New Interest Rate Swap Agreement**” and, together with the Original Interest Rate Swap Agreement and any other New Interest Rate Swaps Agreement, the “**Interest Rate Swap Agreements**”).

In the event that the relevant ratings of an Interest Rate Swap Provider, or any Guarantor, as applicable, is or are, as applicable, downgraded by a Rating Agency below the ratings specified in the relevant Interest Rate Swap Agreement (in accordance with the requirements of the Rating Agencies) for such Interest Rate Swap Provider, and, in the case of S&P, as a result of the downgrade the then current ratings of the Covered Bonds would or may, as applicable, be adversely affected, such Interest Rate Swap Provider will be required to take certain remedial measures which may include providing collateral for its obligations, arranging for its obligations to be transferred to an entity with ratings required by the relevant Rating Agency, procuring another entity with rating(s) required by the relevant Rating Agency to become co-obligor in respect of its obligations, or taking such other action as it may agree with the relevant Rating Agency. A failure to take such steps will allow the LLP to terminate the relevant Interest Rate Swap Agreement **provided that** if termination would result in a payment due to the Interest Rate Swap Providers, the LLP may only terminate if it has put in place equivalent hedging arrangements with a replacement Interest Rate Swap Provider.

Each Interest Rate Swap Agreement may also be terminated in certain other circumstances (each referred to as an “**Interest Rate Swap Early Termination Event**”), including:

- at the option of any party to an Interest Rate Swap Agreement, if there is a failure by the other party to pay any amounts due under the relevant Interest Rate Swap Agreement subject to any applicable grace period; and
- upon the occurrence of an insolvency of an Interest Rate Swap Provider, or any Guarantor, or the merger of one of the parties without an assumption of the obligations under the relevant Interest Rate Swap Agreement (except in respect of a transfer by the LLP to the Security Trustee in its fiduciary capacity).

Upon the termination of an Interest Rate Swap pursuant to an Interest Rate Swap Early Termination Event, the LLP or the relevant Interest Rate Swap Provider may be liable to make a termination payment to the other in accordance with the provisions of the relevant Interest Rate Swap Agreement.

If withholding taxes are imposed on payments made by an Interest Rate Swap Provider under an Interest Rate Swap, the Interest Rate Swap Provider shall always be obliged to gross up these payments. If withholding taxes are imposed on payments made by the LLP to the Interest Rate Swap Provider under an Interest Rate Swap, the LLP shall not be obliged to gross up those payments.

If the LLP is required to sell Selected Loans in the Portfolio in order to provide liquidity in respect of Covered Bonds following a breach of the Pre-Maturity Liquidity Test or the Asset Coverage Test or in respect of the Earliest Maturing Covered Bonds following an HBOS Event of Default and service of a Notice to Pay on the LLP, then to the extent that such Selected Loans include Fixed Rate Loans, either:

- (a) the Interest Rate Swap(s) in connection with such Fixed Rate Loans will partially terminate and any breakage costs payable by or to the LLP in connection with such termination will be taken into account in calculating the Adjusted Required Redemption Amount for the sale of the Selected Loans; or
- (b) such Interest Rate Swap(s) will be partially novated to the purchaser of such Fixed Rate Loans, and such purchaser will thereby become party to a separate interest rate swap transaction with the relevant Interest Rate Swap Provider.

The Interest Rate Swap Agreements are (or, as applicable, will be) governed by English law.

### **Covered Bond Swap Agreements**

Bank of Scotland (in its capacity as swap provider, the “**Covered Bond Swap Provider**”) has entered into or will enter into swap transactions (the “**Covered Bond Swaps**”, and together with the Interest Rate Swaps, the “**Swaps**”) with the LLP and the Security Trustee in its fiduciary capacity, each such Covered Bond Swap governed by an ISDA master agreement, including a schedule and confirmation (the “**Covered Bond Swap Agreements**”), to hedge (after service on the LLP of a Notice to Pay and following an HBOS Event of Default and the service of an HBOS Acceleration Notice) certain interest rate, currency and/ or other risks in respect of amounts received by the LLP under the Loans and the Interest Rate Swaps and amounts payable by the LLP under the Covered Bond Guarantee in



respect of Covered Bonds. Where required to hedge such risks, there will be one Covered Bond Swap Agreement and Covered Bond Swap in relation to each Series of Covered Bonds. Under the Covered Bond Swaps, after service on the LLP of a Notice to Pay, the Covered Bond Swap Provider will pay to the LLP amounts equivalent to the amounts that would be payable by the LLP under the Covered Bond Guarantee in respect of interest and principal payable under the Covered Bonds and, in return, the LLP will pay to the Covered Bond Swap Provider on each LLP Payment Date an amount in Sterling calculated by reference to LIBOR for three-month Sterling deposits for the relevant Interest Period plus a spread.

Under the terms of each Covered Bond Swap, in the event that the relevant rating of the Covered Bond Swap Provider (or for such time as the Covered Bond Swap Provider is the Issuer, its Deemed Ratings) or any Guarantor, as applicable is downgraded by a Rating Agency below the rating(s) specified in the relevant Covered Bond Swap Agreement (in accordance with the requirements of the Rating Agencies) for the Covered Bond Swap Provider, and, where applicable, as a result of the downgrade, the then current ratings of the Covered Bonds would or may, as applicable, be adversely affected, the Covered Bond Swap Provider will, in accordance with the relevant Covered Bond Swap Agreement, be required to take certain remedial measures which may include providing collateral for its obligations under the Covered Bond Swap, arranging for its obligations under the Covered Bond Swap to be transferred to an entity with the ratings required by the relevant Rating Agency, procuring another entity with the ratings required by the relevant Rating Agency to become co-obligor in respect of its obligations under the Covered Bond Swap, or taking such other action as it may agree with the relevant Rating Agency. A failure to take such steps will allow the LLP to terminate the Covered Bond Swap.

A Covered Bond Swap Agreement may also be terminated in certain other circumstances (each referred to as a “**Covered Bond Swap Early Termination Event**”), including:

- at the option of any party to the Covered Bond Swap Agreement, if there is a failure by the other party to pay any amounts due under such Covered Bond Swap Agreement; and
- upon the occurrence of an insolvency of the Covered Bond Swap Provider, or any Guarantor, or the merger of one of the parties without an assumption of the obligations under the relevant Covered Bond Swap Agreement (except in respect of a transfer by the LLP to the Security Trustee in its fiduciary capacity).

Upon the termination of a Covered Bond Swap, the LLP or the Covered Bond Swap Provider may be liable to make a termination payment to the other in accordance with the provisions of the relevant Covered Bond Swap Agreement. The amount of this termination payment will be calculated and made in Sterling.

If withholding taxes are imposed on payments made by the Covered Bond Swap Provider to the LLP under a Covered Bond Swap, the Covered Bond Swap Provider shall always be obliged to gross up those payments. If withholding taxes are imposed on payments made by the LLP to the Covered Bond Swap Provider under a Covered Bond Swap, the LLP shall not be obliged to gross up those payments.

The Covered Bond Swap Agreements are (or, as applicable, will be) governed by English law.

### **Bank Account Agreement**

Pursuant to the terms of a bank account agreement entered into on the Programme Date between the LLP, Bank of Scotland as account bank (in such capacity, the “**Account Bank**”), the Cash Manager and the Security Trustee (the “**Bank Account Agreement**”), the LLP will maintain with the Account Bank the accounts described below, which will be operated in accordance with the Cash Management Agreement, the LLP Deed and the Deed of Charge:

- (a) the GIC Sub-Accounts into which are paid all amounts received from Borrowers in respect of Loans in the Portfolio. On each LLP Payment Date as applicable, amounts required to meet the LLP’s various creditors and amounts to be distributed to the Members under the LLP Deed will be transferred to the Transaction Account; and
- (b) the Transaction Accounts into which monies standing to the credit of the relevant GIC Sub-Accounts will be transferred on each LLP Payment Date and applied by the Cash Manager in accordance with the Priorities of Payments described below under *Cashflows*.

If the short-term, unsecured, unsubordinated and unguaranteed debt obligations of the Account Bank cease to be rated at least A-1 by S&P and P-1 by Moody's (the "**Account Bank Ratings**") then within 30 London Business Days of such occurrence either:

- The GIC Sub-Accounts and the Transaction Accounts will be closed and new accounts opened under the terms of a new bank account agreement substantially on the same terms as the Bank Account Agreement opened with a financial institution (i) whose short-term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least A-1 by S&P and P-1 by Moody's and (ii) which is an authorised person under FSMA; or
- the Account Bank will obtain a guarantee of its obligations under the Bank Account Agreement on terms acceptable to the Security Trustee, acting reasonably, from a financial institution whose short-term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least A-1 by S&P and P-1 by Moody's,

(in each case, **provided that** the Rating Agencies then rating the Covered Bonds confirm that the then current ratings of the Covered Bonds would not be adversely affected thereby) unless each Rating Agency confirms that its then current rating of the Covered Bonds will not be adversely affected as a result of the Account Bank Rating falling below P-1/A-1 (or the reason for this having occurred) within 15 days of such downgrade. If the Rating Agency confirmations are given as above, reference to the "**Account Bank Ratings**" shall be deemed to be the relevant ratings of the Account Bank at the time of such confirmations, but the original rating shall be reinstated if the relevant rating of the Account Bank is subsequently upgraded to the original level.

For the purposes hereof:

"**GIC Sub-Accounts**" means the Principal GIC Sub-Account, the Revenue GIC Sub-Account, the Reserve GIC Sub-Account, each Liquidation GIC Sub-Account maintained in the name of the LLP held with the Account Bank and maintained subject to the terms of the Guaranteed Investment Contract, the Bank Account Agreement and the Deed of Charge or such additional or replacement account as may be for the time being in place with the prior consent of the Security Trustee and "**GIC Sub-Account**" means any one of them.

"**LLP Accounts**" means each GIC Sub-Account, each Transaction Account and any additional or replacement accounts opened in the name of the LLP from time to time.

"**Transaction Principal Account**" means the so named account in the name of the LLP held with the Account Bank and maintained subject to the terms of the Bank Account Agreement and the Deed of Charge or such other account as may for the time being be in place with the prior consent of the Security Trustee and designated as such.

"**Transaction Revenue Account**" means the so named account in the name of the LLP held with the Account Bank and maintained subject to the terms of the Bank Account Agreement and the Deed of Charge or such other account as may for the time being be in place with the prior consent of the Security Trustee and designated as such.

"**Transaction Accounts**" mean the Transaction Revenue Account and the Transaction Principal Account.

The Bank Account Agreement is governed by English law.

### **Guaranteed Investment Contract**

On the Programme Date, the LLP entered into a guaranteed investment contract with Bank of Scotland (in its capacity as GIC provider, the "**GIC Provider**") and the Cash Manager (the "**Guaranteed Investment Contract**" or "**GIC**"), pursuant to which the GIC Provider has agreed to pay interest on the monies standing to the credit thereof at specified rates determined in accordance with the GIC.

If the short-term, unsecured, unsubordinated and unguaranteed debt obligations of the GIC Provider cease to be rated at least A-1 by S&P and P-1 by Moody's (the "**GIC Provider Ratings**") then within 30 London Business Days of such occurrence either:

- The GIC Sub-Accounts and the Transaction Accounts will be closed and new accounts opened under the terms of a new bank account agreement substantially on the same terms as the Bank Account Agreement opened with a financial institution (i) whose short-term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least A-1 by S&P and P-1 by Moody's and (ii) which is an authorised person under FSMA; or

- the GIC Provider will obtain a guarantee of its obligations under the Guaranteed Investment Contract on terms acceptable to the Security Trustee, acting reasonably, from a financial institution whose short-term, unsecured, unsubordinated and unguaranteed debt obligations are rated at least A-1 by S&P and P-1 by Moody's,

(in each case, **provided that** the Rating Agencies then rating the Covered Bonds confirm that the then current ratings of the Covered Bonds would not be adversely affected thereby) unless each Rating Agency confirms that its then current rating of the Covered Bonds will not be adversely affected as a result of the GIC Provider Rating falling below P-1/A-1 (or the reason for this having occurred) within 30 days of such downgrade. If the Rating Agency confirmations are given as above, reference to the “**GIC Provider Ratings**” shall be deemed to be the relevant ratings of the GIC Provider at the time of such confirmations, but the original rating shall be reinstated if the relevant rating of the GIC Provider is subsequently upgraded to the original level.

The Guaranteed Investment Contract is governed by English law.

### **Corporate Services Agreements**

The Liquidation Member, Bank of Scotland and the LLP entered into a corporate services agreement with Structured Finance Management Limited (the “**English Corporate Services Provider**”) on the Programme Date (the “**English Corporate Services Agreement**”), pursuant to which the English Corporate Services Provider has agreed to provide corporate services to the Liquidation Member.

The English Corporate Services Agreement is governed by English law.

Holdings entered into a corporate services agreement with Structured Finance Management Offshore Limited (the “**Jersey Corporate Services Provider**”) on the Programme Date (the “**Jersey Corporate Services Agreement**”), pursuant to which the Jersey Corporate Services Provider has agreed to provide corporate services to Holdings.

The Jersey Corporate Services Agreement is governed by the laws of the Island of Jersey.

### **Deed of Charge**

Pursuant to the terms of a deed of charge entered into on the Programme Date by the LLP, the Security Trustee and the other Secured Creditors (the “**Deed of Charge**”), the secured obligations of the LLP and all other obligations of the LLP under or pursuant to the Transaction Documents to which it is a party are secured, *inter alia*, by the following security (the “**Security**”) over the following property, assets and rights (the “**Charged Property**”):

- a first fixed charge (which may take effect as a floating charge) over the LLP's interest in the Loans and their Related Security and other related rights comprised in the Portfolio;
- an assignment by way of first fixed security over all of the LLP's interests, rights and entitlements under and in respect of any Transaction Document to which it is a party;
- a first fixed charge (which may take effect as a floating charge) over the rights and benefits of the LLP in the LLP Accounts and any other account of the LLP and all amounts standing to the credit of the LLP Accounts and such other accounts;
- a first fixed charge (which may take effect as a floating charge) over the rights and benefits of the LLP to any Excess Proceeds received from the Bond Trustee;
- a first fixed charge (which may take effect as a floating charge) over the rights and benefits of the LLP in respect of all Authorised Investments and Substitution Assets purchased from time to time from amounts standing to the credit of the LLP Accounts; and
- a first floating charge over all the assets and undertaking of the LLP governed by English law and not, from time to time, subject to any fixed charge in favour of the Security Trustee pursuant to the Deed of Charge.

“**Secured Creditors**” means the Security Trustee (in its own capacity and on behalf of the other Secured Creditors), the Bond Trustee (in its own capacity and on behalf of the Covered Bondholders), the Covered Bondholders, the Receiptholders, the Couponholders, the Issuer, the Sellers, the Servicers, the Account Bank, the GIC Provider, the Cash Manager, the Swap Providers, the Corporate Services Provider, the Paying Agents and any other person which becomes a Secured Creditor pursuant to the Deed of Charge.

***Release of Security***

In the event of any sale of Loans (including Selected Loans) and their Related Security by the LLP pursuant to and in accordance with the Transaction Documents, the Security Trustee will (subject to the written request of the LLP), release those Loans from the Security created by and pursuant to the Deed of Charge on the date of such sale but only if the Security Trustee provides its prior written consent to the terms of such sale as described under, *LLP Deed – Method of Sale of Selected Loans* above (which consent shall be given if the Cash Manager provides to the Security Trustee a certificate confirming that the Selected Loans are being refinanced or sold in accordance with the Transaction Documents).

***Enforcement***

If an LLP Acceleration Notice is served on the Issuer and the LLP, the Security Trustee shall be entitled to appoint a Receiver, and/or enforce the Security constituted by the Deed of Charge (including selling the Portfolio), and/or take such steps as it shall deem necessary, subject in each case to being indemnified and/or secured to its satisfaction. All proceeds received by the Security Trustee from the enforcement of the Security will be applied in accordance with the Post-Enforcement Priority of Payments described under *Cashflows* below.

***Governing Law***

The Deed of Charge is governed by English law.

## CREDIT STRUCTURE

The Covered Bonds are direct, unsecured and unconditional obligations of the Issuer and the Group Guarantor only. The LLP has no obligation to pay the Guaranteed Amounts under the Covered Bond Guarantee until a Notice to Pay has been served by the Bond Trustee on the LLP, an HBOS Event of Default has occurred and an HBOS Acceleration Notice has been served or, if earlier, following the occurrence of an LLP Event of Default, service by the Bond Trustee of an LLP Acceleration Notice on the Issuer and the LLP. The Issuer will not be relying on payments by the LLP in respect of the Term Advances or receipt of Revenue Receipts or Principal Receipts from the Portfolio in order to pay interest or repay principal under the Covered Bonds.

There are a number of features of the Programme which enhance the likelihood of timely and, as applicable, ultimate payments to Covered Bondholders, as follows:

- the Group Guarantee and the Covered Bond Guarantee provide credit support to the Issuer;
- the Pre-Maturity Liquidity Test is intended to provide liquidity to the LLP in respect of principal due on the Final Maturity Date of Covered Bonds;
- the Asset Coverage Test is intended to ensure that the ratio of the LLP's assets to the Covered Bonds is maintained at a certain level;
- the Amortisation Test is intended to test the asset coverage of the LLP's assets in respect of the Covered Bonds following the service of a Notice to Pay on the LLP;
- a Reserve Fund will be established in the Reserve GIC Sub-Account to trap Available Revenue Receipts if the Issuer's short-term ratings or Deemed Rating, as applicable, fall below A-1 by S&P or P-1 by Moody's; and
- under the terms of the Guaranteed Investment Contract, the GIC Provider has agreed to pay a variable rate of interest on all amounts held by the LLP in the GIC Sub-Accounts at a rate of 0.25 per cent. per annum below LIBOR for three-month Sterling deposits.

Certain of these factors are considered more fully in the remainder of this section.

### *Guarantees*

Under the terms of the Group Guarantee, if the Issuer defaults in the payment on the due date of any monies due and payable under the Trust Deed or the Covered Bonds, the Group Guarantor has agreed to unconditionally pay or procure to be paid unconditionally upon demand the amount in respect of which such default has been made.

The Covered Bond Guarantee provided by the LLP under the Trust Deed guarantees payment of Guaranteed Amounts when the same become Due for Payment in respect of all Covered Bonds issued under the Programme. The Covered Bond Guarantee will not guarantee any amount becoming payable in respect of the Covered Bonds for any other reason, including any accelerated payment pursuant to Condition 9 (*Events of Default and Enforcement*) following the occurrence of an HBOS Event of Default. In this circumstance (and until an LLP Event of Default occurs and an LLP Acceleration Notice is served), the LLP's obligations will only be to pay the Guaranteed Amounts as they fall Due for Payment on each Scheduled Payment Date.

See further *Summary of the Principal Documents – Trust Deed* as regards the terms of the Guarantees. See further *Cashflows – Guarantee Priority of Payments* as regards the payment of amounts payable by the LLP to Covered Bondholders and other Secured Creditors following the occurrence of an HBOS Event of Default.

### *Pre-Maturity Liquidity*

The Pre-Maturity Liquidity Test is intended to provide liquidity for the Covered Bonds when the Issuer's credit ratings or Deemed Ratings, as applicable, fall to a certain level. On each London Business Day (each the "**Pre-Maturity Liquidity Test Date**") prior to the occurrence of an HBOS Event of Default or the occurrence of an LLP Event of Default, the LLP or the Cash Manager on its behalf will determine if the Pre-Maturity Liquidity Test has been breached, and if so, it shall immediately notify the Members, the Bond Trustee and the Security Trustee thereof.

The Issuer will fail and be in breach of the "**Pre-Maturity Liquidity Test**" on a Pre-Maturity Liquidity Test Date if:

- (a) the Issuer's (i) long-term credit rating or Deemed Rating, as applicable, from S&P falls to A (or lower) and the Final Maturity Date of the Series of Covered Bonds will fall within a certain period of time (specified in the applicable Final Terms for such Series of Covered Bonds (the "**Pre-Maturity Long-Term Rating Period**") for such Series) from the relevant Pre-Maturity Liquidity Test Date or (ii) short-term credit rating or Deemed Rating, as applicable, from S&P falls to A-1 (or lower) and the Final Maturity Date of the Series of Covered Bonds will fall within a certain period of time (specified in the applicable Final Terms for such Series of Covered Bonds (the "**Pre-Maturity Short-Term Rating Period**") for such Series) from the relevant Pre-Maturity Liquidity Test Date; or
- (b) the Issuer's (i) long-term credit rating or Deemed Rating, as applicable, from Moody's falls to A2 (or lower) and the Final Maturity Date of the Series of Covered Bonds will fall within the Pre-Maturity Long-Term Rating Period for such Series from the relevant Pre-Maturity Liquidity Test Date or (ii) short-term credit rating or Deemed Rating, as applicable, from Moody's falls to P-2 (or lower) and the Final Maturity Date of the Series of Covered Bonds will fall within the Pre-Maturity Short-Term Rating Period for such Series from the relevant Pre-Maturity Liquidity Test Date.

Following a breach of the Pre-Maturity Liquidity Test in respect of a Series of Covered Bonds, the LLP shall offer to sell Selected Loans and their Related Security to Purchasers or refinance Selected Loans and their Related Security, subject to:

- (a) any Cash Capital Contribution made by the Members (other than the Liquidation Member) from time to time; and
- (b) any right of pre-emption enjoyed by the Sellers pursuant to the terms of the Loan Sale Agreement,

**provided that** the Bond Trustee will serve a Notice to Pay on the LLP if the Pre-Maturity Liquidity Test in respect of any Series of Covered Bonds is breached less than the shorter of (i) the Pre-Maturity Long-Term Rating Period and (ii) the Pre-Maturity Short-Term Rating Period prior to the Final Maturity Date of that Series of Covered Bonds, and the relevant parties have not taken the required action (as described above) following the breach within the earlier to occur of (i) 10 Business Days from the date that the Sellers are notified of the breach of the Pre-Maturity Liquidity Test and (ii) the Final Maturity Date of that Series of Covered Bonds such that by the end of such period, there shall be an amount equal to the Required Redemption Amount of that Series of Covered Bonds standing to the credit of the relevant Liquidation GIC Sub-Account (after taking into account the Required Redemption Amount of all other Series of Covered Bonds which mature prior to or on the same date as the relevant Series of Covered Bonds). The method for selling or refinancing Selected Loans and their Related Security is described in *Summary of Principal Documents – The LLP Deed – Sales of Selected Loans and their Related Security if the Pre-Maturity Liquidity Test is breached above*. The proceeds of sale or refinancing of Selected Loans and their Related Security and/or the proceeds of any Cash Contribution as described above, will be recorded to the relevant Liquidation GIC Sub-Accounts.

In certain circumstances, Revenue Receipts will also be available to repay a Covered Bond, as described in *Cashflows – Pre-Acceleration Revenue Priority of Payments* below.

Failure by the Issuer and/or the Group Guarantor to pay the full amount due in respect of a Series of Covered Bonds on the Final Maturity Date thereof will constitute an HBOS Event of Default.

Following service of a Notice to Pay on the LLP after an HBOS Event of Default and the service of an HBOS Acceleration Notice, the LLP shall apply funds standing to the credit of the Liquidation GIC Sub-Accounts to repay the relevant Series of Covered Bonds.

If the Issuer and/or the Group Guarantor fully repay the relevant Series of Covered Bonds cash standing to the credit of any Liquidation GIC Sub-Account shall be applied by the LLP in accordance with the Pre-Acceleration Principal Priority of Payments, unless:

- (a) the Issuer is failing the Pre-Maturity Liquidity Test in respect of any other Series of Covered Bonds, in which case the cash will be transferred to the relevant Liquidation GIC Sub-Account in order to provide liquidity for that other Series of Covered Bonds; or
- (b) the Issuer is not failing the Pre-Maturity Liquidity Test, but the Management Committee elects to transfer the cash to the credit of the relevant Liquidation GIC Sub-Accounts in order to provide liquidity for any future Series of Covered Bonds.

Amounts standing to the credit of the relevant Liquidation GIC Sub-Accounts following the repayment of the Covered Bonds as described above may, except where the Management Committee has elected or is required to retain such amounts on the relevant Liquidation GIC Sub-Account, also be used to repay the corresponding Term Advance and distribute any excess Available Principal Receipts back to the Members *pro rata* in proportion to their respective Capital Contribution Balances on dates other than LLP Payment Dates, subject to the LLP making provision for higher ranking items in the Pre-Acceleration Principal Priority of Payments.

#### ***Asset Coverage Test***

The Asset Coverage Test is intended to ensure that the LLP can meet its obligations under the Covered Bond Guarantee. Under the LLP Deed, the LLP and its Members (other than the Liquidation Member) must ensure that on each Calculation Date the Adjusted Aggregate Loan Amount will be in an amount equal to, or in excess of, the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date. If the Adjusted Aggregate Loan Amount is not equal to, or greater than, the aggregate Principal Amount Outstanding of the Covered Bonds for two consecutive Calculation Dates, the Asset Coverage Test will be breached and the Bond Trustee will serve a Notice to Pay on the LLP, see further *Summary of Principal Documents – LLP Deed – Sale or Refinancing of Selected Loans and their Related Security if the Pre-Maturity Liquidity Test or Asset Coverage Test is breached*. The Asset Coverage Test is a formula which adjusts the aggregate of the Current Balance of each Loan in the Portfolio and has further adjustments to take account of failure by Sellers, in accordance with the Loan Sale Agreement, to repurchase Defaulted Loans or Loans that do not materially comply with the Representations and Warranties on the relevant Transfer Date. See further *Summary of the Principal Loans – LLP Deed – Asset Coverage Test*, above.

#### ***Amortisation Test***

The Amortisation Test is intended to ensure that if, following the service of a Notice to Pay on the LLP (but prior to service on the LLP and the Issuer of an LLP Acceleration Notice), the assets of the LLP available to meet its obligations under the Covered Bond Guarantee fall to a level where Covered Bondholders may not be repaid, an LLP Event of Default will occur and all amounts owing under the Covered Bonds may be accelerated. Under the LLP Deed, the LLP and its Members (other than the Liquidation Member) must ensure that on each Calculation Date following the service of a Notice to Pay on the LLP the Amortisation Test Aggregate Loan Amount will be in an amount at least equal to the aggregate Principal Amount Outstanding of the Covered Bonds as calculated on the relevant Calculation Date. The Amortisation Test is a formula which adjusts the aggregate of the Current Balance of each Loan in the Portfolio and has further adjustments to take account of Loans which are Defaulted Loans. See further *Summary of the Principal Documents – LLP Deed – Amortisation Test*, above.

#### ***Reserve Fund***

If at any time prior to an HBOS Event of Default the Issuer's short-term, unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings, as applicable, cease to be rated A-1 by S&P or P-1 by Moody's, the LLP will be required to establish a reserve fund (the "**Reserve Fund**") in the Reserve GIC Sub-Account which will be credited with Available Revenue Receipts up to the Reserve Fund Required Amount. The LLP will not be required to maintain the Reserve Fund following an HBOS Event of Default and/or the service of a Notice to Pay.

The Reserve Fund will be funded from Available Revenue Receipts after the LLP has paid all of its obligations in respect of items ranking higher than the Reserve Fund falling at item (c) of the Pre-Acceleration Revenue Priority of Payments on each LLP Payment Date.

On each Calculation Date the amount standing to the credit of the Reserve GIC Sub-Account in excess of the Reserve Fund Required Amount will be withdrawn from the Reserve Fund and made available as Available Revenue Receipts. Following the occurrence of an HBOS Event of Default and/or service of a Notice to Pay on the LLP or the Issuer's short-term unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings, as applicable, being restored to a rating of at least A-1 by S&P or P-1 by Moody's, the entire amount standing to the credit of the Reserve Fund, in either case, will be withdrawn from the Reserve GIC Sub-Account and made available as Available Revenue Receipts.

"**Reserve Fund Required Amount**" means, on the date the Issuer's short-term, unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings (as applicable) are not rated

at least A-1 by S&P or P-1 by Moody's and on each subsequent Calculation Date on which such short-term unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings (as applicable) are not rated at least A-1 by S&P or P-1 by Moody's an amount equal to A plus B, where:

A = an amount equal to the Scheduled Interest due on the next following Interest Payment Date on each Series of Covered Bonds; and

B = an amount equal to the greater of:

- (i) if the short-term, unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings (as applicable) of the Issuer are not rated at least P-1 by Moody's, an amount equal to the amount of interest which would be scheduled to fall due in the 24 months following such date under the three Loans with the greatest Current Balance on such date, multiplied by a fraction, the numerator of which is the Principal Amount Outstanding of the Covered Bonds on such date and the denominator of which is an amount equal to the aggregate of the Current Balance of the Loans, the value of any Substitution Assets and any amounts standing to the credit of the GIC Sub-Accounts, **provided that** such amount may be reduced by the amount of any LLP Reserve Guarantee available to the LLP on such date; and
- (ii) if the short-term, unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings (as applicable) of the Issuer are not rated at least A-1 by S&P, £600,000,

**provided that** if on any date the amount specified under sub-paragraph (ii) (above) is greater than the amount calculated under sub-paragraph (i) (above) solely as a result of the reduction of the amount calculated under sub-paragraph (i) (above) by virtue of the LLP Reserve Guarantee, the amount calculated under sub-paragraph (i) (above) shall be deemed to be greater.

**"LLP Reserve Guarantee"** means a guarantee (in a form which is acceptable to Moody's) of the LLP's obligations under the Covered Bond Guarantee in an amount up to the amount set out in paragraph B(i) of the definition of the Reserve Fund Required Amount (prior to the operation of the proviso in such paragraph) by a Guarantor rated at least P-1 and which has agreed in such guarantee not to claim against the LLP for any fees, costs or other amounts in relation to any right by indemnity or other compensatory payment following any payment by the Guarantor under such LLP Reserve Guarantee.



## CASHFLOWS

As described above under *Credit Structure*, until an HBOS Event has occurred, an HBOS Acceleration Notice has been served and a Notice to Pay is served on the LLP or, if earlier, an LLP Acceleration Notice has been served, the Covered Bonds will be obligations of the Issuer and the Group Guarantor only. Neither the Issuer nor the Group Guarantor is reliant, in any way, on the cashflows of the LLP to satisfy their respective obligations under the Covered Bonds.

This section summarises the cashflows of the LLP only, as to the allocation and distribution of amounts standing to the credit of the LLP Accounts and their order of priority (all such orders of priority, the “**Priorities of Payments**”) (i) prior to the service of a Notice to Pay, (ii) prior to an HBOS Event of Default and an LLP Event of Default, (iii) following an HBOS Event of Default (but prior to an LLP Event of Default) and (iv) following an LLP Event of Default in accordance with the LLP Deed or the Deed of Charge, as applicable.

### Definitions

For the purposes hereof:

“**Available Principal Receipts**” means on a relevant Calculation Date, an amount equal to the aggregate of (without double counting):

- (a) the amount of Principal Receipts received during the immediately preceding Calculation Period and credited to the Principal GIC Sub-Account;
- (b) any other amount standing to the credit of the Principal GIC Sub-Account including (i) the proceeds of any Term Advance (where such proceeds have not been applied to acquire New Portfolios, refinance an existing Term Advance, invest in Substitution Assets or make a Capital Distribution to a Member), (ii) any Cash Capital Contributions received from a Member and (iii) the proceeds from any sale of or refinancing Selected Loans pursuant to the terms of the LLP Deed or the Loan Sale Agreement;
- (c) following repayment of any Covered Bonds by the Issuer and the Group Guarantor on the Final Maturity Date or Extended Final Maturity Date, as applicable, thereof, any amounts standing to the credit of the relevant Series’ Liquidation GIC Sub-Account Ledger in respect of such Series of Covered Bonds (except where the LLP has elected to or is required to transfer such amounts to other Series’ Liquidation GIC Sub-Accounts); and
- (d) all amounts in respect of principal (if any) received by the LLP under the Covered Bond Swap Agreement on the relevant LLP Payment Date (other than any termination payments or Swap Collateral Excluded Amounts).

“**Available Revenue Receipts**” means on a relevant Calculation Date, an amount equal to the aggregate of:

- (a) the amount of Revenue Receipts received during the previous Calculation Period and credited to the Revenue GIC Sub-Account;
- (b) prior to the service of a Notice to Pay, amounts standing to the credit of the Reserve Fund in excess of the Reserve Fund Required Amount;
- (c) other net income of the LLP including all amounts of interest received on the LLP Accounts, the Substitution Assets and Authorised Investments in the preceding Calculation Period and amounts received by the LLP under the Interest Rate Swap Agreements and in respect of interest received by the LLP under the Covered Bond Swap Agreements on the relevant LLP Payment Date (other than any termination payments or Swap Collateral Excluded Amounts);
- (d) any other Revenue Receipts not referred to in paragraphs (a) to (c) above received during the previous Calculation Period and standing to the credit of the Revenue GIC Sub-Account; and
- (e) (i) the amount standing to the credit of the Reserve Fund in excess of the Reserve Fund Required Amount or (ii) following the occurrence of an HBOS Event of Default and/or service on the LLP of a Notice to Pay or the Issuer’s short-term unsecured, unsubordinated and unguaranteed debt obligations or Deemed Ratings (as applicable) being restored to a rating of at least A-1 by S&P or P-1 by Moody’s, the entire amount standing to the credit of the Reserve Fund.

“**Covered Bond Swap Rate**” means in relation to a Covered Bond or Series of Covered Bonds, the exchange rate or interest rate specified in the Covered Bond Swap Agreement relating to such

Covered Bond or Series of Covered Bonds or, if the Covered Bond Swap Agreement has terminated, the applicable spot rate.

“**Earliest Maturing Covered Bonds**” means at any time the relevant Series of the Covered Bonds that has the earliest Final Maturity Date as specified in the applicable Final Terms (ignoring any acceleration of amounts due under the Covered Bonds prior to the occurrence of an LLP Event of Default).

“**Excluded Swap Termination Amount**” means in relation to a Swap Agreement, an amount equal to the amount of any termination payment due and payable (i) to the relevant Swap Provider as a result of a Swap Provider Default with respect to such Swap Provider or (ii) to the relevant Swap Provider following a Swap Provider Downgrade Event with respect to such Swap Provider.

“**Final Maturity Date**” means the Interest Payment Date on which each Series of Covered Bonds is expected to be redeemed at their Principal Amount Outstanding in accordance with the Conditions as specified in the relevant Final Terms.

“**Interest Payment Date**” means in relation to any Fixed Rate Covered Bond, such date or dates as indicated in the applicable Final Terms and, in relation to any Floating Rate Covered Bond or Index Linked Interest Covered Bond, either:

- (a) the date which falls the number of months or other period specified as the “**Specified Period**” in the applicable Final Terms after the preceding Interest Payment Date or the Interest Commencement Date (in the case of the first Interest Payment Date); or
- (b) such date or dates as are indicated in the applicable Final Terms.

“**LLP Payment Period**” means the period from and including an LLP Payment Date to, but excluding, the next following LLP Payment Date.

“**Principal Receipts**” means:

- (a) principal repayments under the Loans (including payments of arrears, Accrued Interest and Arrears of Interest as at the relevant Transfer Date of a Loan);
- (b) recoveries of principal from defaulting Borrowers under Loans being enforced (including the proceeds of sale of the relevant Property);
- (c) any payment pursuant to any insurance policy in respect of a property which is the subject of a Legal Charge in connection with a Loan in the Portfolio; and
- (d) the proceeds of the repurchase of any Loan by any Seller from the LLP pursuant to the Loan Sale Agreement (including, for the avoidance of doubt, amounts attributable to Accrued Interest and Arrears of Interest thereon, as at the relevant repurchase date).

“**Revenue Receipts**” means:

- (a) payments of interest (excluding Accrued Interest and Arrears of Interest as at the relevant Transfer Date of a Loan) and other fees due from time to time under the Loans and other amounts received by the LLP in respect of the Loans other than the Principal Receipts;
- (b) recoveries of interest and outstanding fees from defaulting Borrowers under Loans being enforced; and
- (c) recoveries of interest and/or principal from defaulting Borrowers under Loans in respect of which enforcement procedures have been completed.

“**Sale Proceeds**” means the cash proceeds realised from the sale of Selected Loans and their Related Security.

“**Swap Collateral**” means, at any time, any asset (including, without limitation, cash and/or securities) which is paid or transferred by a Swap Provider to the LLP as collateral to secure the performance by such Swap Provider of its obligations under the relevant Swap Agreement together with any income or distributions received in respect of such asset (to the extent that corresponding amounts in respect thereof have not been paid to the Swap Provider) and any equivalent of such asset into which such asset is transformed (to the extent such asset has not been repaid or redelivered to such Swap Provider).

“**Swap Collateral Excluded Amounts**” means, at any time, the amount of Swap Collateral which may not be applied at that time in satisfaction of the relevant Swap Provider’s obligations to the LLP under the terms of the relevant Swap Agreement.

“**Swap Provider Default**” means the occurrence of an Event of Default or Termination Event (each as defined in each of the Swap Agreements) where the relevant Swap Provider is the Defaulting Party or the sole Affected Party (each as defined in relevant Swap Agreement), as applicable, other than a Swap Provider Downgrade Event.

“**Swap Provider Downgrade Event**” means the occurrence of an Additional Termination Event or an Event of Default (each as defined in the relevant Swap Agreement) following a failure by the Swap Provider to comply with the requirements of the ratings downgrade provisions set out in the relevant Swap Agreement.

The “**Sterling Equivalent**” of any amount means (a) in relation to a Covered Bond or Series of Covered Bonds which is denominated in a currency other than Sterling, the Sterling equivalent of such amount ascertained using the Covered Bond Swap Rate relating to such Covered Bonds and (b) in relation to a Covered Bond or Series of Covered Bonds denominated in Sterling, the applicable amount in sterling.

#### **Allocation and Distribution of Revenue Receipts Prior to the Service of a Notice to Pay**

Prior to service of a Notice to Pay or the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice or Service of an LLP Acceleration Notice on the Issuer and the LLP, Revenue Receipts will be allocated and distributed as described in *Pre-Acceleration Revenue Priority of Payments* below.

On the Calculation Date immediately preceding each LLP Payment Date, the LLP or the Cash Manager on its behalf shall calculate:

- (a) the amount of Available Revenue Receipts available for distribution on the immediately following LLP Payment Date;
- (b) the Reserve Fund Required Amount; and
- (c) where the Pre-Maturity Liquidity Test has been breached in respect of a Series of Covered Bonds, on each Calculation Date falling in the period commencing on the date of such breach and ending on the Final Maturity Date of the relevant Series of Covered Bonds, whether or not the amount standing to the credit of the relevant Liquidation GIC Sub-Account at such date is less than the Required Redemption Amount for the relevant Series of Covered Bonds at such date (together with the Required Redemption Amount of all other Series of Covered Bonds which mature prior to or on the same date as the relevant Series of Covered Bonds).

If an LLP Payment Date is the same as an Interest Payment Date, then the distribution of Available Revenue Receipts under the Pre-Acceleration Revenue Priority of Payments will be delayed until the Issuer and/or the Group Guarantor have made the scheduled interest and/or principal payments on that Interest Payment Date.

#### ***Pre-Acceleration Revenue Priority of Payments***

On each LLP Payment Date, the LLP or the Cash Manager on its behalf will transfer funds from the Revenue GIC Sub-Account to the Transaction Revenue Account, in an amount equal to the amount of Available Revenue Receipts.

Prior to service of a Notice to Pay or the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice or service of an LLP Acceleration Notice on the Issuer and the LLP, Available Revenue Receipts will be applied by or on behalf of the LLP on each LLP Payment Date (except for amounts due to third parties by the LLP under paragraphs (a) and (b), which shall be paid when due) in making the following payments and provisions (the “**Pre-Acceleration Revenue Priority of Payments**”) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction of any amounts due and payable by the LLP to third parties and incurred without breach by the LLP of the Transaction Documents to which it is a party (and for which payment has not been provided for elsewhere in the relevant Priorities of Payments) and to provide for any such amounts expected to become due and payable by the LLP in the immediately succeeding LLP Payment Period and to pay and discharge any liability of the LLP for taxes;

- (b) *second*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof of:
- (i) any remuneration then due and payable to the Servicers and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicers under the provisions of the Servicing Agreements in the immediately succeeding LLP Payment Period, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager under the provisions of the Cash Management Agreement in the immediately succeeding LLP Payment Period, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) amounts (if any) due and payable to the Account Bank (including costs) pursuant to the terms of the Bank Account Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iv) amounts due and payable to the Corporate Services Providers pursuant to the terms of the Corporate Services Agreements; and
  - (v) amounts due and payable to the Asset Monitor pursuant to the terms of the Asset Monitor Agreement (other than the amounts referred to in paragraph (j) below), together with applicable VAT (or similar taxes) thereon as provided therein;
- (c) *third*, to pay *pro rata* and *pari passu* any amount due to the Interest Rate Swap Providers (including any termination payment due and payable by the LLP under the relevant Interest Rate Swap Agreement (but excluding any Excluded Swap Termination Amount)) pursuant to the terms of the relevant Interest Rate Swap Agreements;
- (d) *fourth*, towards a credit to the Reserve GIC Sub-Account of an amount up to but not exceeding the amount by which the Reserve Fund Required Amount exceeds the existing balance on the Reserve GIC Sub-Account as calculated on the immediately preceding Calculation Date;
- (e) *fifth*, if the LLP is required to make a deposit to the relevant Series' Liquidation GIC Sub-Account in accordance with the LLP Deed, towards a credit *pro rata* to each Series Liquidation GIC Sub-Account of an amount in respect of such Series' Liquidation Ledger up to, but not exceeding, the difference between:
- (i) the Required Redemption Amount for such Series as calculated on the immediately preceding Calculation Date for the relevant Series of Covered Bonds; and
  - (ii) any amounts standing to the credit of such Series' Liquidation GIC Sub-Account on the immediately preceding Calculation Date;
- (f) *sixth*, if a Servicer Event of Default has occurred, all remaining Available Revenue Receipts to be credited to the Revenue GIC Sub-Account until such Servicer Event of Default is either remedied or waived by the Security Trustee or a new servicer is appointed to service the Portfolio (or the relevant part thereof);
- (g) *seventh*, in or towards payment *pro rata* and *pari passu* in accordance with the respective amounts thereof any Excluded Swap Termination Amount due and payable by the LLP under the relevant Interest Rate Swap Agreements;
- (h) *eighth*, towards payment of any amounts due and payable (excluding principal amounts due and payable) to the Issuer pursuant to the terms of the Intercompany Loan Agreement;
- (i) *ninth*, towards payment of any indemnity amount due to the Members pursuant to the LLP Deed;
- (j) *tenth*, towards payment of any indemnity amount due to the Asset Monitor pursuant to the Asset Monitor Agreement;
- (k) *eleventh*, in respect of Deferred Consideration due to the Sellers for the transfer of the Loans and their Related Security to the LLP, to pay all remaining Available Revenue Receipts (except for an amount equal to the profit to be paid to the Members in accordance with (l) below) to the Sellers *pari passu*, but so that only Available Revenue Receipts that are specifically attributable to Loans sold by a relevant Seller shall be paid to that Seller; and

- (l) *twelfth*, towards payment *pro rata* and *pari passu* to the Members of the sum of £3,000 (or such other sum as may be agreed by the Members from time to time) in aggregate, to be allocated and paid to each Member in proportion to their respective Capital Contribution Balances as at the relevant Calculation Date subject to a minimum of £1.00 each, as their profit for their respective interests as Members in the LLP.

#### **Allocation and Distribution of Principal Receipts Prior to Service of a Notice to Pay**

Prior to service of a Notice to Pay on the LLP or the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice or the service of an LLP Acceleration Notice on the Issuer and the LLP, Principal Receipts will be allocated and distributed as described in *Pre-Acceleration Principal Priority of Payments* below.

On each Calculation Date, the LLP or the Cash Manager on its behalf will calculate the amount of Available Principal Receipts available for distribution on the immediately following LLP Payment Date.

On each LLP Payment Date, the LLP or the Cash Manager on its behalf will transfer funds from the Principal GIC Sub-Account to the Transaction Principal Account, in an amount equal to the lower of (a) the amount required to make the payments described below and (b) the amount of all Available Principal Receipts.

If an LLP Payment Date is the same as an Interest Payment Date or Final Maturity Date, then the distribution of Available Principal Receipts under the Pre-Acceleration Principal Priority of Payments will be delayed until the Issuer and/or Group Guarantor have made scheduled interest and/or principal payments on that Interest Payment Date.

#### ***Pre-Acceleration Principal Priority of Payments***

Prior to service of a Notice to Pay or the occurrence of an HBOS Event of Default and the service of an HBOS Acceleration Notice or an LLP Acceleration Notice on the Issuer and the LLP, all Available Principal Receipts (other than Cash Capital Contributions made from time to time by the Issuer, which shall (subject to complying with the Asset Coverage Test) be distributed to the Issuer as a Capital Distribution) will be applied by or on behalf of the LLP on each LLP Payment Date in making the following payments and provisions (the “**Pre-Acceleration Principal Priority of Payments**”):

- (a) *first*, if the Pre-Maturity Liquidity Test has been failed by the Issuer in respect of any Series of Covered Bonds, to credit all Principal Receipts *pro rata* to each Series’ Liquidation GIC Sub-Account in an amount in respect of such Series’ Liquidation GIC Sub-Account up to but not exceeding the difference between:
  - (i) the Required Redemption Amount calculated on the immediately preceding Calculation Date for the relevant Series of Covered Bonds; and
  - (ii) any amounts standing to the credit of such Series’ Liquidation GIC Sub-Account on the immediately preceding Calculation Date;
- (b) *second*, to acquire New Loans and their Related Security offered to the LLP by the Sellers in accordance with the terms of the Loan Sale Agreement in an amount sufficient to ensure that taking into account the other resources available to the LLP, the LLP is in compliance with the Asset Coverage Test, but so that only Available Principal Receipts that are specifically attributable to Loans sold by a specific Seller shall be firstly applied to acquire New Loans and their Related Security from that Seller and thereafter to the extent that such Seller fails or declines to sell New Loans to the LLP, to acquire New Loans from any Seller and/or to acquire Substitution Assets;
- (c) *third*, to deposit the remaining Principal Receipts in the Principal GIC Sub-Account in an amount sufficient to ensure that taking into account the other resources available to the LLP, the LLP is in compliance with the Asset Coverage Test;
- (d) *fourth*, **provided that** all amounts outstanding under a Series of Covered Bonds have been repaid in full, in or towards repayment of the corresponding Term Advance related to such Series of Covered Bonds; and
- (e) *fifth*, subject to complying with the Asset Coverage Test, to make a Capital Distribution *pari passu* to each Member (other than the Liquidation Member and the Issuer) by way of distribution *pro rata* in proportion to such Member’s Capital Contribution Balance in the LLP,

in an amount equal to any remaining Available Principal Receipts, **provided that** (1) (subject to (3)) only Available Principal Receipts that are specifically attributable to Loans sold or Cash Contributions made by a specific Member (in its capacity as a Seller), shall be paid to that Member, (2) no Member shall receive an amount in aggregate that is greater than that Member's Capital Contributions Balance in the LLP, and (3) to the extent there remains any amount after taking into account (1) and (2), such surplus amount shall be distributed to the other Members (other than the Liquidation Member, the Issuer and any Member that has received an amount equal to its Capital Contribution Balance) by way of distribution *pro rata* in proportion to each Member's Capital Contribution Balance in the LLP.

#### **Allocation and Distribution of Monies Following Service of a Notice to Pay**

At any time after the service of a Notice to Pay on the LLP, but prior to service of an LLP Acceleration Notice on the Issuer and the LLP or service of an HBOS Acceleration Notice, all monies received will continue to be applied in accordance with the Pre-Acceleration Revenue Priority of Payments and the Pre-Acceleration Principal Priority of Payments, save that no monies may be applied under paragraphs (d), (i), (j), (k) or (l) of the Pre-Acceleration Revenue Priority of Payments or paragraphs (b), (c), (d) or (e) of such Pre-Acceleration Principal Priority of Payments, and so that the provisions of paragraph (a) of such Pre-Acceleration Principal Priority of Payments shall also apply to any breach of the Asset Coverage Test. These provisions will apply until the first to occur of (i) service of an LLP Acceleration Notice, (ii) service of an HBOS Acceleration Notice or (iii) the date on which in each case, the funds standing to the credit of each Series' Liquidation GIC Sub-Account are in an amount up to but not exceeding the Required Redemption Amount for such Series calculated on the immediately preceding Calculation Date.

Following service of an HBOS Acceleration Notice, on each LLP Payment Date, the LLP or the Cash Manager on its behalf will transfer funds from the GIC Sub-Accounts to the Transaction Accounts, in an amount equal to the lower of (a) the amount required to make the payments set out in the Guarantee Priority of Payments and (b) the amount standing to the credit of the GIC Sub-Accounts.

The LLP will create and maintain ledgers for each Series of Covered Bonds and record amounts allocated to such Series of Covered Bonds for the purposes of payments which may fall due under paragraphs (d) and (e) below, and such amounts, once allocated, will only be available to pay amounts due under the Covered Bond Guarantee and amounts due under the Covered Bond Swap relevant in respect of the relevant Series of Covered Bonds on the scheduled repayment date thereof.

On the date that all outstanding amounts under each Series of Covered Bonds have been repaid in full, all monies standing to the GIC Sub-Accounts will be applied in accordance with the Pre-Acceleration Revenue Priority of Payments and Pre-Acceleration Principal Priority of Payments as applicable and as set out above.

#### ***Guarantee Priority of Payments***

If a Notice to Pay is served on the LLP (as set out in the LLP Deed), the LLP shall following an HBOS Event of Default on the relevant Final Maturity Date apply all monies standing to the credit of the relevant Series' Liquidation GIC Sub-Account (and transferred to the Transaction Accounts on the relevant LLP Payment Date) to repay the relevant Series of Covered Bonds in accordance with the LLP Deed (as described in *Credit Structure – Pre-Maturity Liquidity*). Subject thereto, on each LLP Payment Date after the service of a Notice to Pay on the LLP (but prior to the occurrence of an LLP Event of Default), following the service of an HBOS Acceleration Notice the LLP or the Cash Manager on its behalf will apply monies standing to the credit of the Transaction Accounts to make the following payments and provisions in the following order of priority (the “**Guarantee Priority of Payments**”) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:
  - (i) all amounts due and payable or to become due and payable to the Bond Trustee in the immediately succeeding LLP Payment Period under the provisions of the Trust Deed together with interest and applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) all amounts due and payable or to become due and payable to the Security Trustee in the immediately succeeding LLP Payment Period under the provisions of the Deed of Charge together with interest and applicable VAT (or similar taxes) thereon as provided therein;

- (iii) any remuneration then due and payable to the Paying Agents under the provisions of the Agency Agreement together with applicable VAT (or similar taxes) thereon as provided therein; and
  - (iv) any amounts then due and payable by the LLP to third parties and incurred without breach by the LLP of the Transaction Documents to which it is a party (and for which payment has not been provided for elsewhere) and to provide for any such amounts expected to become due and payable by the LLP in the immediately succeeding LLP Payment Period and to pay or discharge any liability of the LLP for taxes;
- (b) *second*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:
- (i) any remuneration then due and payable to the Servicers and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicers in the immediately succeeding LLP Payment Period under the provisions of the Servicing Agreements together with applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager in the immediately succeeding LLP Payment Period under the provisions of the Cash Management Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) amounts (if any) due and payable to the Account Bank (including costs) pursuant to the terms of the Bank Account Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iv) amounts due and payable to the Corporate Services Providers pursuant to the Corporate Services Agreements; and
  - (v) amounts due and payable to the Asset Monitor (other than the amounts referred to in paragraph (j) below) pursuant to the terms of the Asset Monitor Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
- (c) *third*, in or towards satisfaction *pro rata* according to the respective amounts thereof, of any amounts due and payable to the Interest Rate Swap Providers (including any termination payment due and payable by the LLP under the relevant Interest Rate Swap Agreement but excluding any Excluded Swap Termination Amount) pursuant to the terms of the Interest Rate Swap Agreements;
- (d) *fourth*, to pay *pro rata* and *pari passu* according to the respective amounts thereof of:
- (i) the amounts due and payable to the Covered Bond Swap Provider (other than in respect of principal) *pro rata* and *pari passu* in respect of each relevant Series of Covered Bonds (including any termination payment due and payable by the LLP under the relevant Covered Bond Swap Agreement but excluding any Excluded Swap Termination Amount) in accordance with the terms of the relevant Covered Bond Swap Agreement; and
  - (ii) to the Bond Trustee or (if so directed by the Bond Trustee) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* Scheduled Interest that is Due for Payment on each Series of Covered Bonds,

**provided that** if the amount available for distribution under this paragraph (d) (excluding any amounts received from the Covered Bond Swap Provider) would be insufficient to pay the Sterling Equivalent of the Scheduled Interest that is Due for Payment on each Series of Covered Bonds under (ii) above, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis and the amount payable by the LLP to the Covered Bond Swap Provider in respect of each Series of Covered Bonds under (i) above shall be reduced by the amount of the shortfall applicable to the Covered Bonds in respect of which such payment is to be made;

- (e) *fifth*, to pay or provide for *pro rata* and *pari passu* according to the respective amounts thereof of:
- (i) the amounts (in respect of principal) due and payable to the Covered Bond Swap Provider *pro rata* and *pari passu* in respect of the relevant Series of Covered Bonds (including any termination payment due and payable by the LLP under the relevant Covered Bond Swap Agreement but excluding any Excluded Swap Termination Amount) in accordance with the terms of the relevant Covered Bond Swap Agreement;

- (ii) to the Bond Trustee or (if so directed by the Bond Trustee) the Principal Paying Agent on behalf of the Covered Bondholders *pro rata* and *pari passu* Scheduled Principal in relation to each outstanding Series of Covered Bonds;
  - (iii) an amount in respect of each outstanding Series of Covered Bond equal to the Sterling Equivalent of the Principal Amount Outstanding of such Series of Covered Bond (after deducting the amount of any Scheduled Principal due to be paid under paragraph (e)(ii)) to be paid to the Liquidation GIC Sub-Account maintained for such Series of Covered Bond; and
  - (iv) **provided that** if the amount available for distribution under this paragraph (e) (excluding any amounts received from the Covered Bond Swap Provider) would be insufficient to pay the Sterling Equivalent of the amounts that are, or will be, payable under (ii) or (iii) above, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis and the amount payable by the LLP to the Covered Bond Swap Provider in respect of each Series of Covered Bonds under (i) above shall be reduced by the amount of the shortfall applicable to the Covered Bonds in respect of which such payment is to be made;
- (f) *sixth*, to deposit the remaining monies in the GIC Sub-Accounts for application on the next following LLP Payment Date in accordance with the priority of payments described in paragraphs (a) to (e) (inclusive) above, until the Covered Bonds have been fully repaid or provided for (such that the Required Redemption Amount has been accumulated in respect of each outstanding Series of Covered Bonds);
  - (g) *seventh*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof of any Excluded Swap Termination Amount due and payable by the LLP to the relevant Swap Provider under the relevant Swap Agreement;
  - (h) *eighth*, after the Covered Bonds have been fully repaid or provided for (such that the Required Redemption Amount has been accumulated in respect of each outstanding Series of Covered Bonds), any remaining monies will be applied in and towards repayment in full of amounts outstanding under the Intercompany Loan Agreement;
  - (i) *ninth*, towards payment of any indemnity amount due to the Members pursuant to the LLP Deed;
  - (j) *tenth*, towards payment of certain costs, expenses and indemnity amounts due by the LLP to the Asset Monitor pursuant to the Asset Monitor Agreement; and
  - (k) *eleventh*, thereafter any remaining monies will be applied in accordance with the LLP Deed.

**Application of monies received by the Security Trustee following the occurrence of an LLP Event of Default and enforcement of the Security**

Under the terms of the Deed of Charge, all monies received or recovered by the Security Trustee (or a Receiver appointed on its behalf) following the occurrence of an LLP Event of Default and service of an LLP Acceleration Notice on the Issuer and the LLP will be applied following the enforcement of the Security in the following order of priority (the “**Post-Enforcement Priority of Payments**”) (in each case only if and to the extent that payments or provisions of a higher priority have been made in full):

- (a) *first*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:
  - (i) all amounts due and payable or to become due and payable to the Bond Trustee under the provisions of the Trust Deed together with interest and applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) all amounts due and payable or to become due and payable to the Security Trustee and any Receiver appointed by the Security Trustee under the provisions of the Deed of Charge together with interest and applicable VAT (or similar taxes) thereon as provided therein; and
  - (iii) any remuneration then due and payable to the Paying Agents under or pursuant to the Agency Agreement together with applicable VAT (or similar taxes) thereon as provided therein;
- (b) *second*, in or towards satisfaction *pro rata* according to the respective amounts thereof of:



- (i) any remuneration then due and payable to the Servicers and any costs, charges, liabilities and expenses then due or to become due and payable to the Servicers under the provisions of the Servicing Agreements, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (ii) any remuneration then due and payable to the Cash Manager and any costs, charges, liabilities and expenses then due or to become due and payable to the Cash Manager under the provisions of the Cash Management Agreement, together with applicable VAT (or similar taxes) thereon as provided therein;
  - (iii) amounts due to the Account Bank (including costs) pursuant to the terms of the Bank Account Agreement, together with applicable VAT (or similar taxes) thereon as provided therein; and
  - (iv) amounts (including costs and expenses) due to the Corporate Services Provider pursuant to the terms of the Corporate Services Agreement;
- (c) *third*, to pay *pro rata* and *pari passu* according to the respective amounts thereof, of any amounts due and payable to the Interest Rate Swap Providers (including any termination payment (but excluding any Excluded Swap Termination Amounts)) pursuant to the terms of the Interest Rate Swap Agreements;
- (d) *fourth*, to pay *pro rata* and *pari passu* according to the respective amounts thereof, of:
- (i) the amounts due and payable to the Covered Bond Swap Provider *pro rata* and *pari passu* in respect of each relevant Series of Covered Bonds (including any termination payment due and payable by the LLP under the relevant Covered Bond Swap Agreement (but excluding any Excluded Swap Termination Amount)) in accordance with the terms of the relevant Covered Bond Swap Agreement; and
  - (ii) to the Bond Trustee on behalf of the Covered Bondholders *pro rata* and *pari passu* in respect of interest and principal due and payable on each Series of Covered Bonds,
- provided that** if the amount available for distribution under this paragraph (d) (excluding any amounts received from the Covered Bond Swap Provider) would be insufficient to pay the Sterling Equivalent of the interest and principal due and payable on each Series of Covered Bonds under (d)(ii) above, the shortfall shall be divided amongst all such Series of Covered Bonds on a *pro rata* basis and the amount payable by the LLP to the Covered Bond Swap Provider in respect of each Series of Covered Bonds under (d)(i) above shall be reduced by the amount of the shortfall applicable to the Covered Bonds in respect of which such payment is to be made;
- (e) *fifth*, in or towards satisfaction *pro rata* and *pari passu* according to the respective amounts thereof, of any Excluded Swap Termination Amounts due and payable by the LLP to the relevant Swap Provider under the relevant Swap Agreement;
- (f) *sixth*, after the Covered Bonds have been fully repaid, any remaining monies shall be applied in or towards repayment in full of all amounts outstanding under the Intercompany Loan Agreement;
- (g) *seventh*, towards payment of any indemnity amount due to the Members pursuant to the LLP Deed; and
- (h) *eighth*, thereafter any remaining monies shall be applied in or towards payment to the Members pursuant to the LLP Deed.

## DESCRIPTION OF SOCIAL HOUSING SECTOR

### Introduction

The social housing sector provides housing for those without access to the means to adequately provide it for themselves and approximately 3.7 million households (18% of all households in England) comprised the social rented sector, based on 2007 Labour Force Survey data. Of those, approximately 60 per cent. were tenants of local authorities and approximately 1.5 million were tenants of housing associations.

The existence and size of the social housing sector is largely due to government initiatives and government funding and support for housing associations over the last three decades.

### Background to the Social Housing Sector

In England the provision of social housing can be traced at least back to the almshouses (some said to have been founded in the twelfth century), which still provide accommodation for over 30,000 households. Organisations with the characteristics of modern housing associations have existed, and have provided and managed, social housing since the early nineteenth century.

Through the course of the last two centuries, as a succession of Acts of Parliament shows, the government has become increasingly involved in social housing. In the twentieth century that involvement increasingly acquired a financial dimension. From 1919 onwards the expansion in social housing has been largely supported by central government subsidy for its construction; and the Housing Act 1930 and the Unemployment Assistance Act 1934 were the first steps in assisting the poor to meet the cost of housing by providing a form of financial support.

The Housing Act 1964 created the Housing Corporation, a statutory body subject to the control of the Department for Communities and Local Government and prepared the way for the present framework for the sector which has developed through the Housing Acts of 1974, 1980 and 1985, the Housing Associations Act 1985 and the Housing Acts of 1988, 1996 and 2004.

On 15th November 2007, a bill was introduced to Parliament that, if enacted, will have a significant impact on the statutory framework governing the social housing sector in England. For more information, see *The Housing and Regeneration Bill* below.

### The Role of the Housing Corporation

From 1964 the Housing Corporation has promoted and assisted in the development of housing associations, including registered social landlords, with the power to make Loans to them, compulsorily to purchase land for them, and to intervene and take action if any gets into difficulty. Subsequent Acts of Parliament have expanded its role and added to its powers so that it may be regarded as the regulatory authority for the sector. It maintains the register of “social landlords” (in which those who were registered housing associations under the Housing Associations Act 1985 are now registered under the Housing Act 1996). Its “section 9 consent”, named after that section of the Housing Associations Act 1985 (now section 9 of the Housing Act 1996), is required for all secured borrowings by registered social landlords. Through its administration of the grant system the Housing Corporation directs new social housing development in accordance with its assessments of long term housing demand. It publishes standards for expenditure on management and maintenance of social housing stock and monitors the performance, both operationally and financially, of registered social landlords. Under the Housing Act 1996 it has extensive powers to obtain information, and extended rights to propose and (with the consent of affected secured creditors) to take action should a registered social landlord be threatened with insolvency or the enforcement of any security which it has given.

### Housing Act 1996

Together with the orders made under it the Housing Act 1996 contemplates the extension of and extends the statutory framework which has governed the activities of registered housing associations in England and Wales under the Housing Associations Act 1985, which it largely replaced (as that Act replaced the Housing Act 1974).

As a result of the Housing Act 1996 “registered housing associations” under the Housing Associations Act 1985 are now called “registered social landlords”.

## **Registered Social Landlords**

Apart from the fact that it exists to provide social housing, a defining characteristic of a housing association, and an absolute requirement if the housing association is registered with the Housing Corporation, is that it must not trade for profit. Registration with the Housing Corporation makes the housing association subject to the supervision and control of the Housing Corporation. It also entitles the housing association to certain privileges, including eligibility for money from public sources. To be eligible for registration with the Housing Corporation a housing association must be a registered charity or a society registered with the Registrar of Friendly Societies under the Industrial and Provident Societies Act 1965 or a company incorporated under the Companies Act which satisfies certain conditions most recently set out in section 2(2) of the Housing Act 1996.

Some housing associations are registered charities and most are Industrial and Provident Societies registered with the Registrar of Friendly Societies or as companies limited by guarantee registered with the Registrar of Companies and some registered charities. Registration as an Industrial and Provident Society can be with charitable or non-charitable rules. Files held at the Registry of Friendly Societies on each registered social landlord which is an Industrial and Provident Society are publicly accessible and contain details of that housing association's rules, rule changes, annual returns and accounts, and any floating charges registered over its assets.

## **Charities**

An Industrial and Provident Society which is also a charity does not have to register with the Charity Commissioners (Section 3(5) and Schedule 2 of the Charities Act 1993) and is known as an "exempt charity". However the Charity Commissioners do have certain powers in relation to exempt charities. These include the power to authorise dealing with property that would otherwise be outside the powers of the charity in question and the power concurrently with the High Court to make schemes for the administration of a charity.

## **Housing Act 2004**

This is the most recent Housing Act. The Act impacts on social housing most noticeably through changes to the Right To Buy scheme (designed to halt potential abuse of the scheme), the extension of the power of the Housing Corporation to give social housing grants to non-registered social landlords and an extension to the Right to Acquire scheme.

## **The Management of Housing Associations which are Registered Social Landlords**

Each registered social landlord is controlled by a management committee (or board) of typically, unpaid, voluntary members, often professional people, with no pecuniary interest (which is a statutory requirement pursuant to Housing Act 1996 Schedule 1 Part 1) either in the association itself or in any third party which it employs. Training is available to members from various sources.

Paid officers, usually headed by a Chief Executive, are responsible for the day to day running of each association. The relevant senior officers report on a regular basis to the members, often grouped in sub-committees with delegated authority to deal with particular matters or geographic areas. It is normal practice now for the larger associations to have independent, internal audit teams which have direct reporting access to the members.

## **Management of Properties**

Housing management is the core function of registered social landlords and specialised systems have been developed for its performance. Generally, these are based around housing officers each of whom is responsible for a specific pool of properties and whose responsibilities extend from letting to rent collection and will include the provision of assistance to tenants in the claiming of housing benefit. In its Regulatory Code the Housing Corporation provides a specification of housing management requirements. The Corporation monitors the housing management performance of registered social landlords. A succession of independent surveys have recorded a high level of satisfaction among housing association tenants with the management service provided.

## **Maintenance of Properties**

The efficacy of housing association expenditure on maintenance is attested by the results of the English House Condition Survey which is published every five years by the Office of the Deputy Prime Minister. The last published survey (carried out in 2001 and published in July 2003) found registered social landlord properties provide the highest level of decent homes of all tenures, including

owner occupation, and to be largely well maintained. Non-decent homes are characterised as being unfit, in disrepair, in need of modernisation or providing insufficient thermal comfort. The Government proposed in the Green Paper to bring all social housing up to a decent standard by 2010. Progress in achieving this will be monitored by the Housing Corporation.

The Housing Corporation also monitors maintenance performance. Section 3 of the Regulatory Code imposes extensive requirements in respect of maintenance on registered social landlords. They should, among other things, maintain their housing stock in a lettable condition that exceeds the statutory minimum requirements; provide effective, efficient and responsive repair services to their residents with published service standards; and priority is given to having the necessary investment in the future of their stock.

### **The Housing and Regeneration Bill**

The Housing and Regeneration Bill (the “**Housing Bill**”) was introduced to Parliament on 15th November 2007. The Housing Bill in its current form if enacted will have a significant impact on the legislative framework surrounding the social housing sector in England. In particular, the Housing Bill enables the abolition of the Housing Corporation and in so doing creates two new organisations, the Homes and Communities Agency (the “**HCA**”) and the Office for Tenants and Social Landlords (the “**Office**”). Under the Housing Bill the HCA will undertake certain functions currently undertaken by the Housing Corporation relating to investment in housing and take over the role of English Partnerships in land acquisition and regeneration, with the Office, in its role as regulator of social housing in England, to assume the Housing Corporation’s regulatory functions, developing an approach to regulation that is justified and tailored to individual housing associations, while relying increasingly on associations’ self assessment and self regulation. The Housing Bill makes many other changes to the area of social housing, such as amending the way the Right to Buy scheme works.

The preceding paragraph is in no way intended to give a comprehensive and detailed summary of the Housing Bill and how, if enacted in its current form, it will affect the social housing sector and its surrounding legislative framework, but is merely intended to introduce prospective purchasers of Covered Bonds to its existence and potential impact on the Housing Corporation in particular. Prospective investors are urged to seek advice and to consult their professional advisers as to the possible consequences of the Housing Bill and how it will affect the social housing sector in general.

## THE PORTFOLIO

The Initial Portfolio and each New Portfolio acquired by the LLP (the “**Portfolio**”), consisting of Loans and their Related Security sold by Sellers to the LLP from time to time, in accordance with the terms of the Loan Sale Agreement, as more fully described under *Summary of the Principal Documents – Loan Sale Agreement*”.

For the purposes hereof:

“**Initial Portfolio**” means the portfolio of Loans and their Related Security, particulars of which are set out in the Loan Sale Agreement (other than any Loans and their Related Security which have been redeemed in full prior to the First Transfer Date), and all right, title, interest and benefit of the Original Seller in and to:

- (a) all payments of principal and interest (including, for the avoidance of doubt, all Accrued Interest and Arrears of Interest), and other sums due or to become due in respect of such Loans and Related Security including, without limitation, the right to demand, sue for, recover and give receipts for all principal monies, interest and costs and the right to sue on all covenants and any undertakings made or expressed to be made in favour of the relevant Original Seller under the applicable Loan Agreement;
- (b) the right to exercise all the powers of the Original Seller in relation thereto;
- (c) all the estate and interest in the Properties vested in the Original Seller;
- (d) each Certificate of Title and Valuation Report (in each case where available) and any right of action of the Original Seller against any solicitor, licensed conveyancer, qualified conveyancer, valuer or other person in connection with any report, valuation, opinion, certificate or other statement of fact or opinion given in connection with such Loans and Related Security, or any part thereof or affecting the decision of the Original Seller to make or offer to make any such Loan or part thereof;
- (e) all rights, title and interests of the Original Seller (including, without limitation, the proceeds of all claims) to which the Seller is entitled under any insurance policy taken out by a Borrower; and
- (f) any warranties of title given to the Borrower and assigned to the Seller by the Borrower in respect of any Property.

“**New Portfolio**” means in each case the portfolio of New Loans and their Related Security (other than any New Loans and their Related Security which have been redeemed in full prior to the Transfer Date or which do not otherwise comply with the terms of the Loan Sale Agreement as at the Transfer Date), particulars of which are set out in the relevant New Portfolio Notice, and all right, title, interest and benefit of the relevant Seller in and to the rights and assets set out in paragraphs (a) to (e) above (except that the “relevant Seller” should be read in place of “Original Seller”).

See also the following *Risk Factors under Risk Factors – Risk Factors relating to the LLP – Limited description of the Portfolio – Maintenance of Portfolio – Changes to the Lending Criteria of the Sellers and – The Loans of New Sellers may be included in the Portfolio*.

## DESCRIPTION OF LIMITED LIABILITY PARTNERSHIPS

Since 6th April, 2001 it has been possible to incorporate a limited liability partnership in England, Wales and Scotland (but not Northern Ireland) under the Limited Liability Partnerships Act 2000 (the “LLPA 2000”). Limited liability partnerships are legal entities that provide limited liability to the members of a limited liability partnership combined with the benefits of the flexibility afforded to partnerships and the legal personality afforded to companies.

### **Corporate characteristics**

A limited liability partnership is more like a company than a partnership. A limited liability partnership is a body corporate with its own property and liabilities, separate from its members. Like shareholders in a limited company, the liability of the members of a limited liability partnership is limited to the amount of their capital because it is a separate legal entity and when the members decide to enter into a contract, they bind the limited liability partnership in the same way that directors bind a company. Members may be liable for their own negligence and other torts, like company directors, if they have assumed a personal duty of care and have acted in breach of that duty. Third parties can assume that members, like company directors, are authorised to act on behalf of the limited liability partnership.

The provisions of the Companies Act and the Insolvency Act 1986 have been modified by the Limited Liability Partnerships Regulations 2001 so as to apply most of the insolvency and winding up procedures for companies equally to a limited liability partnership and its members. As a distinct legal entity a limited liability partnership can grant fixed and floating security over its assets and a limited liability partnership will survive the insolvency of any of its members. An administrator or liquidator of an insolvent member would be subject to the terms of the members’ agreement relating to the limited liability partnership, but a liquidator of an insolvent member may not take part in the administration of the limited liability partnership or its business.

Limited liability partnerships must file annual returns and audited annual accounts at Companies House for each financial year in the same way as companies.

### **Partnership characteristics**

A limited liability partnership retains certain characteristics of a partnership. It has no share capital and there are no capital maintenance requirements. The members are free to agree how to share profits, who is responsible for management and how decisions are made, when and how new members are appointed and the circumstances in which its members retire. The members’ agreement is a private document and there is no obligation to file it at Companies House.

### **Taxation**

Limited liability partnerships are tax transparent except in certain winding-up proceedings. As such, the members of a limited liability partnership, and not the limited liability partnership itself, are taxed in relation to the business of the limited liability partnership in broadly the same way that the members of a partnership are taxed in relation to the business of that partnership.

## TAXATION

### UK Taxation

*The following comments relate only to withholding and do not deal with any other aspect of the United Kingdom taxation treatment that may be applicable to holders of Covered Bonds (including, for instance, income tax, capital gains tax and corporation tax). The comments are of a general nature and are based on current United Kingdom law and practice.*

*Any holders of Covered Bonds who are in doubt as to their tax position (under the law of the United Kingdom and/or any other jurisdiction that may be relevant to such holders) should consult their professional advisers.*

#### ***Payment of Interest by the Issuer on the Covered Bonds***

Interest on the Covered Bonds may be paid without withholding or deduction for or on account of United Kingdom tax where the Covered Bonds are “listed on a recognised stock exchange” within the meaning of section 1007 of the Income Tax Act 2007. Her Majesty’s Revenue & Customs (“HMRC”) have stated on their website that the London Stock Exchange is a recognised stock exchange for these purposes. Securities will be treated as listed on the London Stock Exchange if they are admitted to the Official List and have been admitted to trading by the London Stock Exchange.

In all cases falling outside the exemption described above, interest on the Covered Bonds may be paid under deduction of United Kingdom income tax at the savings rate (currently 20 per cent.). However, if the draft United Kingdom Finance Bill 2008 is enacted in its current form, when the Finance Bill receives Royal Assent, the rate of withholding for the tax year 2008/2009 will be the basic rate (currently 20 per cent.). In each case, the withholding will be subject to such relief as may be available, for example under the provisions of any applicable double taxation treaty, or in certain other circumstances.

#### ***Payments by the Guarantors***

If a Guarantor makes any payment in respect of interest on the Covered Bonds (or any other amounts due under the Covered Bonds other than the repayment of amounts subscribed for under the Covered Bonds) such payment may be subject to United Kingdom withholding tax, whether or not the Covered Bonds are listed on a “**recognised stock exchange**”. If payments by the Group Guarantor are subject to any withholding or deduction for or on account of tax, additional amounts may become payable by the Group Guarantor subject to Condition 7. The LLP will not be required to pay such additional amounts.

#### ***Provision of Information***

Holders of Covered Bonds should note that where any interest on Covered Bonds is paid to them (or to any person acting on their behalf ) by the Issuer or any person in the United Kingdom acting on behalf of the Issuer (a “paying agent”), or is received by any person in the United Kingdom acting on behalf of the relevant holder of Covered Bonds (other than solely by clearing or arranging the clearing of a cheque) (a “collecting agent”), then the Issuer, the paying agent or the collecting agent (as the case may be) may, in certain cases, be required to supply to HMRC details of the payment and certain details relating to the relevant holder of Covered Bonds (including the holder’s name and address). These provisions will apply whether or not the interest has been paid subject to withholding or deduction for or on account of United Kingdom income tax and whether or not the holder of Covered Bonds is resident in the United Kingdom for United Kingdom taxation purposes. Where a holder of Covered Bonds is not so resident, the details provided to HMRC may, in certain cases, be passed by HMRC to the tax authorities of the jurisdiction in which the holder is resident for taxation purposes.

## SUBSCRIPTION AND SALE

The Dealers, in a programme agreement (as the same may be amended and/or supplemented and/or restated from time to time, the “**Programme Agreement**”) dated the Programme Date have agreed with the Issuer, the Group Guarantor and the LLP a basis upon which such Dealers or any of them may from time to time agree to purchase Covered Bonds. Any such agreement will extend to those matters stated under *Form of the Covered Bonds and Terms and Conditions of the Covered Bonds*. In the Programme Agreement, the Issuer (failing which, the Group Guarantor) will agree to reimburse the Dealers for certain of their expenses in connection with the establishment and any future update of the Programme and the issue of Covered Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

### **United States**

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

The Covered Bonds are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986, as amended, and regulations thereunder.

Each Dealer represents and agrees, and each subsequent Dealer appointed under the Programme will be required to represent and agree, that, except as permitted by the Programme Agreement it will not offer, sell or deliver Covered Bonds (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 issue date of the Tranche of which such Covered Bonds are a part, within the United States or to, or for the account or benefit of, U.S. persons. Each Dealer further agrees, and each subsequent Dealer appointed under the Programme will be required to agree, that it will send to each dealer to which it sells any Covered Bonds during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Covered Bonds within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this sub-paragraph have the meanings given to them by Regulation S under the Securities Act.

Until 40 days after the commencement of the offering of any Series of Covered Bonds, an offer or sale of such Covered Bonds within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act, if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Each issuance of Index Linked Covered Bonds or Dual Currency Covered Bonds shall be subject to such additional U.S. selling restrictions as the Issuer and the relevant Dealer(s) may agree as a term of the issuance and purchase of such Covered Bonds, which additional selling restrictions shall be set out in the applicable Final Terms.

### **Public Offer Selling Restriction under the Prospectus Directive**

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make an offer of Covered Bonds which are the subject of the offering contemplated by this Prospectus as completed by the Final Terms in relation thereto to the public in that Relevant Member State, except that it may, with effect from and including the Relevant Implementation Date, make an offer of Covered Bonds to the public in that Relevant Member State:

- (a) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;



- (b) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- (c) at any time for fewer than 100 natural or legal persons (other than qualified investors as defined in the Prospectus Directive) subject to obtaining the prior consent of the relevant Dealer or Dealers nominated by the Issuer for any such offer;
- (d) at any time if the denomination per Covered Bond being offered amounts to at least €50,000; or
- (e) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive.

provided that no such offer of Covered Bonds referred to in (a) to (e) above shall require the Issuer or any Dealer to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression “offer of Covered Bonds to the public” in relation to any Covered Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Covered Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Covered Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression “Prospectus Directive” means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

#### **Selling Restrictions addressing additional United Kingdom Securities Laws**

Each Dealer has represented and agreed that, and each further Dealer appointed under the Programme will be required to represent and agree that:

- (a) 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 Covered Bonds in circumstances in which Section 21(1) of the FSMA does not or, in the case of the Issuer would not, if it was not an authorised person, apply to the Issuer, the Group Guarantor or the LLP; and
- (b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Covered Bonds in, from or otherwise involving the United Kingdom.

#### **Japan**

The Covered Bonds have not been and will not be registered under the Financial Instruments and Exchange Law of Japan (Law No. 25 of 1948, as amended) and, accordingly, each Dealer undertakes that it will not offer or sell any Covered Bonds, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan except under circumstances which will result in compliance with all applicable laws, regulations and ministerial guidelines promulgated by the relevant Japanese governmental and regulatory authorities and in effect at the relevant time.

#### **The Netherlands**

Covered Bonds (including rights representing an interest in a Global Covered Bond) issued by the Issuer in respect of which the offer and sale to individuals or entities resident, domiciled or established in The Netherlands (“Dutch Residents”) has not been made in accordance with (b) below, shall only be issued to Dutch Residents in accordance with the following conditions (“High Denomination Notes”):

such Covered Bonds shall upon the relevant issue date have a minimum denomination of at least EUR 100,000 (or its foreign currency equivalent) or such lower amount as may be designated by an amendment to the Dutch Central Bank’s 2005 policy rules (*Beleidsregel 2005 kernbegrippen markttoetreding en handhaving Wtk 1992*; the “Policy Rules”) pursuant to the Exemption Regulation under the Dutch Act on the Supervision of Credit Institutions 1992 (*Wet toezicht kredietwezen 1992*; the “Exemption Regulation”) after the date hereof;

either the Issuer is not reasonably able to identify any Dutch Resident holders of such Covered Bonds on the relevant issue date (other than the Dealer(s)) or, to the extent such Covered Bonds are issued directly to such holders or issued in circumstances where the Issuer is reasonably aware of their identity on or prior to the issue date (as will be the case for the Dealers), such holders must qualify as a professional market party (“PMP”, as defined below) within the meaning of the Exemption Regulation and be verified as such by the Issuer on or prior to such issue date in accordance with the Policy Rules; and

such Covered Bonds are held at the time of issuance through a clearing system that is established in a European Economic Area member state, the United States, Japan, Australia, Canada or Switzerland in which securities can only be held through a licensed bank or securities firm or directly by a member of such clearing system qualifying as a PMP.

Covered Bonds (including rights representing an interest in a Global Covered Bond) which are not High Denomination Notes may only be offered, directly or indirectly, as part of their initial distribution or at any time thereafter, in The Netherlands, to Dutch Residents qualifying as “Professional Market Parties” or “PMPs” provided they acquire the Notes for their own account and provided that:

the Covered Bonds bear a legend to the following effect:

“THIS COVERED BOND (OR ANY INTEREST THEREIN) MAY NOT BE SOLD, TRANSFERRED OR DELIVERED TO INDIVIDUALS OR LEGAL ENTITIES WHO ARE ESTABLISHED, DOMICILED OR HAVE THEIR RESIDENCE IN THE NETHERLANDS (“DUTCH RESIDENTS”) OTHER THAN PROFESSIONAL MARKET PARTIES WITHIN THE MEANING OF THE EXEMPTION REGULATION UNDER THE DUTCH ACT ON THE SUPERVISION OF CREDIT INSTITUTIONS 1992 (AS AMENDED OR RE-ENACTED) (EACH, A “PMP”).

EACH DUTCH RESIDENT HOLDER OF THIS COVERED BOND (OR ANY INTEREST THEREIN), BY PURCHASING THIS COVERED BOND (OR ANY INTEREST THEREIN), WILL BE DEEMED TO HAVE REPRESENTED AND AGREED FOR THE BENEFIT OF THE ISSUER THAT (1) IT IS A PMP AND IS ACQUIRING THIS COVERED BOND (OR ANY INTEREST THEREIN) FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A PMP, THAT (2) THIS COVERED BOND (OR ANY INTEREST THEREIN) MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED TO DUTCH RESIDENTS OTHER THAN A PMP ACQUIRING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A PMP AND THAT (3) IT WILL, IN ACCORDANCE WITH THE 2005 POLICY RULES ON KEY CONCEPTS OF MARKET ACCESS AND ENFORCEMENT OF THE WTK (BELEIDSREGEL 2005 KERNBEGRIPPEN MARKTTOETREDING EN HANDHAVING WTK 1992) BY THE DUTCH CENTRAL BANK (DE NEDERLANDSCHE BANK N.V.), VERIFY THAT SUCH TRANSFEREE QUALIFIES AS A PMP; AND (4) IT WILL PROVIDE NOTICE OF THE TRANSFER RESTRICTIONS DESCRIBED HEREIN TO ANY SUBSEQUENT TRANSFEREE”

if such Covered Bonds have a maturity of less than 12 months and are money market instruments as referred to in article 1a(d) of the Decree on the Dutch Securities Markets Supervision Act 1995 (Besluit toezicht effectenverkeer 1995), such Covered Bonds must have a denomination of at least EUR 50,000 (or its equivalent in any other currency) per Covered Bond and if any such Covered Bonds are issued:

at a discount, they may only be offered if their issue price is no less than EUR 50,000 (or its equivalent in any other currency);

on a partly-paid basis, they may only be offered if paid-up by their initial holders to at least such amount; or

with a denomination of precisely EUR 50,000 (or its equivalent in any other currency), they may only be offered on a fully-paid basis and at par or at a premium.

In addition and without prejudice to the relevant restrictions set out under (A) and (B) above, Zero Coupon Notes (as defined below) in definitive form of the Issuer may only be transferred and accepted, directly or indirectly, within, from or into The Netherlands through the mediation of either the Issuer or a member firm of Euronext Amsterdam N.V. in full compliance with the Dutch Savings Certificates Act (Wet inzake spaarbewijzen) of 21 May 1985 (as amended) and its implementing regulations. No such mediation is required: (a) in respect of the transfer and acceptance of rights

representing an interest in a Zero Coupon Note in global form, or (b) in respect of the initial issue of Zero Coupon Notes in definitive form to the first holders thereof, or (c) in respect of the transfer and acceptance of Zero Coupon Notes in definitive form between individuals not acting in the conduct of a business or profession, or (d) in respect of the transfer and acceptance of such Zero Coupon Notes within, from or into The Netherlands if all Zero Coupon Notes (either in definitive form or as rights representing an interest in a Zero Coupon Note in global form) of any particular Series are issued outside The Netherlands and are not distributed into The Netherlands in the course of initial distribution or immediately thereafter. As used herein “Zero Coupon Notes” are Covered Bonds that are in bearer form and that constitute a claim for a fixed sum against the Issuer and on which interest does not become due during their tenor or on which no interest is due whatsoever.

“Professional Market Parties” or “PMPs” means:

any person or entity who or which is subject to supervision by a regulatory authority in any country in order to lawfully operate in the financial markets (which includes: authorised credit institutions, investment firms, other authorised or regulated financial institutions, insurance companies, collective investment schemes and their management companies, pension funds and their management companies, commodity dealers);

any person or entity who or which engages in a regulated activity on the financial markets but who or which is not subject to supervision by a regulatory authority (which includes: exempt credit institutions, investment firms, financial institutions, insurance companies, collective investment schemes and their management companies, pension funds and their management companies, commodity dealers);

the Dutch government (*de Staat der Nederlanden*), the Dutch Central Bank (*De Nederlandsche Bank N.V.*), a foreign governmental body being part of a central government, a foreign central bank, Dutch or foreign regional, local or other decentralised governmental institutions, international treaty organisations and supranational organisations;

any entity whose corporate purpose is solely to invest in securities (which includes, without limitation, hedge funds);

any company or legal entity which meets at least two of the following three criteria according to its most recent consolidated or nonconsolidated annual accounts: (i) an average number of employees during the financial year of at least 250; (ii) total assets of at least EUR 43,000,000; or (iii) an annual net turnover of at least EUR 50,000,000;

any company having its registered office in The Netherlands which does not meet at least two of the three criteria mentioned in (e) above and which has (a) expressly requested the Dutch Authority for the Financial Markets (*Stichting Autoriteit Financiële Markten*; the “AFM”) to be considered as a qualified investor, and (b) been entered on the register of qualified investors maintained by the AFM;

any natural person who is resident in The Netherlands if this person meets at least two (2) of the following criteria:

the investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, ten (10) per quarter over the previous four (4) quarters;

the size of the investor’s securities portfolio exceeds EUR 500,000; or

the investor works or has worked for at least one (1) year in the financial sector in a professional position which requires knowledge of investment in securities;

provided this person has:

expressly requested the AFM to be considered as a qualified investor; and

been entered on the register of qualified investors maintained by the AFM;

any company or legal entity that has been specifically established for the purpose of engaging (and that has engaged) in transactions resulting in the acquisition of assets (within the meaning of Article 2:364 Dutch Civil Code) that serve as security for negotiable instruments that are offered or about to be offered (including without limitation companies or entities engaged in securitisation transactions involving RMBS, CMBS, CDO’s, Credit Default Swaps, CLN’s and Covered Bonds);

where relevant and applicable, the subsidiaries of any of the entities mentioned under (a) through (h) above, provided such subsidiaries are subject to prudential supervision (either directly or indirectly through consolidated supervision at the level of their parent company);

any enterprise or entity with total assets of at least EUR 500,000,000 (or the equivalent thereof in another currency) according to its balance sheet at the end of the financial year preceding the date it provides repayable funds within the meaning of the Dutch Act on the Supervision of Credit Institutions (Wet toezicht kredietwezen 1992; the “WTK”);

any enterprise, entity or natural person with a net equity (eigen vermogen) of at least EUR 10,000,000 (or the equivalent thereof in another currency) according to its balance sheet at the end of the financial year preceding the date it provides repayable funds within the meaning of the WTK and who or which has been active in the financial markets on average twice a month over a period of at least two consecutive years preceding such date;

any entity that has a credit rating from an approved rating agency or that has issued securities having such a rating; and

such other entities designated by the competent Netherlands authorities after the date hereof by any amendment of the applicable regulations.

### **General**

Each Dealer agrees that it will (to the best of its knowledge and belief) comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Covered Bonds or possesses or distributes the Prospectus and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Covered Bonds under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and none of the Issuer, the Guarantors, the Bond Trustee, the Security Trustee and any other Dealer shall have any responsibility therefor.

None of the Issuer, the Guarantors, the Bond Trustee, the Security Trustee and any of the Dealers represents that Covered Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating any such sale.

With regard to each Tranche, the relevant Dealer will be required to comply with any additional restrictions agreed between the Issuer and the relevant Dealer and set out in the applicable Final Terms.

The Programme Agreement provides that the Dealers shall not be bound by any of the restrictions relating to any specific jurisdiction (set out above) to the extent that such restrictions shall, as a result of change(s) or change(s) in official interpretation, after the date hereof, of applicable laws and regulations, no longer be applicable but without prejudice to the obligations of the Dealers described in the paragraph headed *General* above.

## GENERAL INFORMATION

The Programme and the issue of Covered Bonds have been duly authorised by a resolution of a committee of the board of directors of the Issuer dated 7 December 2004, the giving of the Covered Bond Guarantee has been duly authorised by a resolution of a committee of the board of directors of each of the Members of the LLP dated 21 December 2004, and the giving of the Group Guarantee has been duly authorised by a resolution of a committee of the board of directors of HBOS passed on 30 November 2004.

The update of the Programme and the issue of further tranches of Covered Bonds has been duly authorised by:

- (1) Written resolutions of a committee of the board of directors of the Issuer dated 5 October 2007;
- (2) Written resolutions of a committee of the board of directors of the Group Guarantor dated 5 October 2007; and
- (3) A resolution of the management board of the LLP dated 18 October 2007.

### Listing of Covered Bonds

The admission of Covered Bonds to the Official List will be expressed as a percentage of their nominal amount (excluding accrued interest). It is expected that each Tranche of Covered Bonds which is to be admitted to the Official List and to trading on the regulated market of the London Stock Exchange will be admitted separately as and when issued, subject only to the issue of a Temporary Global Covered Bond or a Permanent Global Covered Bond as the case may be, initially representing the Covered Bonds of such Tranche. The listing of the Programme in respect of Covered Bonds is expected to be granted on or about 20 May 2008.

### Documents Available

So long as Covered Bonds are capable of being issued under the Programme, copies of the following documents will, when published, be available free of charge during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) from the registered office of the Issuer and from the specified office of the Paying Agent:

- (a) the Regulations of the Issuer and the constitutive documents of the Guarantors;
- (b) the consolidated audited financial statements of each of the Issuer and the Group Guarantor in respect of the financial periods ended 31 December 2006 and 2007. The Issuer and the Group Guarantor each currently prepares audited consolidated and non-consolidated accounts on an annual basis. The LLP currently prepares audited non-consolidated accounts on an annual basis;
- (c) the most recently published audited annual financial statements of the Issuer, the Group Guarantor and the most recently published unaudited interim financial statements (if any) of the Issuer and the Group Guarantor. The Issuer and the Group Guarantor each currently prepares unaudited consolidated and non-consolidated interim accounts on a semi-annual basis. The LLP is currently not required to produce any interim financial statements;
- (d) the most recently published audited non-consolidated annual financial statements of the LLP;
- (e) the forms of the Global Covered Bonds, the definitive Covered Bonds, the Receipts, the Coupons and the Talons;
- (f) a copy of this Base Prospectus;
- (g) any future Base Prospectus, Base Prospectuses, information memoranda and supplements including Final Terms (including a Final Terms relating to an unlisted Covered Bond) to this Base Prospectus and any other documents incorporated herein or therein by reference; and
- (h) each of the following transaction documents (the “**Transaction Documents**”), namely:
  - Loan Sale Agreement
  - Servicing Agreement
  - Intercompany Loan Agreement
  - LLP Deed
  - Cash Management Agreement
  - each Interest Rate Swap Agreement
  - each Covered Bond Swap Agreement

- Guaranteed Investment Contract
- Bank Account Agreement
- English Corporate Services Agreement and the Jersey Corporate Services Agreement
- Deed of Charge (and any documents entered into pursuant to the Deed of Charge)
- Trust Deed
- Agency Agreement
- Programme Agreement
- each Subscription Agreement (as applicable in the case of each issue of listed Covered Bonds subscribed pursuant to a subscription agreement)
- Master Definitions and Construction Agreement

### **Clearing Systems**

The Covered Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The appropriate Common Code and ISIN for each Tranche of Covered Bonds allocated by Euroclear will be specified in the applicable Final Terms. If the Covered Bonds are to clear through an additional or alternative clearing system the appropriate information will be specified in the applicable Final Terms.

### **Significant or Material Change**

There has been no significant change in the financial or trading position of the Issuer's Group, the Group Guarantor or the LLP since 31 December 2007 and there has been no material adverse change in the financial position or prospects of the Issuer's Group, the Group Guarantor or the LLP since 31 December 2007.

### **Litigation**

Save for the Test Case described on page 107 of this Base Prospectus, neither the Issuer's group, the Group Guarantor's group, nor the LLP is or has been involved in any governmental, legal or arbitration proceedings (including any proceedings which are pending or threatened of which the Issuer, either Group Guarantor or the LLP is aware) which may have or have had in the 12 months preceding the date of this Base Prospectus a significant effect on the financial position or the profitability of the Issuer's Group, the Guarantor's Group or the LLP.

### **Auditors**

The auditors of the Issuer, the LLP and the Group Guarantor are KPMG Audit Plc, chartered accountants and registered auditor. KPMG Audit Plc have audited, without qualification, in accordance with generally accepted auditing standards in the United Kingdom, the Issuer's and the Group Guarantor's accounts for the financial years ended on 31 December 2006 and 31 December 2007 and the LLP's accounts for the periods ended on 31 December 2006 and 31 December 2007.

### **Reports**

The Trust Deed provides that the Bond Trustee may rely on reports or other information from professional advisers or other experts in accordance with the provisions of the Trust Deed, whether or not any such report or other information, or engagement letter or other document entered into by the Bond Trustee and the relevant person in connection therewith, contains any monetary or other limit on the liability of the relevant person.

So long as the Covered Bonds are admitted to listing on the London Stock Exchange, the Issuer shall notify the London Stock Exchange of any replacement or substitution of the Issuer by filing a new Prospectus with the UK Listing Authority at the FSA. A Guarantor shall notify the London Stock Exchange of any replacement or substitution of a Guarantor by filing a supplemental Base Prospectus with the UK Listing Authority at the FSA. In addition, the Issuer or such Guarantor will publish a notice in respect of such replacement or substitution in accordance with Condition 13 of the Conditions.

### **Post-issuance**

The Issuer does not intend to provide post-issuance information.

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