

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION.** If you are in any doubt as to what action you should take, you are recommended to seek immediately your own financial advice from your stockbroker, solicitor, accountant or other independent financial adviser duly authorised under the Financial Services and Markets Act 2000 (“FSMA”) if you are resident in the United Kingdom or, if not, from another appropriately authorised independent financial adviser.

If you sell or have sold or otherwise transferred all of your HBOS Shares you should send any Application Form, if and when received, as soon as possible to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer is/was effected for delivery to the purchaser or the transferee. **However, the distribution of this document, the Application Forms and/or any related documents, and/or the transfer of the Open Offer Entitlements through CREST into jurisdictions other than the UK may be restricted by law and therefore persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any failure to comply with any such restrictions may constitute a violation of the securities laws or regulation of such jurisdictions. In particular, subject to certain exceptions, this document, the enclosures and the Application Form and any other such documents should not be distributed, forwarded to or transmitted in or into the United States or the Restricted Jurisdictions.** If you sell or have sold or otherwise transferred only part of your holding of HBOS Shares, you should retain any such documents received.

**You should read this document in its entirety and, in particular, Part II (“Risk Factors”), which you should read in full.**



## **HBOS plc**

*(incorporated under the Companies Act 1985 under registered number SC218813)*

### **Placing and Open Offer of 7,482,394,366 Open Offer Shares at 113.6 pence per Open Offer Share**

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This document is a prospectus relating to the Open Offer Shares which has been prepared in accordance with the Prospectus Rules of the Financial Services Authority (“FSA”) made under Section 73A of FSMA. This document has been approved by the FSA in accordance with Section 85 of FSMA and made available to the public in accordance with Rule 3.2 of the Prospectus Rules. HBOS has requested that the FSA provide a certificate of approval and a copy of this document to the relevant competent authority in each of Austria, Belgium, Cyprus, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, Netherlands, Norway, Portugal, Romania, Spain and Sweden.

Certain information in relation to the HBOS Group and the Lloyds TSB Group has been incorporated by reference into this document, see Part XXIV (“Information Incorporated by Reference”).

Dresdner Kleinwort Limited, which is authorised and regulated by the FSA, is acting for the Company and for no-one else in connection with the Placing and Open Offer and will not be responsible to anyone than the Company for providing the protections afforded to clients of Dresdner Kleinwort Limited, or for affording advice in relation to the Placing and Open Offer or any matters referred to herein. Dresdner Bank AG, London Branch, which is authorised by the German Federal Financial Supervisory Authority and authorised and subject to limited regulation by the FSA, is acting for the Company and for no-one else in connection with the Placing and Open Offer and will not be responsible to anyone other than the Company for providing the protections afforded to clients of Dresdner Bank AG, London Branch, or for affording advice in relation to the Placing and Open Offer or any other matters referred to herein. Details about the extent of Dresdner Bank AG, London Branch’s authorisation and regulation by the FSA are available from Dresdner Bank AG, London Branch on request.

Morgan Stanley & Co. International plc is acting for the Company and for no-one else in connection with the Placing and Open Offer and will not be responsible to anyone other than the Company for providing the protections afforded to clients of Morgan Stanley & Co. International plc, or for affording advice in relation to the Placing and Open Offer or any matters referred to herein.

Apart from the responsibilities and liabilities, if any, which may be imposed on any of Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley & Co. International plc by FSMA or the regulatory regime established thereunder, none of Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley & Co. International plc accept any responsibility whatsoever for the contents of this document or for any other statement made or purported to be made by any of them, or on behalf of any of them, in connection with the HBOS Group, the Lloyds TSB Group, the Enlarged Group, the Open Offer Shares, the Placing and Open Offer or the Acquisition.

Each of Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch and Morgan Stanley & Co. International plc accordingly disclaims all and any liability whatsoever whether arising in tort, contract or otherwise (save as referred to above) which any of them might otherwise have in respect of this document or any other such statement.

**The latest time and date for acceptance and payment in full under the Open Offer is 11.00 a.m. (London time) on 9 January 2009. The procedures for acceptance and payment is set out in Part VII (“Terms and Conditions of the Placing and Open Offer”) of this document and, where relevant, in the Application Form.**

Qualifying Non-CREST Shareholders will be sent an Application Form. Qualifying CREST Shareholders (who will not receive an Application Form) will receive a credit to their appropriate stock accounts in CREST in respect of their Open Offer Entitlements and Excess CREST Open Offer Entitlements which is expected to be enabled for settlement on 15 December 2008. Applications under the Open Offer may only be made by the Qualifying Shareholder originally entitled or by a person entitled by virtue of a *bona fide* market claim arising out of a sale or transfer of HBOS Shares prior to the date on which the HBOS Shares were marked “ex” the entitlement by the London Stock Exchange. Qualifying CREST Shareholders who are CREST sponsored members should refer to their CREST sponsors regarding the action to be taken in connection with this document and the Open Offer. The Application Form is personal to Qualifying Shareholders and cannot be transferred, sold, or assigned except to satisfy *bona fide* market claims.

Holdings of HBOS Shares in certificated and uncertificated form will be treated as separate holdings for the purpose of calculating entitlements under the Open Offer.

No statement in this document or incorporated by reference into this document is intended as a profit forecast or profit estimate for any period and no statement in this document or incorporated by reference into this document should be interpreted to mean that the earnings or earnings per share will necessarily be greater or lesser than those for the relevant preceding financial periods for either HBOS or Lloyds TSB, as appropriate.

The contents of this document should not be construed as legal, business or tax advice. Prospective investors should consult their own legal advisers, financial advisers or tax advisers for advice.

Any reproduction or distribution of this document in whole or in part, and any disclosure of its contents or use of any information herein for any purpose other than considering an investment in the Open Offer Shares is prohibited. Each offeree of the Open Offer Shares by accepting delivery of this document agrees to the foregoing.

Subject to certain exceptions, neither this document nor the Application Form constitutes an offer of Open Offer Shares to any HBOS Shareholder with a registered address in, or who is resident in, the United States or the Restricted Jurisdictions or to HBOS ADS holders. None of the Open Offer Shares have been or will be registered under the relevant laws of any state, province or territory of the United States or the Restricted Jurisdictions. This document does not constitute an offer to sell or a solicitation of an offer to buy Open Offer Shares in any jurisdiction in which such offer or solicitation is unlawful. Subject to certain exceptions, neither this document nor the Application Form will be distributed in or into the United States or any of the Restricted Jurisdictions. All Overseas Shareholders and any person (including, without limitation, a nominee or trustee) who has a contractual or legal obligation to forward this document or any Application Form, if and when received, or other document to a jurisdiction outside the United Kingdom should read paragraph 6 of Part VII (“Terms and Conditions of the Placing and Open Offer”).

**For the Open Offer, HBOS is relying upon exemptions from registration under the US securities laws for an offer that does not involve a public offering in the United States. None of the Open Offer Shares have been recommended by any US federal or state securities commission or any other US regulatory authority and they have not determined that this document is accurate or complete. Any representation to the contrary is a criminal offence.**

**The Open Offer Shares have not been and will not be registered under the Securities Act or under any other relevant securities laws of any state or other jurisdiction of the United States and, accordingly, may not be offered, sold, taken up, exercised, resold, renounced, transferred or delivered, directly or indirectly, in or into the United States at any time without registration or an applicable exemption from the registration requirements of the Securities Act and in compliance with state securities laws.**

Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch, Morgan Stanley & Co. International plc and HBOS may arrange for the offer of Open Offer Shares in the United States

only to persons reasonably believed to be “qualified institutional buyers” within the meaning of Rule 144A under the Securities Act (“QIBs”) in reliance on an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. The Open Offer Shares offered outside the United States are being offered in reliance on Regulation S under the Securities Act. **Prospective investors are hereby notified that sellers of the Open Offer Shares may be relying on the exemption from registration provisions under Section 5 of the Securities Act, as amended, provided by Rule 144A thereunder.**

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

Subject to certain exceptions, neither this document nor the Application Form constitutes, or will constitute, or forms part of any offer or invitation to sell or issue, or any solicitation of any offer to purchase or subscribe for, Open Offer Shares to any purchaser with a registered address in, or who is resident in, the United States. If you are in the United States, you may not acquire any Open Offer Shares offered hereby unless you are a QIB. Notwithstanding the foregoing, the Open Offer Shares may be offered to and acquired by a limited number of purchasers in the United States reasonably believed to be QIBs, in offerings exempt from or in a transaction not subject to, the registration requirements under the Securities Act. If you are a QIB, in order to acquire any Open Offer Shares, you must sign and deliver an investor letter, substantially in the form described in paragraph 6.1 of Part VII (“Terms and Conditions of the Placing and Open Offer”).

If you sign such an investor letter, you will be, amongst other things:

- representing that you and any account for which you are acquiring the Open Offer Shares are a QIB;
- agreeing not to reoffer, sell, pledge or otherwise transfer the Open Offer Shares and following completion of the Acquisition, Consideration Shares, except in an offshore transaction in accordance with Rule 904 of Regulation S under the Securities Act; and
- agreeing not to deposit any Open Offer Shares into HBOS’s ADS facilities and, following completion of the Acquisition, any Consideration Shares into Lloyds TSB’s ADS facilities.

Any envelope containing an Application Form and post-marked from the United States will not be valid unless it contains a duly executed investor letter in the appropriate form as described in paragraph 6.1 of Part VII (“Terms and Conditions of the Placing and Open Offer”). Similarly, any Application Form in which the exercising purchaser requests Open Offer Shares to be issued in registered form and gives an address in the United States will not be valid unless it contains a duly executed investor letter.

The payment paid in respect of Application Form(s) that does not meet the foregoing criteria will be returned without interest.

Any person in the United States who obtains a copy of this document and who is not a QIB is required to disregard it.

### **Available Information**

If, at any time, HBOS is neither subject to Section 13 or Section 15(d) of the US Securities Exchange Act of 1934, as amended, nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, HBOS will furnish, upon request, to any holder or beneficial holder of the Open Offer Shares, or any prospective purchaser designated by any such holder or beneficial owner, the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act. In such cases, HBOS will also furnish to each such owner all notices of general shareholders’ meetings and other reports and communications that HBOS generally makes available to shareholders.

### **Incorporation by reference of information published by Lloyds TSB**

As further described in this document, the Placing and Open Offer is inter-conditional with the Acquisition. Therefore, any Open Offer Shares acquired under the Placing and Open Offer will be acquired by Lloyds TSB pursuant to the Acquisition and holders of HBOS Shares (including those acquired by HBOS Shareholders or other investors under the Placing and Open Offer) will receive Lloyds TSB Shares in accordance with the terms of the Acquisition.

Lloyds TSB has today, 18 November 2008, published the Lloyds TSB Prospectus, which is the document that Lloyds TSB is required by the FSA to publish in order that all Lloyds TSB Shares

issued pursuant to the Lloyds TSB Placing and Open Offer and in connection with the Acquisition can be admitted to listing on the Official List and to trading on the London Stock Exchange's main market for listed securities.

Given the inter-conditionality of the Placing and Open Offer and the Acquisition referred to above, HBOS considers that certain information published by Lloyds TSB in the Lloyds TSB Prospectus concerning the Lloyds TSB Group and the Enlarged Group including, among other things, the future strategy for the Enlarged Group, is information which is necessary to enable HBOS Shareholders and others to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Company and of the rights attaching to the Open Offer Shares.

Accordingly, HBOS has incorporated by reference into this document certain information published by Lloyds TSB in the Lloyds TSB Prospectus and the Lloyds TSB Circular. Both these documents are available on the Lloyds TSB website at [www.mediacentre.lloydstsb.com/ir](http://www.mediacentre.lloydstsb.com/ir).

Due to the timing of publication of the Lloyds TSB Circular relative to the Lloyds TSB Prospectus, certain information in the Lloyds TSB Prospectus has itself been incorporated by reference from the Lloyds TSB Circular that was published on 3 November 2008. In accordance with the requirements of the UK Listing Authority, HBOS is consequently obliged to incorporate information which was itself incorporated by reference in the Lloyds TSB Prospectus, direct from the Lloyds TSB Circular.

Full details of all information that has been incorporated by reference into this document are set out in Part XXIV ("Information Incorporated by Reference"), which also describes how copies of all such information can be obtained.

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

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

## Currency Exchange Rate Information

The following table sets out the high rate of exchange for pounds, expressed in US dollars, in effect during the periods indicated, the low rate of exchange in effect during such periods, the rate of exchange in effect at the end of such periods and the average rate of exchange during such periods, in each case based on the Noon Buying Rate in New York City for cable transfers in foreign currencies as certified by the Federal Reserve Bank of New York (the “**Noon Buying Rate**”) for conversion of one pound to US dollars.

	<i>Calendar Year</i>				
	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>	<i>2003</i>
High	2.1104	1.9794	1.9292	1.9482	1.7842
Low	1.9235	1.7256	1.7138	1.7544	1.5500
Rate at end of period	1.9843	1.9586	1.7188	1.916	1.7842
Average rate per period <sup>(1)</sup>	2.0020	1.8434	1.8204	1.8330	1.6347

	<i>Calendar Month</i>					
	<i>November 2008 (until 14 November)</i>	<i>October 2008</i>	<i>September 2008</i>	<i>August 2008</i>	<i>July 2008</i>	<i>June 2008</i>
High	1.6156	1.7804	1.8558	1.9743	2.0038	1.9938
Low	1.4799	1.5472	1.7497	1.8190	1.9685	1.9467
Rate at end of period	1.4860	1.6165	1.7804	1.8190	1.9806	1.9906
Average rate per period <sup>(1)</sup>	1.5558	1.68833	1.7983	1.8869	1.9886	1.9665

(1) The average rate is calculated on the rate on each business day of the month for monthly averages, and on the last business day of each month for annual averages.

On 14 November 2008, the Noon Buying Rate for conversion of pounds into US dollars was £1.00 = \$1.4860.

No representation is made that pounds were, could have been, or could be, converted into US dollars at the above mentioned rates or at any other rate.

## DATE

This Prospectus is dated 18 November 2008.

## WHERE TO FIND HELP

A Shareholder Guide that will accompany the Application Form will provide further information for HBOS Shareholders. If you have further questions, please telephone the Shareholder Helpline on the numbers set out below.

From inside the UK: 0870 702 0102

From outside the UK: +44 870 702 0102

The Shareholder Helpline is available from 8.30 a.m. to 5.30 p.m. on any Business Day. Calls cost 6 pence, plus up to 6 pence per minute from a BT Together landline. Mobile and other providers' charges may vary.

**Please note that, for legal reasons, the Shareholder Helpline will only be able to provide information included in this document and information relating to the Company's register of members. It is not able to provide advice on the merits of the Open Offer, as to whether applicants should take up their Open Offer Entitlements or provide legal, financial, tax or investment advice.**

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## PART I

### SUMMARY

**THE FOLLOWING SUMMARY SHOULD BE READ AS AN INTRODUCTION TO THIS PROSPECTUS. ANY DECISION TO INVEST IN OPEN OFFER SHARES SHOULD BE BASED ON A CONSIDERATION OF THIS PROSPECTUS, AND THE DOCUMENTS INCORPORATED BY REFERENCE, AS A WHOLE.**

Where a claim relating to information contained in, or incorporated by reference into, this document is brought before a court, a plaintiff investor might, under the national legislation of the EEA States, have to bear the costs of translating this document before legal proceedings are initiated. Under the Prospectus Directive, in each member state of the European Economic Area, civil liability attaches to those persons who are responsible for this summary, including any translation of this summary, but only if this summary is misleading, inaccurate or inconsistent when read together with the other parts of this document (including information incorporated herein by reference).

#### 1 Introduction

On 18 September 2008, with the support of the UK Government, HBOS and Lloyds TSB announced a recommended acquisition of HBOS by Lloyds TSB. On 13 October 2008, as part of a co-ordinated package of capital and funding measures for the UK banking sector implemented by HM Treasury, HBOS and Lloyds TSB announced that they intended to participate in the Proposed Government Funding and thereby facilitate access to the UK Government backed provision of liquidity and that they had agreed to proceed with the Acquisition on revised terms.

Pursuant to the Proposed Government Funding, a combined total of £17 billion of capital (before costs and expenses) will be raised by HBOS and Lloyds TSB, of which £11.5 billion (£8.5 billion in ordinary shares and £3 billion in preference shares) will be raised by HBOS through the Capital Raising and £5.5 billion (£4.5 billion in ordinary shares and £1 billion in preference shares) will be raised by Lloyds TSB.

Immediately following the Effective Date, if none of the HBOS Shareholders participate in the Placing and Open Offer and none of the Lloyds TSB Shareholders participate in the Lloyds TSB Placing and Open Offer which is expected to complete immediately prior to the Acquisition, it is expected that existing HBOS Shareholders will own approximately 20 per cent. of the ordinary share capital of the Enlarged Group, existing Lloyds TSB Shareholders will own approximately 36.5 per cent. and that HM Treasury will own approximately 43.5 per cent., compared with 47.6 per cent., 52.4 per cent. and 0 per cent. respectively, if HBOS Shareholders and Lloyds TSB Shareholders fully participate in the Open Offer and Lloyds TSB Open Offer respectively.

The Acquisition and the Placing and Open Offer are inter-conditional. If the Acquisition, Placing and Open Offer and New HBOS Preference Share Issue do not complete, HBOS will be required to find alternative methods of increasing its capital base, and funding its business. On 11 October 2008, the FSA gave a preliminary indication to HBOS that if the Acquisition were not to occur, it would require HBOS to raise £12 billion of additional capital, made up of £9 billion of HBOS Shares and £3 billion of HBOS Preference Shares. Whilst HBOS would seek to raise additional capital in those circumstances, there can be no certainty that the amount required would not be more than £12 billion or that HBOS would be able to successfully raise capital or as to the terms on which capital could be raised, including the terms of any participation by HM Treasury in any capital raising, or as to whether such fundraising would be on a pre-emptive basis. Guidance provided by the written statement to Parliament issued by the Chancellor of the Exchequer on 18 November 2008 (which sets out the general principles which HM Treasury would expect to apply in dealing with future applications to the UK Government's bank recapitalisation scheme if those UK banks raising capital at the time of the statement sought to negotiate a substantially new proposal or new agreement with HM Treasury about a recapitalisation) confirms, *inter alia*, that on an ordinary equity issue, the price at which the UK Government might be prepared to participate would be the lower of a discount to then prevailing market price or, if applicable, the price agreed on 13 October 2008, and at a discount of not less than the discount agreed in any transaction already announced. Other qualifying criteria, as outlined by the Chancellor in that statement, would also need to be met.



There can also be no assurance that HBOS would be successful in increasing its capital to the levels required to qualify for access to the Proposed Government Funding arrangements or to satisfy the requirements of the FSA on an ongoing basis. This could result in an increase in funding costs arising from any credit rating downgrades or increased reliance on Government supported liquidity schemes; contraction of HBOS's balance sheet and a longer time horizon than the one contemplated by the Acquisition for the resumption of any dividend payments on HBOS Shares. Any capital raising might also be more dilutive and is unlikely to be available within the same time period as the Acquisition and Capital Raising.

There can be no certainty as to sources of capital if the HBOS Resolutions are not passed or the Acquisition does not proceed. The HBOS Directors would expect the UK Government to take appropriate action consistent with the policy objectives set out in HM Treasury's announcement of 8 October 2008 on Financial Support to the Banking Industry, which are to ensure stability of the financial system, and to protect ordinary savers, depositors, businesses and borrowers. Such action may include the issuance to HM Treasury of HBOS Shares on a basis which could be more dilutive to HBOS Shareholders than the Placing and Open Offer and the issuance to HM Treasury of other securities on terms less economically advantageous and more restrictive than the New HBOS Preference Shares or the loss of independent or private sector status for HBOS. The occurrence of any such action may cause the value of HBOS Shares to decline substantially with negative implications for HBOS Shareholders.

## **2 Summary of the Placing and Open Offer**

Qualifying Shareholders are being invited to apply to acquire approximately 7.5 billion Open Offer Shares at the Issue Price of 113.6 pence per Open Offer Share, to raise approximately £8.5 billion (before costs and expenses). To the extent Open Offer Shares are not taken up under the Open Offer, including the Excess Application Facility, or placed with placees other than HM Treasury pursuant to a placing, which may or may not take place, subject to certain conditions, HM Treasury has agreed to acquire such Open Offer Shares at the Issue Price.

Qualifying Shareholders, subject to the terms and conditions of the Open Offer, are being given the opportunity under the Open Offer to apply to acquire Open Offer Shares at the Issue Price on the following basis:

### **1.3839 Open Offer Shares for every one Existing HBOS Share**

An Excess Application Facility will enable Qualifying Shareholders to apply for Open Offer Shares in excess of their Open Offer Entitlement.

**The Placing and Open Offer is inter-conditional with the Acquisition such that any Open Offer Shares acquired under the Placing and Open Offer will be cancelled and exchanged for Lloyds TSB Shares pursuant to the Acquisition.** The terms of the Acquisition provide that each HBOS Share (including Open Offer Shares) will be exchanged for 0.605 Consideration Shares. The subscription for New HBOS Shares pursuant to the Placing and Open Offer is therefore equivalent to acquiring Lloyds TSB Shares at 187.77p per Lloyds TSB Share. Under the terms of the Lloyds TSB Placing and Open Offer, New Lloyds TSB Shares are being offered to Lloyds TSB Shareholders at 173.3p per New Lloyds TSB Share.

Before making any decision to acquire Open Offer Shares under the Placing and Open Offer, investors should consider both the HBOS share price and the Lloyds TSB share price in the market at that time, in the light of the implied price of 187.77p per Lloyds TSB Share. **If you have any doubt about what action to take, you should consult your independent financial adviser.**

It is expected that Open Offer Shares will be issued at 8.00 a.m. on 15 January 2009. The Open Offer Shares, which will be cancelled pursuant to the Acquisition, will not be admitted to listing on the Official List or trading on the London Stock Exchange or any other exchange. However, it is expected that the Consideration Shares, to be issued by Lloyds TSB to holders of Scheme Shares (including the Open Offer Shares) pursuant to the Acquisition will be issued on 16 January 2009 after close of trading. Applications will be made to the FSA for the Consideration Shares to be admitted to the Official List and for them to be admitted to trading on the London Stock Exchange's main market for listed securities. It is expected that Admission of the Consideration Shares will become effective, and that dealings in the Consideration Shares, fully paid, will commence at 8.00 a.m. on 19 January 2009.

### **3 Summary of the Acquisition Terms**

Under the terms of the Acquisition, and subject to the Conditions, HBOS Shareholders will be entitled to receive:

#### **0.605 of a Consideration Share for every 1 HBOS Share**

Based on the Closing Price of 166 pence per Lloyds TSB Share on 14 November 2008, prior to the completion of the Placing and Open Offer and the Lloyds TSB Placing and Open Offer, the Acquisition values HBOS at approximately £5.4 billion.

It is intended that the Acquisition will be effected by way of a scheme of arrangement and, subject to the satisfaction, or where appropriate, waiver, of the Conditions, it is expected that the Scheme will become Effective on 16 January 2009. The Acquisition remains subject to anti-trust review in a number of jurisdictions.

It is proposed that HBOS Preference Shares (including those held by HM Treasury at the relevant time) will be cancelled and that Replacement Lloyds TSB Preference Shares will be issued by Lloyds TSB in exchange.

The terms of the proposed Acquisition give HBOS Shareholders the opportunity to acquire a stake in a merged group that has a strong franchise and considerable scope to generate significant synergies. The Enlarged Group is expected to have excellent breadth and balance, with good positions in Retail, Corporate Banking, SME Business Banking and Long Term Savings.

Based on published information as at 30 June 2008, and taking into account Lloyds TSB's equity placing completed on 19 September 2008, the Placing and Open Offer, the Rights Issue and the Lloyds TSB Placing and Open Offer, it is estimated that the Enlarged Group would have had a core Tier 1 ratio of 8.8 per cent. at 30 June 2008.

### **4 Conditions to the Acquisition and the Placing and Open Offer**

The Placing and Open Offer, the Acquisition and the New HBOS Preference Share Issue are inter-conditional. If they do not complete or the relevant HBOS Resolutions are not approved, the Proposed Government Funding would not be available to HBOS.

The Placing and Open Offer, the Acquisition and the New HBOS Preference Share Issue will be conditional on, among other things:

- approval of the Scheme at the Court Meeting and by the Court;
- the relevant Lloyds TSB and HBOS resolutions required to implement the Acquisition and the Scheme being passed;
- the Placing and Open Offer Agreement having become unconditional in all respects;
- the Lloyds TSB Placing and Open Offer Agreement not having been terminated prior to the Scheme Court Hearing; and
- the New HBOS Preference Shares having been allotted.

### **5 Information on the HBOS Group and the Lloyds TSB Group**

#### **5.1 HBOS Group**

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 United Kingdom and internationally (Ireland, Australia, Europe and North America). The HBOS Group's products and services can be categorised into the following business divisions:

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

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(1) This unaudited data has been extracted (without adjustment) from the HBOS Interim Results 2008.

## 5.2 Lloyds TSB Group

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

## 6 Financial Information

For the six months ended 30 June 2008<sup>(1)</sup>, HBOS reported net operating income of approximately £2.4 billion and generated profit before taxation of £848 million (compared with net operating income of £12.4 billion and profit before taxation of £3.0 billion for the same period to 30 June 2007). HBOS reported total assets of £681.4 billion and shareholders' equity of £21.1 billion as at 30 June 2008 (as compared to total assets of £624.1 billion and shareholders' equity of £21.9 billion as at 30 June 2007).

For the six months ended 30 June 2008<sup>(2)</sup>, Lloyds TSB reported revenues of £4.6 billion and net income of £0.6 billion (compared with £5.6 billion and £1.6 billion, respectively, for the six months ended 30 June 2007). As at 30 June 2008, Lloyds TSB reported total assets of £367.8 billion and shareholders' equity of £10.8 billion (as compared to total assets of £353.1 billion and shareholders' equity of £11.4 billion at 30 June 2007). As at 30 June 2008, Lloyds TSB's risk asset ratios were 11.3 per cent. for total capital, 8.6 per cent. for Tier 1 capital and 6.2 per cent. for core Tier 1 capital.

## 7 Current Trading, Trends and Prospects

### HBOS Group

The HBOS Group is operating in difficult market conditions. Relative to the same period in 2007, in the nine months to the end of September 2008, profitability has been impacted by higher impairments, negative fair value adjustments to the Treasury Portfolio, the sale of BankWest and short term fluctuations in investment returns. However, despite higher funding costs, net interest income from the HBOS Group's banking businesses has increased and the Insurance & Investment business has made a good contribution. This, together with tight Group cost control, demonstrates the strength of the HBOS Group's core business.

HBOS's capital ratios benefit from the proceeds of the Rights Issue and capitalisation of the interim dividend for 2008. As at 30 September 2008, the HBOS Group's Tier 1 ratio was 8.1% and Core Tier 1 ratio was 6.0%.

In the Retail division, where secured lending arrears have risen broadly in line with our expectations, there has been an increase in the secured impairment charge to £440 million for the nine month period to 30 September 2008 (£213 million 30 June 2008). Unsecured lending arrears are as expected, giving rise to an impairment charge of £806 million for the same period (£509 million 30 June 2008).

In the Corporate division, since 30 June 2008, the Corporate credit environment has deteriorated, with an increasing number of customers operating under stressed conditions. The construction and real estate sectors have been impacted more severely than other sectors where current performance indicates lower levels of stress. We have been actively managing the increasing proportion of credits moving into the high risk category and will continue to do so. The total impairment charge for the nine month period to 30 September 2008 has increased to £1,721 million (£469 million 30 June 2008). The third quarter charge reflects a significant increase in the collective provision in view of the worsening economic outlook. The Corporate investment portfolio for the period to 30 September 2008 showed a loss of £93 million (£134 million profit 30 June 2008), taking into account profits on the sale of investment securities, other operating income, and share of profits/losses of associates and jointly controlled entities, less impairment on investment securities. Losses from associates and jointly controlled entities were £105 million in the period to 30 September (£34 million loss 30 June 2008) and impairment of investment securities increased to £284 million (£145 million 30 June 2008). As at 30 September 2008, the book value of the investment portfolio was £4.8 billion (£4.9 billion 30 June 2008).

In relation to the Treasury Portfolio, as at 30 September, losses due to market dislocation totalled £1,827 million (£1,095 million 30 June 2008), including £457 million impairment losses on the

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(2) This unaudited data has been extracted (without adjustment) from the Lloyds TSB Interim Results 2008.

Banking Book relating to Lehmans and Washington Mutual (£Nil 30 June 2008). Further impairment losses of around £150 million are expected to be taken in relation to Icelandic banks. Negative fair value adjustments (FVAs) to securities held in the Banking Book in the period to 30 September totalled on a post tax basis £3.8 billion (£1.9 billion 30 June 2008), including £588 million in respect of securities transferred from the Trading Book following the International Accounting Standards Board's decision to permit the reclassification of assets held in the Trading Book with effect from 1 July 2008.

### **Lloyds TSB Group**

The Lloyds TSB Group continues to trade well and deliver good income growth from its relationship businesses in an immensely challenging period for financial services companies. Excluding the impact of market dislocation, insurance-related volatility and higher impairments which have led to a substantial reduction in statutory profit before tax in the first nine months of 2008, each division has achieved revenue growth in excess of cost growth. Further improvement in the Lloyds TSB Group's cost:income ratio derives from the efficiency improvement programme which is expected by the Lloyds TSB Directors to deliver approximately £250 million in 2008. Lloyds TSB has also continued to capture market share, maintained its strong liquidity and funding position and remains on track to deliver a good trading performance in 2008.

Following the recent amendments to IAS 39 the Lloyds TSB Group has reviewed the classification of its trading portfolios. The effect of which has been to reduce the charge, in the third quarter of 2008, relating to market dislocation by £114 million, to £270 million. At 30 September 2008, the Lloyds TSB Group's portfolio of available-for-sale assets totalled £24.7 billion. During the third quarter of 2008, a net £792 million reserves adjustment was made to reflect the fact that, whilst not currently impaired, there has been a reduction in the market value of these assets.

The Lloyds TSB Group has also seen some improved signs of stabilisation in global money markets, lower LIBOR interest rates and an easing of general liquidity and funding pressures. The Lloyds TSB Group has recently secured some longer term funding, including a £400 million 10 year bond, without any recourse to any Government guarantees.

## **8. Enlarged Group Dividend Policy**

No dividend may be paid on Lloyds TSB Shares while any of the Enlarged Group HMT Preference Shares are outstanding, unless otherwise agreed by HM Treasury. This restriction does not preclude Lloyds TSB's issue of shares by way of the Capitalisation Issue for the 2008 financial year at a level to be determined by the Lloyds TSB Board at the appropriate time.

## **9 Risk Factors**

A number of factors affect the operating results, financial conditions and prospects of the HBOS Group and the Lloyds TSB Group and, following the Effective Date, will affect the operating results, financial condition and prospects of the Enlarged Group. In particular, investors should consider the following material risks:

### **9.1 Risks relating to the HBOS Group and its Business**

- general economic conditions;
- borrower and counterparty credit quality;
- changes in interest rates, credit spreads, foreign exchange rates and commodity and equity prices and other market risks;
- future earnings being affected by declines in financial asset valuations resulting from deterioration in market conditions;
- the use of financial models incorporating assumptions, judgments and estimates;
- liquidity and funding;
- insurance claims;
- investment business including investments returns and actuarial assumptions;
- operational and reputational risks;
- borrowing costs and credit ratings;
- capital requirements;
- significant regulatory developments;

- in certain jurisdictions, the HBOS Group is responsible for contributing to Compensation Schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers;
- litigation and regulatory investigations;
- associated with operating in a highly competitive environment;
- associated with changes in taxation rates or laws;
- failure to attract or retain senior management or other key employees; and
- if the Acquisition does not proceed, HBOS will be required to find alternative methods of increasing its capital base and funding its business.

**9.2 Risks relating to the Placing and Open Offer and to investments in the HBOS Shares:**

- Acquiring new HBOS Shares under the Open Offer may not be the most cost effective way to acquire new Lloyds TSB Shares;
- HBOS's share price will fluctuate; and
- HBOS Shareholders who do not acquire Open Offer Shares will experience dilution.

**9.3 Risks relating to the Lloyds TSB Group and, if the Acquisition becomes Effective, the Enlarged Group:**

- general and sector specific economic conditions;
- market fluctuations;
- market conditions resulting in material negative adjustments to the estimated fair values of financial assets;
- borrower and counterparty credit quality;
- liquidity;
- having insufficient capital resources to meet the minimum regulatory requirements;
- systemic risks;
- continuing deterioration of credit-worthiness of monoline insurers and other market counterparties;
- insurance claim rates and pension scheme benefit payment levels and changes in insurance customer and employee pension scheme member behaviour;
- the ability to maintain credit ratings;
- operational risks including weaknesses in internal processes and procedures;
- loss of consumer confidence and reduced retail deposits;
- terrorist acts and other acts of war, and geopolitical, pandemic or other such events;
- undertakings in the Lloyds TSB Placing and Open Offer Agreement;
- adverse regulatory developments or changes in government policy including potential costs relating to the FSCS;
- changes in taxation rates or law; and
- failure to attract or retain senior management or other key employees.

**9.4 Risks relating to the Acquisition:**

- the Acquisition does not become Effective, resulting in the need to raise additional capital in an alternative manner;
- the required HBOS Shareholder and Lloyds TSB Shareholder approvals will not be obtained;
- conditions to the Acquisition will not be satisfied or waived;
- not obtaining timely regulatory approvals for the Scheme and the Acquisition;
- the Acquisition may not yield the anticipated benefits, or that it may result in unanticipated costs;
- adverse tax consequences resulting from a change of ownership of HBOS; and
- change of control provisions or termination rights in HBOS Group's agreements may be triggered upon the completion of the Acquisition.

**9.5 *Risks relating to investment in Lloyds TSB Shares:***

- risk associated with HM Treasury potentially becoming the largest shareholder of the Enlarged Group;
- volatility in the price of Lloyds TSB Shares;
- Lloyds TSB will not be able to pay dividends until it has repurchased or redeemed the Enlarged Group HMT Preference Shares; and
- HM Treasury's actions under the BSP Act could impact on the rights of Lloyds TSB Shareholders and/or HBOS Shareholders.

**9.6 *Additional risks for Overseas Shareholders***

- that the ability to bring actions or enforce judgments against HBOS or HBOS Directors may be limited.

## PART II

### RISK FACTORS

*This section describes the risk factors which are considered by the HBOS Directors to be material in relation to the HBOS Group.*

*If the Acquisition becomes Effective, any HBOS Shares you hold on the Effective Date and any HBOS Shares you acquire in the Open Offer will be cancelled and exchanged for Lloyds TSB Shares and you will be subject to certain risks relating to the ownership of Lloyds TSB Shares. You should read "Risk Factors-Risks relating to the Placing and Open Offer and to investment in Lloyds TSB Shares" in Part II of the Lloyds TSB Prospectus for a description of these risks, which include risks relating to the Enlarged Group. These risks, along with the other risk factors in Part II of the Lloyds TSB Prospectus, are incorporated by reference into this prospectus. See "Incorporation by reference of information published by Lloyds TSB" on page 4 of this prospectus and Part XXIV ("Information Incorporated by Reference") of this prospectus for further information.*

*Where risks are described in terms of a risk to an investment in HBOS Shares, these apply and are equally relevant to the Open Offer Shares, as well as to the HBOS ADSs which are based on the underlying HBOS Shares.*

*The HBOS Group's operating results, financial condition and prospects could be materially and adversely affected by the risks described below. In that event, the value of the HBOS Shares or Consideration Shares could decline and investors could lose all or part of their investment in the HBOS Shares or Consideration Shares.*

*These risks should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. Additional risks and uncertainties that are not presently known to the HBOS Directors, or which they currently deem immaterial, may also have an adverse effect on the HBOS Group's operating results, financial condition and prospects. The information given is as of the date of this document and, except as required by the FSA, the London Stock Exchange, the Takeover Panel, the Listing Rules, the Prospectus Rules, the Disclosure and Transparency Rules, the City Code or any other applicable law or regulation, will not be updated. Any forward-looking statements are made subject to the reservations specified under "Forward-Looking Statements" on page 26 of this prospectus.*

*You should consider carefully the risks and uncertainties described below, together with all other information contained in this document and the information incorporated by reference herein, before making any investment decisions.*

#### **1 Risks relating to the HBOS Group and its Business**

##### **1.1 *The HBOS Group's business is affected by general economic conditions in the markets in which it operates and in particular in the UK. Adverse developments, such as the current and ongoing crisis in the global financial markets and further deterioration of general economic conditions, particularly in the UK, have already materially adversely affected the HBOS Group's earnings and profits and could lead them to deteriorate further***

The HBOS Group's business is affected by economic conditions in the UK, where the majority of the HBOS Group's earnings are generated, as well as in the other geographical areas in which it operates. Over approximately the past 15 months, the global economy and the global financial system have been experiencing a period of significant turbulence and uncertainty, particularly the dislocations of the financial markets around the world that began in August 2007 and which have substantially worsened since September 2008. This dislocation has severely impacted general levels of liquidity, the availability of credit and the terms on which credit is available. This crisis in the financial markets led the UK and other governments to inject liquidity into the financial system and to require (and participate in) recapitalisation of the banking sector to reduce the risk of failure of certain large institutions and provide confidence to the market. Despite this intervention, the volatility of, and market disruption in the banking sector have continued to a degree unprecedented in recent history. This market dislocation has also been accompanied more recently by recessionary conditions and trends in a number of economies across the world, including the UK. There is increasing concern about a deep and prolonged global recession.

These conditions have already led to significant write-downs of investment and trading portfolios and increased impairment losses and thereby have adversely affected the HBOS Group's earnings and financial position. Continued deterioration in the UK or other major economies throughout the world, including, but not limited to, business and consumer confidence, employment trends, the state of the economy, including the state of the UK housing market, the commercial real estate sector, equity and bond markets, inflation, the availability and cost of credit, the liquidity of, global financial markets and market interest rates at the time may significantly impact the HBOS Group's earnings and financial position. In particular, significantly higher UK unemployment, reduced corporate profitability and/or increased corporate or personal insolvency rates are expected to reduce borrowers' ability to repay loans and may cause prices of residential or commercial real estate or other asset prices to fall further, thereby reducing the collateral value of many of the HBOS Group's loans and increasing impairment losses. An economic downturn, lower transaction volumes in key markets, such as UK housing, and/or difficult market conditions are also expected to reduce demand for and persistency of certain of the HBOS Group's products, resulting in lower volumes and profitability. The HBOS Group's investment and trading portfolios have been adversely affected by the general economic downturn and market volatility, and a deepening of the downturn and further market volatility may lead to further write-downs of investments. The profitability of the HBOS Group's insurance business could be affected by increased claims from factors such as increased unemployment. The HBOS Group has been and will continue to be exposed to adverse economic conditions in other jurisdictions where it has material operations.

**1.2 *The financial performance of the HBOS Group is affected by borrower and counterparty credit quality in the markets in which it operates, in particular in the UK. The UK and global economy has deteriorated recently and faces further difficult conditions. This has led to a significant rise in the HBOS Group's impairment provisions against loans and write-downs in investments and continued deterioration of the UK or global economy may cause significant further rises***

Risks arising from changes in credit quality and the recoverability of loans, investments and amounts due from counterparties are inherent in a wide range of HBOS's businesses. Adverse changes in the credit quality of HBOS's borrowers and counterparties, their behaviour and falls in collateral values have affected and may further affect the recoverability and value of HBOS's assets and require further increases in HBOS's impairment provision for bad and doubtful debts and other provisions and in turn adversely affect the financial performance of the HBOS Group. In particular, higher UK unemployment, reduced corporate profitability, declining asset prices and/or increased personal or corporate insolvencies and/or increased interest rates may reduce borrowers' ability to repay loans.

The HBOS Group provides secured and unsecured loans to borrowers, principally in the UK. UK house prices have declined significantly in recent months, reflecting deteriorating economic conditions, falling buyer confidence, reduced affordability and lower availability of credit from lenders. General deterioration in the economy and continued dislocation of the financial system, combined with continued tightened lending criteria, are expected to lead to further falls in house prices. Many borrowers in the UK borrow on short-term fixed or discounted floating rates and when such rates expire the continued reduced supply of mortgages, together with the potential for higher mortgage rates, may lead to some borrowers facing significantly higher mortgage interest payments, which could result in higher delinquency rates. The HBOS Group provides mortgages to homeowners (including self-certified borrowers) and also to buy-to-let investors, where an excess supply of rental property or falls in rental demand could also impact the borrowers' income and ability to service the loans. These factors and more difficult general economic conditions, such as increased unemployment, could lead to a further material increase in impairment losses.

The HBOS Group has exposures to a range of corporate customers in different sectors. These exposures arise from loans, joint ventures and equity and other investments. Within its portfolio, the HBOS Group has exposures to investors in and developers of commercial real estate and residential property. Commercial real estate prices have shown significant declines over the last 15 months and developers of commercial and residential property are facing particularly challenging market conditions, including substantially lower prices and volumes. Beyond this sector, economic conditions are deteriorating more broadly and this may lead to



further declines in values of collateral and investments, weakening consumer and corporate spending, declining corporate profitability and an increase in corporate insolvencies. These developments could materially adversely impact the HBOS Group's ability to recover on these loans or lead to write-downs of investments.

The HBOS Group routinely executes a high volume of transactions with and has significant exposures to counterparties in the financial services industry, including insurance companies, brokers and dealers, commercial banks, investment banks and other institutional clients. The financial sector has recently faced unprecedented turbulence, including significant numbers of failures or nationalisations of financial institutions. The HBOS Group has incurred significant impairment losses on exposures to a number of counterparties affected by this turmoil. The HBOS Group remains exposed to counterparty risk across a broad range of financial institutions and will continue to be exposed to the risk of loss if counterparty financial institutions fail or are otherwise unable to meet their obligations.

The HBOS Group uses a range of policies and techniques to mitigate credit risk, including credit scoring, behavioural scoring and affordability measures for retail portfolios, credit assessments for corporate portfolios and credit risk policies. The HBOS Group also imposes product, sector and country limits to avoid excessive concentrations of risk. However, these measures will only mitigate, and not avoid, credit risk and the assumptions on which they are based may prove inadequate or inaccurate in light of economic changes, such as the current period of unprecedented economic stress, or otherwise, in which case credit risk could have a material adverse impact on the HBOS Group's financial condition and results of operations.

### **1.3 *Changes in interest rates, credit spreads, foreign exchange rates and commodity and equity prices and other market risks affect the HBOS Group's business and financial results***

Market risk is defined as the potential loss in value or earnings of the HBOS Group arising from changes in external market factors such as interest rates, credit spreads, foreign exchange rates, commodity and equity prices and the potential for customers to act in a manner which is inconsistent with business, pricing and hedging assumptions. Changes in interest rate levels, yield curves and credit spreads may affect the interest rate margin realised between lending and borrowing costs. Since August 2007, there has been a period of high and volatile inter-bank lending rates, which has exacerbated this issue. In order to remain competitive, or as a result of rates being fixed in existing loan commitments or facilities, the HBOS Group may be unable to increase the interest rates that it charges to its customers in response to increases in interest rates that affect its wholesale borrowing or increases in the rates it pays to wholesale and retail customers, thereby leading to reduced margins.

Changes in currency rates affect the value of assets and liabilities denominated in foreign currencies and may affect earnings reported by HBOS. In the HBOS Group's international businesses, earnings and net assets are denominated in local currency, which will fluctuate with exchange rates in sterling terms.

Market risk within the insurance and investment businesses arises in a number of ways and depending upon the product: some risks are borne directly by the customer and some by the HBOS Group's insurance and investment businesses. Some insurance contracts involve guarantees or options that increase in value in adverse markets. There is a risk that the insurance and investment businesses will bear some of the cost of such guarantees and options. Further, the performance of investment markets (such as equities, property and fixed income) have a direct impact on the HBOS Group's financial position and performance and can affect investor confidence, resulting in lower sales or reduced persistency.

Market and other risks – principally interest rate, inflation, equity and mortality – also arise from the HBOS Group's defined benefit pensions obligations.

Marketable assets are held in the HBOS Group's trading and banking books and give rise to market risk as a result of movements in credit spreads. This risk, and its possible impact, is described under "HBOS's future earnings could be affected by declines in financial asset valuations resulting from deterioration in market conditions" below.

It is difficult to predict with accuracy changes in economic or market conditions, and further deterioration would have a material adverse effect on the HBOS Group's business, financial position and results of operations.

#### **1.4 *HBOS's earnings have been and could be further affected by declines in financial asset valuations resulting from deterioration in market conditions***

Financial markets have recently been subject to stress conditions unprecedented in recent times, where steep falls in perceived or actual asset values have been accompanied by a severe reduction in market liquidity.

The HBOS Group's Treasury division holds a portfolio of debt securities. Included within this portfolio, the HBOS Group has credit exposure to monolines, both through wrapped bonds and purchased credit default swap protection. Monoline and other insurers have been adversely affected by exposures to residential mortgages and their perceived creditworthiness has deteriorated significantly. The HBOS Group has made substantial negative fair value adjustments relating primarily to its holdings of asset backed securities and floating rate notes in its trading books, and to its available for sale reserves in respect of its holding of debt securities in its banking book. In addition, it has incurred significant impairment losses on certain of its floating rate notes arising from the failure of a number of financial institutions during recent turmoil in the financial system.

The fair value of these assets could fall further and therefore result in additional negative adjustments, particularly in light of current dislocation and the threat of global recession. In addition, default by a monoline insurer in respect of wrapped bonds or credit default swaps held by the HBOS Group would lead to significant further deterioration in asset values. Valuations in future periods, reflecting then-prevailing market conditions, may result in further negative changes in the fair values of the HBOS Group's treasury assets. The value ultimately realised by HBOS may be different from the current or estimated fair value and continued deterioration in the global financial system or the global economy may result in further credit impairments. Any of these factors could require HBOS to recognise further fair value adjustments or realise impairment charges, any of which may have a material adverse effect on its capital position, financial condition and results of operations.

#### **1.5 *The values of certain securities held by the HBOS Group are recorded at fair value as determined by using financial models incorporating assumptions, judgements and estimates that are inherently uncertain and which may change over time***

Under IFRS as adopted by the EU, HBOS recognises at fair value: (i) financial instruments classified as "held-for-trading" or "designated as at fair value through profit or loss", (ii) financial assets classified as "available-for-sale" and (iii) derivatives. The fair value of investment securities trading in active markets is based on market prices or broker/dealer valuations. Where quoted prices on instruments are not readily and regularly available from a recognised broker, dealer or pricing service, or available prices do not represent regular transactions in the market (as is the case at times of market stress as has been experienced in recent months), the fair value is estimated. These estimates are referenced based on quoted market prices for securities with similar credit, maturity and yield characteristics or similar valuation models. In certain circumstances, the data for individual financial instruments or classes of financial instrument utilised by such valuation models may not be available or may become unavailable due to market stress, and to the extent available, may not be representative of fair values, as has recently been the case. In such circumstances, HBOS's internal valuation models require it to make assumptions, judgements and estimates in order to establish fair value. In common with other financial institutions, these internal valuation models are complex, and the assumptions, judgements and estimates HBOS is required to make often relate to matters that are inherently uncertain, particularly so in light of the current and ongoing crisis in the financial markets, and may result in valuations that vary significantly from available broker/dealer quotations. Such assumptions, judgements and estimates are updated to reflect changing trends and market conditions. If the recent deterioration in market conditions were to continue, there is a risk that the fair values of these securities could be materially reduced. Any change in the fair values of the financial instruments could have a material adverse effect on the HBOS Group's business, financial position and results of operations.

#### **1.6 *Funding and liquidity risks are inherent in the HBOS Group's operations***

Liquidity risk is the risk that the HBOS Group does not have sufficient financial resources to meet its obligations when they fall due or will have to do so at excessive cost. This risk arises from mismatches in the maturities and the timing of cashflows relating to assets,

liabilities and off-balance sheet instruments. The HBOS Group relies and intends to rely increasingly on customer savings and transmission balances, as well as ongoing access to the wholesale lending markets, central bank liquidity facilities such as the Special Liquidity Scheme and the Extended Open Market Operations operated by the Bank of England, and support from HM Treasury's guarantee scheme.

The ability of the HBOS Group to access wholesale funding sources and raise retail deposits on favourable economic terms is dependent on a variety of factors, including a number of factors outside of its control, such as general market conditions including the state of UK and global finance markets, an increase in competitive behaviour, and confidence in the UK banking system in general or the HBOS Group in particular. Following speculation on HBOS's future in mid-September, the HBOS Group suffered deposit outflows. In the retail and corporate markets, any further loss in confidence in the UK banking system or the HBOS Group could lead to significantly increased retail or commercial deposit withdrawals and could prevent the HBOS Group from meeting minimum liquidity requirements. In wholesale markets, the HBOS Group has previously looked 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.

As a result of the increasingly turbulent conditions in the global financial markets in the second half of 2008, there has been a significant deterioration in the inter-bank and term funding markets and a consequent material reduction in the availability of longer-term funding. As a result, HBOS has had to source more shorter-term and overnight funding, with a consequent increase of refinancing risk.

In recent months, the strain in the financial systems has increased substantially, leading to a significant tightening in market liquidity and the threat of a more marked deterioration in the global economic outlook, with a consequent increase in recourse to liquidity schemes provided by central banks. While various governments including the UK government have taken substantial measures to ease the current crisis in liquidity, such as the measures announced in the UK on 8 October 2008 and 13 October 2008, there can be no assurance that these global measures will succeed in improving the funding and liquidity of the markets in which the major banks, including the HBOS Group, operate. In addition, the availability and the terms on which central bank liquidity facilities (such as those offered by the Bank of England) as well as HM Treasury's guarantee scheme will be made available to the HBOS Group and how and when such measures will be implemented are uncertain. There can be no assurance that these measures will not lead to an increase in the overall cost of funding of the HBOS Group. The HBOS Group expects it will substantially rely for the foreseeable future on the continued availability of central bank liquidity facilities (particularly those with the Bank of England) as well as HM Treasury's guarantee scheme for short- and medium-term debt issuance. If the Bank of England liquidity facilities, HM Treasury's guarantee scheme or other sources of short-term funding do not continue to be made available at current levels or at all, or if the current systemic market liquidity stress worsens, the HBOS Group could face serious liquidity constraints, which could have a material adverse impact on its solvency and, in the absence of the UK Government taking appropriate action to support the HBOS Group's liquidity consistent with the policy objectives set out in HM Treasury's announcement of 8 October 2008, could cause the value of HBOS Shares to decline substantially, with negative implications for HBOS Shareholders and, *in extremis*, could result in HBOS being unable to meet its ongoing funding requirements.

#### **1.7 The HBOS Group's insurance businesses are subject to inherent risk involving claims**

Insurance risk is the risk that claims arise (in both life assurance and general insurance contracts) from events outside the HBOS Group's control over and above those which have been assumed in pricing and reserving.

Catastrophic weather conditions, particularly storms and flooding, and adverse changes in economic conditions, including increased unemployment, could lead to increased general insurance claims. While the HBOS Group reinsures some of the risks it has assumed, especially in order to mitigate the impact of extreme weather events in the household book, increased claims would adversely affect the profitability of current and future insurance products and services.

Demographic and medical developments, which give rise to changes in mortality and morbidity, could have an adverse impact on the value of the HBOS Group's life assurance portfolio.

**1.8 *The HBOS Group's investment businesses are subject to inherent risks including investment returns and actuarial assumptions***

Changes in the general economic climate, conditions of financial markets (equities, property or fixed interest assets) and competitor actions can impact the level of demand for the HBOS Group's investment products, their persistency, the value of assets under management and the profit of the HBOS Group's businesses.

Under IFRS, UK banks account for long term assurance contracts, being insurance contracts and investment contracts with discretionary participation features, on an Embedded Value ("EV") basis. Applying the EV basis results in the earlier recognition of profit on new business, but subsequently a lower contribution from existing business, when compared to the recognition of profits on investment contracts under IAS 39 (Financial Instruments: Recognition and Measurement). Differences between actual and expected experience on existing business may have a significant impact on an EV basis, as changes in experience can result in significant adjustments to modelled future cashflows. EV is calculated based on best estimate assumptions made by management, including value of investments under management, mortality experience and persistency. As a result of the recent deterioration in global financial markets, values of many investments have declined and could continue to fall, which could have a material adverse effect on the HBOS Group's business, financial position and results of operations.

The insurance and investment business includes the Clerical Medical With-Profits Fund, which comprises approximately 16% of the HBOS Group's long-term insurance and investment contract liabilities. The fund does take some investment risk with the aim of enhancing policyholder returns, but is managed with the intention that the fund is able to support its payouts from its own assets. However, in exceptional circumstances, such as substantial and sudden further deterioration in financial markets, and even after management action, this might not be possible which may adversely impact HBOS's financial position.

**1.9 *Operational and reputational risks are inherent in the HBOS Group's businesses***

Operational risk is the risk of opportunities foregone, reputational damage or financial losses resulting from inadequacies or failures in internal processes, people or systems (including IT systems), or from external events. The HBOS Group's businesses are dependent on the ability to process a very large number of transactions efficiently and accurately. Operational risk and losses can result from fraud (including inaccurate information being provided by counterparties or customers on which the HBOS Group relies), human error, failure to document transactions properly or to obtain proper internal authorisation, failure of third parties to comply with material agreements, failure to comply with legislative or regulatory requirements and conduct of business rules, equipment failures, information loss, natural disasters or the failure of external systems, for example, those of the HBOS Group's suppliers or counterparties.

Damage to HBOS's reputation including to consumer confidence could have a significant adverse impact on the HBOS Group's business. Although HBOS has implemented risk controls and loss mitigation actions, and substantial resources are devoted to developing efficient procedures and to staff training, there can be no assurance that such procedures will be effective in controlling each of the operational risks or that damage to HBOS's reputation will not arise, which could have a material adverse effect on the HBOS Group's business, financial position and results of operations.

**1.10 *HBOS's borrowing costs and its access to the capital markets depend significantly on its credit ratings***

As at the date of this prospectus, the long-term credit ratings for HBOS and Bank of Scotland are, respectively: A+ and AA- on credit watch with developing implications from S&P's rating service; Aa2 and Aa1 on review for possible downgrade from Moody's rating service; AA and AA on negative watch from Fitch Ratings; and AA (high) and AA (high) under review with negative implications from DBRS. Both S&P's rating service and Fitch Ratings have downgraded HBOS's and Bank of Scotland's long- and short-term counterparty credit ratings during the recent turbulence to reflect the increased risks in the financial system in general

and for HBOS in particular. Further reduction in the long-term credit ratings of HBOS or Bank of Scotland may significantly increase the HBOS Group's borrowing costs, limit its access to the capital markets and trigger additional collateral requirements in derivative contracts and other secured funding arrangements. Therefore, a reduction in credit ratings could adversely affect the HBOS Group's access to liquidity and competitive position and, hence, have a material adverse effect on the HBOS Group's business, financial position and results of operations.

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

HBOS and certain other members of the HBOS Group are 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.

The risk-adjusted capital guidelines (the "**Basel Accord**") promulgated by the Basel Committee on Banking Supervision (the "**Basel Committee**"), 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 ("**Basel II**"). 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) with effect from 1 January 2008. This follows a year of parallel running of these approaches. Certain portfolios remain on the standardised approach with agreement with the FSA of a timetable for further roll out of credit risk models over the next two years. Under Basel II, capital requirements are inherently more volatile than under previous regimes and will increase if a number of factors including, but not limited to, default trends or collateral values worsen.

The HBOS Group's banking businesses outside the UK are subject to the capital adequacy regimes of those jurisdictions, some of which will implement Basel II on a longer time frame.

The HBOS Group's life assurance and general insurance businesses in the UK are also subject to the capital requirements prescribed by the FSA and the HBOS Group's life and general insurance companies outside the UK are subject to local regulatory capital requirements. In July 2007, the European Commission published a draft proposal for primary legislation to define broad "framework" principles for Solvency II, a fundamental review of the capital adequacy regime for the European insurance industry. Solvency II aims to establish a revised set of EU-wide capital requirements where the required regulatory capital will be dependent upon the risk profile of the entities, together with risk management standards, that will replace the current Solvency I requirements. At this early stage of development, it is not possible to predict the ultimate impact of this proposed regime on the HBOS Group's capital. However, the final regime could significantly impact the capital the HBOS Group's life assurance and general insurance businesses are required to hold.

HBOS's failure to maintain adequate capital ratios may result in administrative actions or sanctions against it which may have a material adverse impact on the HBOS Group's business, financial position and results of operations.

#### **1.12 Each of the HBOS Group's businesses is subject to substantial regulation and oversight. Any significant regulatory developments could have an effect on how the HBOS Group conducts its businesses and on its results of operations.**

The HBOS Group is subject to laws, regulations, administrative actions and policies in each location in which it operates, all of which are subject to change. This is particularly the case in the current market environment, which is witnessing increased levels of government intervention in the banking sector. The FSA is the main regulator for HBOS, although the HBOS Group's international businesses in the United States, Australia and Ireland are subject to direct scrutiny from the Board of Governors of the Federal Reserve System and the Comptroller of the Currency, the Australian Prudential Regulation Authority and the Irish Financial Regulator, respectively. Further changes in supervision and regulation, in particular in the UK, could materially affect the HBOS Group's businesses, the products and services offered or the value of its assets. Although the HBOS Group works closely with its regulators and continually monitors developments, future changes in regulation, fiscal or other policies can be unpredictable and are beyond the control of the HBOS Group. Areas where changes could have an adverse impact include, but are not limited to:

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

Further changes to the regulatory requirements applicable to the HBOS Group, in particular in the UK, whether resulting from recent events in the credit markets or otherwise, could have a material adverse effect on its business, the products and services it offers, its financial position and results of operations.

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

In the United Kingdom, the Financial Services Compensation Scheme (the “FSCS”) was established under FSMA and is the UK’s statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it. The FSCS is funded by levies on firms authorised by the FSA, including the HBOS Group and, it is expected, the Enlarged Group. In the event that the FSCS raises funds from the authorised firms, raises those funds more frequently or significantly increases the levies to be paid by such firms, the associated costs to the HBOS Group and/or the Enlarged Group may have a material impact on its results of operations and financial condition.

**1.14 *The HBOS Group is subject to litigation and regulatory investigations which may impact its business***

HBOS and its subsidiaries operate in a legal and regulatory environment that exposes them to potentially significant litigation and regulatory risks. As a result, the HBOS Group is and may in the future be involved in various disputes and legal proceedings in the UK and the other jurisdictions in which it operates, including litigation and regulatory investigations. Such cases are subject to many uncertainties, and their outcome is often difficult to predict, particularly in the earlier stages of a case or investigation. Currently, the HBOS Group is responding to regulatory inquiries and investigations and is involved in litigation arising from its operations. Regulatory intervention is an ongoing feature of UK retail banking and changes could affect the profitability of the HBOS Group’s Retail business. For example, HBOS is one of eight banks involved in a test case to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges. In addition, the Competition Commission investigation of the payment protection insurance market may ultimately impact the profitability of HBOS and across the industry more generally. For details about certain litigation and regulatory investigations in which the HBOS Group is involved, see “UK Office of Fair Trading” of Part XII (“Regulation and Supervision”) and paragraph 18 of Part XXII (“Additional Information”).

Adverse regulatory action against the HBOS Group or adverse judgements in litigation to which the HBOS Group is a party could result in restrictions or limitations on the HBOS Group’s operations or result in a material adverse effect on the HBOS Group’s reputation, business and results of operations.

### **1.15 *The HBOS Group's financial performance is subject to substantial competitive pressures***

There is substantial competition for the types of banking and other products and services that the HBOS Group provides in the regions in which it conducts its business. The intensity of this competition is affected by competitor behaviour, consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors.

The HBOS Group's financial performance may be adversely impacted by competition, including declining lending margins or competition for savings driving up funding costs which cannot be recovered from borrowers. Customer attrition, as well as adverse persistency, in the HBOS Group's Investment business and General Insurance business is a risk to current and future earnings. Moreover, government intervention in the banking sector may impact the competitive position of banks within a country and among international competitors which may be subject to different forms of government intervention, thus potentially putting the HBOS Group at a competitive disadvantage compared to local banks in such jurisdictions. The HBOS Group's growth plans are predicated on attracting customers from competitors and retaining and broadening existing customer relationships. If the HBOS Group is not successful in attracting new customer relationships or retaining and broadening existing customer relationships, the HBOS Group will not be able to deliver the level of growth that it expects. The success of the HBOS Group's strategy will also be affected by the competitor reaction of both incumbent banks and new entrants to its markets.

If the HBOS Group is unable to provide attractive product and service offerings that are competitive and profitable, it may lose market share, incur losses on some or all of its activities or fail to attract new and retain existing deposits, which could have a material adverse effect on its business, financial position and results of operations.

### **1.16 *HBOS may be adversely affected by changes in taxation legislation***

HBOS's tax charge is based on current legislation in the countries in which the HBOS Group operates. Taxation legislation may be subject to future changes which could have a material adverse effect on HBOS's results of operation and financial condition.

### **1.17 *HBOS could fail to attract or retain senior management or other key employees***

HBOS's success depends on the ability and experience of its senior management. The loss of the services of certain key employees, particularly to competitors, could have a material adverse effect on the HBOS Group's revenue, profit and financial condition. In addition, as the HBOS Group's business develops, both in the UK and in other jurisdictions, the HBOS Group's future success will depend on its ability to attract and retain highly skilled and qualified personnel, which cannot be guaranteed. The failure to attract or retain a sufficient number of appropriate personnel could significantly impede HBOS's financial plans, growth and other objectives and have a material adverse effect on the HBOS Group's business, financial position and results of operations.

### **1.18 *If the Acquisition does not proceed, HBOS will be required to find alternative methods of increasing its capital base and funding its business.***

If the HBOS Resolutions are not passed, none of the Acquisition, the Placing, the Open Offer or the HBOS HM Treasury Preference Share Subscription will proceed, and HBOS will be required to find alternative methods of increasing its capital base and funding its business. On 11 October 2008, the FSA gave a preliminary indication to HBOS that if the Acquisition were not to occur, it would require HBOS to raise £12 billion of additional capital, made up of £9 billion of HBOS Shares and £3 billion of HBOS Preference Shares.

Whilst HBOS would seek to raise additional new capital, there can be no certainty that the amount required would not be more than £12 billion or that HBOS would be able to successfully raise capital or as to the terms on which capital could be raised, including the terms of any participation by HM Treasury in any capital raising, or as to whether such fundraising would be on a pre-emptive basis. Guidance provided by the written statement to Parliament issued by the Chancellor of the Exchequer on 18 November 2008 (which sets out the general principles which HM Treasury would expect to apply in dealing with future applications to the UK Government's bank recapitalisation scheme if those UK banks raising capital at the time of the statement sought to negotiate a substantially new proposal or new agreement with HM Treasury about a recapitalisation) confirms, *inter alia*, that on an ordinary equity issue, the price at which the UK Government might be prepared to participate would

be the lower of a discount to then prevailing market price or, if applicable, the price agreed on 13 October 2008, and at a discount of not less than the discount agreed in any transaction already announced. Other qualifying criteria, as outlined by the Chancellor in that statement, would also need to be met. There can also be no assurance that HBOS would be successful in increasing its capital to the levels required to qualify for access to the Proposed Government Funding arrangements, or to satisfy the requirements of the FSA on an ongoing basis.

This could result in an increase in funding costs arising from any credit rating downgrades or increased reliance on Government supported liquidity schemes; contraction of HBOS's balance sheet; and a longer time horizon than the one contemplated by the Acquisition and Capital Raising for the resumption of any dividend payments on HBOS Shares. Any capital raising might also be more dilutive and is unlikely to be available within the same time period as the Acquisition and Capital Raising.

There can be no certainty as to sources of capital if the HBOS Resolutions are not passed or the Acquisition does not proceed. The HBOS Directors would expect the UK Government to take appropriate action consistent with the policy objectives set out in HM Treasury's announcement of 8 October 2008 on Financial Support to the Banking Industry, which are to ensure stability of the financial system, and to protect ordinary savers, depositors, businesses and borrowers. Such action may include the issuance to HM Treasury of HBOS Shares on a basis which could be more dilutive to HBOS Shareholders than the Placing and Open Offer and the issuance to HM Treasury of other securities on terms less economically advantageous and more restrictive than the New HBOS Preference Shares, or the loss of independent or private sector status for HBOS. The occurrence of any such action may cause the value of HBOS Shares to decline substantially with negative implications for HBOS Shareholders.

## **2 Risks relating to the Placing and Open Offer and to investments in the Open Offer Shares**

### **2.1 *Acquiring the Open Offer Shares will be equivalent to acquiring new Lloyds TSB Shares at a higher price per share than acquiring new Lloyds TSB Shares in the Lloyds TSB Placing and Open Offer***

Pursuant to the Proposed Government Funding, each of the Lloyds TSB Group and the HBOS Group will be conducting a Placing and Open Offer of new shares. Under the terms of the HBOS Placing and Open Offer, HBOS Shareholders have the opportunity to acquire Open Offer Shares at 113.6p per Open Offer Share. Under the terms of the Lloyds TSB Placing and Open Offer, new Lloyds TSB Shares are being offered to Lloyds TSB Shareholders at 173.3p per new Lloyds TSB Share.

The HBOS Placing and Open Offer is inter-conditional with the Acquisition such that any the Open Offer Shares acquired under the HBOS Placing and Open Offer will be acquired by Lloyds TSB pursuant to the Acquisition. The terms of the Acquisition provide that each HBOS Share (including the Open Offer Shares) will be exchanged for 0.605 Lloyds TSB Shares. The subscription for the Open Offer Shares pursuant to the HBOS Placing and Open Offer is therefore equivalent to acquiring new Lloyds TSB Shares at 187.77p per new Lloyds TSB Share.

Qualifying Shareholders who are considering acquiring Open Offer Shares should therefore bear in mind that the Issue Price of 113.6 pence per Open Offer Share is equivalent to the price of 187.77 pence for a Lloyds TSB Share. Under the terms of the Lloyds TSB Open Offer, Lloyds TSB Shareholders will have the opportunity to acquire Lloyds TSB Open Offer Shares at 173.3 pence per Lloyds TSB Open Offer Share. This difference arises because of the fixed discount of 8.5 per cent. to each company's closing share price as of 10 October 2008 (the last trading date before the announcement of the Capital Raising on 13 October 2008) agreed as a term of the Placing and the Lloyds TSB Placing, and the combined impact of the Placing and Open Offer and the Lloyds TSB Placing and Open Offer. Before making any decision to acquire Open Offer Shares, HBOS Shareholders should consider both the HBOS share price and the Lloyds TSB share price in the market at the time, in the light of the implied price of 187.77 pence per Lloyds TSB Share.



**If you are in any doubt as to the impact the Acquisition and/or the Lloyds TSB Placing and Open Offer has on your decision to participate in the HBOS Placing and Open Offer, you are recommended to seek immediately your own financial advice from your stockbroker, solicitor, accountant or other independent financial adviser duly authorised under the Financial Services and Markets Act 2000 if you are resident in the United Kingdom or, if not, from another appropriately authorised independent financial adviser.**

## **2.2 *HBOS's share price will fluctuate***

The market price of the HBOS Shares could be volatile and subject to significant fluctuations due to a variety of factors, including changes in sentiment in the market regarding the HBOS Shares (or securities similar to them) or the market generally, any regulatory changes affecting the HBOS Group's operations, variations in the HBOS Group's operating results, business developments of the HBOS Group or its competitors, the operating and share price performance of other companies in the industries and markets in which the HBOS Group operates or speculation about the HBOS Group's business in the press, media or investment community. Stock markets have from time to time, including recently and particularly with respect to certain financial institution shares, experienced significant price and volume fluctuations which have affected market prices for securities which may be unrelated to the HBOS Group's operating performance or prospects. Furthermore, the HBOS Group's operating results and prospects from time to time may be below the expectations of market analysts and investors. Any of these events could result in a decline in the market price of the HBOS Shares.

## **2.3 *HBOS Shareholders who do not acquire Open Offer Shares in the Open Offer will experience dilution in their ownership of HBOS***

If the HBOS Shareholders do not take up the offer of Open Offer Shares under the Open Offer by the latest date for application and payment in full in respect of their entitlements that are set out in this document, their proportionate ownership and voting interest in HBOS will be reduced.

## **3 *Risks relating to the Lloyds TSB Group and, if the Acquisition becomes Effective, the Enlarged Group***

A description of the risks relating to the Lloyds TSB Group and, if the Acquisition becomes Effective, the Enlarged Group in relation to the Lloyds TSB Group and/or which will, following the Acquisition, apply to the Enlarged Group, is set out in paragraph 1 of Part II ("Risk Factors") of the Lloyds TSB Prospectus and is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **4 *Risks relating to the Acquisition***

A description of the risks relating to the Acquisition is set out in paragraphs 2.2 to 2.7 of Part II ("Risk Factors") of the Lloyds TSB Prospectus and is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **5 *Risks relating to investment in Lloyds TSB Shares***

A description of the risks relating to investment in Lloyds TSB Shares is set out in paragraphs 3.1, 3.2 and 3.4 to 3.6 of Part II ("Risk Factors") of the Lloyds TSB Prospectus and is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **6 *Additional risks for Overseas Shareholders***

### ***The ability of Overseas Shareholders to bring actions or enforce judgements against HBOS or the HBOS Directors may be limited***

The ability of an Overseas Shareholder to bring an action against HBOS may be limited under law. HBOS is a public limited company incorporated in Scotland. The rights of holders of HBOS Shares

## **PART III**

### **OTHER IMPORTANT INFORMATION**

#### **INFORMATION NOT CONTAINED IN THIS DOCUMENT**

No person has been authorised to give any information or to make any representations other than those contained in this document and, if given or made, such information or representations must not be relied on as having been authorised by the HBOS Group, Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley & Co. International plc. Subject to the Prospectus Rules, the Listing Rules and the Disclosure and Transparency Rules, neither the publication of this document nor any acquisition of any security made under it shall, in any circumstances, create any implication that there has been no change in the affairs of the HBOS Group, the Lloyds TSB Group and/or the Enlarged Group since the date of this document or that the information in it and/or incorporated by reference herein is correct as of any subsequent date. HBOS will comply with its obligation to publish a supplementary prospectus containing further updated information required by law or by any regulatory authority, but assumes no further obligation to publish additional information.

#### **ROUNDING**

Certain figures included in this document and in the information incorporated by reference into this document have been subject to rounding adjustments. Accordingly, discrepancies in tables between the totals and the sums of the relevant amounts are due to such rounding.

#### **WEBSITES**

Except where expressly stated otherwise, neither the content of the Company's nor Lloyds TSB's website (or any other website) nor the content of any website accessible from hyperlinks on the Company's nor Lloyds TSB's website (or any other website) is incorporated into, or forms part of, this document.

#### **TIME**

All references in this document to times are to UK time unless otherwise stated.

#### **DEFINITIONS**

Capitalised terms used in this document have the meanings ascribed to them in Part XXIII ("Definitions") of this document.

#### **FORWARD-LOOKING STATEMENTS**

This document and the information incorporated by reference into this document include certain "forward-looking statements". Statements that are not historical facts, including statements about the HBOS Group's or the Lloyds TSB Group's or their respective directors' and or management's beliefs and expectations are forward-looking statements. Words such as "believes", "anticipates", "estimates", "expects", "intends", "aims", "potential", "will", "would", "could", "considered", "likely", "estimate" and variations of these words and similar future or conditional expressions, are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend upon future circumstances that may or may not occur, many of which are beyond the Company's or Lloyds TSB's control and all of which are based on the HBOS Directors' or the Lloyds TSB Directors' (as the case may be) current beliefs and expectations about future events. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of HBOS, Lloyds TSB or the Enlarged Group, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such forward-looking statements are based on numerous assumptions regarding HBOS', Lloyds TSB's and the Enlarged Group's present and future business strategies and the environment in which the Enlarged Group will operate in the future. These forward-looking statements speak only as at the date of this document.

Examples of such forward-looking statements include, but are not limited to, statements about expected benefits and risks associated with the Acquisition and the Placing and Open Offer,

projections or expectations of profit attributable to shareholders, anticipated provisions or write-downs, economic profit, dividends, capital structure or any other financial items or ratios; statements of plans, objectives or goals of HBOS, Lloyds TSB or the Enlarged Group following completion of the Acquisition, including in relation to the achievement of anticipated cost synergies, other operating efficiencies, business growth opportunities, revenue and other benefits; statements about the future trends in interest rates, liquidity, foreign exchange rates, stock market levels and demographic trends and any impact that those matters may have on HBOS, Lloyds TSB or the Enlarged Group following completion of the Acquisition; statements concerning any future UK, US or other economic environment or performance; statements about strategic goals, competition, regulation, regulatory approvals, dispositions and consolidation or technological developments in the financial services industry; and statements or assumptions underlying such statements.

HBOS Shareholders and potential investors should specifically consider all of the information set out in, and incorporated by reference into, this document before making any investment decision. In particular, HBOS Shareholders and potential investors should consider the risks, uncertainties and other factors are set out in Part II (“Risk Factors”) of this document.

Except as required by the FSA, the London Stock Exchange, the Listing Rules, the Prospectus Rules, the Disclosure and Transparency Rules or any other applicable law or regulation, the Company expressly disclaims any obligations or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document or incorporated by reference into this document to reflect any change in the Company’s or Lloyds TSB’s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

#### **Notice to Investors in the European Economic Area**

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”) an offer to the public of any Open Offer Shares may not be made in that Relevant Member State, other than in the United Kingdom, Austria, Belgium, Cyprus, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, The Netherlands, Norway, Portugal, Romania, Spain and Sweden once this Prospectus has been approved by the UK Listing Authority, as competent authority in the United Kingdom, and published and passported in accordance with the Prospectus Directive as implemented in Austria, Belgium, Cyprus, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, The Netherlands, Norway, Portugal, Romania, Spain and Sweden, except that an offer to the public in that Relevant Member State of any Open Offer Shares may be made at any time under the following exemptions under the Prospectus Directive, if they have been implemented in that Relevant Member State:

- (a) 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) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (c) to fewer than 100 natural or legal persons (other than qualified investors as defined in the Prospectus Directive); or
- (d) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Open Offer Shares shall result in a requirement for the publication of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer to the public” in relation to any HBOS Shares 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 any HBOS Shares to be offered so as to enable an investor to decide to purchase any HBOS Shares, 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.

### **Notice to Australian Investors**

This document is not an Australian law compliant prospectus for the purposes of Divisions 3, 4 and 5 of Part 6D.2 of the Corporations Act (other than section 718) and sections 728(1)(b) and (c), 728(3)(b), 730(1)(b) and (c), 734 and 735 of the Corporations Act. This document has been prepared in accordance with the instrument of relief issued by the Australian Securities and Investments Commission on 13 November 2008, numbered 08-00894. Accordingly, the information disclosed in this document may not be the same as that which would have been disclosed if this document had been prepared in accordance with Australian law. This document will be lodged with the Australian Securities and Investments Commission.

The Open Offer Shares issued to existing HBOS Shareholders under the Open Offer will be issued for the purpose of raising equity capital and not for the purpose of existing HBOS Shareholders on-selling or transferring them.

### **Notice to Bermudian Investors**

The Open Offer Shares are being offered on a private basis to investors who satisfy criteria outlined in this Prospectus. The Prospectus and the Application Form is not subject to, and has not received approval from, either the Bermuda Monetary Authority or the Registrar of Companies in Bermuda and no statement to the contrary, explicit or implicit, is authorised to be made in this regard. The Open Offer Shares being offered may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act 2003 of Bermuda. Additionally, non-Bermudian persons may not carry on or engage in any trade or business in Bermuda unless such persons are authorised to do so under applicable Bermuda legislation.

### **Notice to Canadian Investors**

Any distribution of securities offered in Canada (the “Canadian Offering”) pursuant to the Canadian offering memorandum, which incorporates by reference this document and all documents incorporated by reference herein (the “Canadian Offering Memorandum”), is made in each of the Provinces of Canada (individually, a “Canadian Jurisdiction” and collectively, the “Canadian Jurisdictions”) solely on a private placement basis exempt from the prospectus and registration requirements of applicable securities laws in each of the Canadian Jurisdictions, as part of the concurrent Placing and Open Offer of Open Offer Shares. Any certificates representing the securities offered pursuant to this document may bear legends required or desirable under applicable securities laws or policies.

Any Canadian Offering is made solely by the Canadian Offering Memorandum (which incorporates by reference this document and all documents incorporated by reference herein) and any decision to purchase pursuant to the Canadian Offering should be based solely on information contained in the Canadian Offering Memorandum and subject to the conditions described therein. No person has been authorized to give any information or to make any representations concerning the Canadian Offering other than as contained in the Canadian Offering Memorandum.

HBOS is not a reporting issuer in any province or territory in Canada and its securities are not listed on any stock exchange in Canada and there is currently no public market for the securities described herein in Canada. HBOS currently has no intention of becoming a reporting issuer in Canada, filing a prospectus with any securities regulatory authority in Canada to qualify the resale of the securities described herein to the public, or listing the securities described herein on any stock exchange in Canada. Accordingly, to be made in accordance with securities laws, any resale of the securities described herein in Canada must be made under available statutory exemptions from registration and prospectus requirements or under a discretionary exemption granted by the applicable Canadian securities regulatory authority. Canadian readers are advised to seek legal advice prior to any resale of the securities offered hereby.

By its receipt of this document, each Canadian investor confirms that it has expressly requested that all documents evidencing or relating in any way to the sale of the securities described herein (including for greater certainty any purchase confirmation or any notice) be drawn up in the English language only. *Par la reception de ce document, chaque investisseur canadien confirme paries présentes qu’il a expressement exigé que tous les documents faisant foi ou se rapportant de quelque manière que ce soit à la vente des valeurs mobilières décrites aux présentes (incluant, pour plus de certitude, toute confirmation d’achat ou tout avis) soient rédigés en anglais seulement.*

Canadian readers should be aware that the financial statements and other financial information contained in this document have been prepared in accordance with IFRS and thus may not be comparable to financial statements and financial information of Canadian companies. Holding and disposing of the securities offered under this document may have tax consequences in Canada and other jurisdictions that are not described in this document. Canadian readers are advised to consult their tax advisers.

HBOS is formed under the laws of a jurisdiction outside Canada. All of the directors and officers of HBOS may be located outside Canada and, as a result, it may not be possible for purchasers to effect service of process within Canada upon HBOS or such persons. All or a substantial portion of the assets of HBOS may be located outside Canada and, as a result, it may not be possible for purchasers to satisfy or collect a judgement in Canada against HBOS or its directors and officers or to enforce a judgement obtained in Canadian courts against HBOS or such persons outside Canada.

Each of this document and the Canadian Offering Memorandum is not, and under no circumstances is to be construed as, a prospectus, an advertisement or a public offering of these securities in Canada. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon this prospectus or the merits of the Open Offer Shares, and any representation to the contrary is an offence.

#### **Notice to Investors in the PRC**

This Prospectus and the Application Form does and do not constitute an offer to sell or the solicitation of an offer to buy any securities in the People's Republic of China (excluding Hong Kong, Macau and Taiwan, the "PRC") to any person to whom it is unlawful to make the offer or solicitation in the PRC.

The Company, Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch and Morgan Stanley & Co. International plc do not represent that this Prospectus and/or the Application Form may be lawfully distributed, or that any Open Offer Shares may be lawfully offered, in compliance with any applicable registration or other requirements in the PRC, 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 Company, Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley & Co. International plc which would permit a public offering of any Open Offer Shares or distribution of this Prospectus or the Application Form in the PRC. Accordingly, the Open Offer Shares are not being offered or sold within the PRC by means of this Prospectus or any other document. Neither this Prospectus, the Application Form nor any advertisement or other offering material may be distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations.

#### **Notice to Investors in Hong Kong**

The contents of this Prospectus and the Application Form have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the Open Offer. If you are in any doubt about any of the contents of this Prospectus and/or the Application Form, you should obtain independent professional advice. Please note that (i) none of the Open Offer Shares may be offered or sold in Hong Kong by means of this Prospectus, the Application Form or any other document other than to professional investors within the meaning of Part I of Schedule 1 to the Securities and Futures Ordinance of Hong Kong (Cap. 571) ("**SFO**") and any rules made thereunder ("**professional investors**"), or in other circumstances which do not result in the document being a "prospectus" as defined in the Companies Ordinance of Hong Kong (Cap. 32) ("**CO**") or which do not constitute an offer or invitation to the public for the purposes of the CO or the SFO, and (ii) no person shall issue or possess for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to Open Offer Shares which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to those Open Offer Shares which are or are intended to be disposed of only to persons outside Hong Kong or only to such professional investors.

#### **Notice to Israeli Investors**

The Placing and Open Offer does not constitute an offering to the public in Israel within the meaning of the Israeli Securities Law, 1968. None of the Open Offer Shares may be offered or

sold in Israel other than to investors listed in the First Supplement of the Israeli Securities Law, 1968 to whom an offer of securities may be made without the publication of a prospectus in accordance with the Israeli Securities Law, 1968. A prospectus has not been prepared or filed, and will not be prepared or filed with the Israel Securities Authority in connection with this Placing and Open Offer. Subject to any applicable law, the Open Offer Shares offered in the Open Offer may not be offered or sold in the State of Israel to more than thirty-five offerees, in the aggregate, who are not listed in the First Supplement of the Israeli Securities Law, 1968.

#### **Notice to Japanese Investors**

The solicitation of an offer for the acquisition of Open Offer Share has not been and will not be registered under Article 4, Paragraph 1 of the Financial Instruments and Exchange Law of Japan (Law No. 25 of 1948, as amended) (“**FIEL**”). Any transfer of Open Offer Shares is prohibited if the Japanese subscriber (who is a Resident of Japan as defined under Item 5, Paragraph 1, Article 6 of the Foreign Exchange and Foreign Trade Law (Law No. 228 of 1949, as amended) is an entity which does not qualify as a qualified institutional investor (as defined in Article 10, Paragraph 1 of the Cabinet Office Ordinance concerning the Definitions under Article 2, Paragraph 3, Item 1 of the FIEL (Ordinance of the Ministry of Finance No. 14 of 1993, as amended)) (“**QII**”). The solicitation of an offer for the acquisition of Open offer Shares is on the condition that the subscriber, who must be a QII, enters into an agreement which provides that it will not transfer the shares to any person other than another QII.

#### **Notice to Kenyan Investors**

This Prospectus, the Application Form and the offering of Open Offer Shares have not been approved by the Capital Markets Authority in Kenya. The offer of Open Offer Shares does not constitute an offer of shares to the public on the basis of Section 376(5) of the Companies Act (chapter 486 of the Laws of Kenya). The offer of Open Offer Shares will be carried out as a “private” offer within the meaning of regulation 21 of the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 as amended.

The Prospectus and Application Form will be distributed in Kenya to a limited number of existing shareholders and should not be provided to any person other than the original recipients, and may not be reproduced or used by the original recipient or any other person for any other purpose. The Open Offer Shares may not be offered or sold directly or indirectly to the public in Kenya.

#### **Notice to Malaysian Investors**

This Prospectus has not been approved by the Securities Commission of Malaysia as a prospectus and will not be registered with the Securities Commission of Malaysia. This document is not an offer or invitation to subscribe for or purchase securities and shall not be issued, circulated or distributed in Malaysia.

#### **Notice to New Zealand Investors**

This document is not a New Zealand prospectus or an investment statement and has not been registered, filed with or approved by any New Zealand regulatory authority under or in accordance with the Securities Act 1978 (or any other relevant New Zealand law). This document may not contain all the information that an investment statement or prospectus under New Zealand law is required to contain. Open Offer Shares are offered to the public of New Zealand under this document in reliance on the Securities Act (Overseas Companies) Exemption Notice 2002 (New Zealand).

#### **Notice to Omani Investors**

This Prospectus and the Application Form is being sent at the request of the investor in Oman and should not be distributed to any person in Oman other than its intended recipient without the prior consent of the Capital Market Authority in Oman.

The Open Offer Shares, this Prospectus, the Application Form or any offering material relating to the Open Offer Shares may not be distributed to any person in Oman without the prior consent of the Capital Market Authority and then only in accordance with any terms and conditions of such consent.

### **Notice to Philippine Investors**

The Open Offer Shares are being offered or sold in the Philippines as transactions exempt from the registration requirements of the securities regulation code on the basis of offers or sales to existing stockholders (under Section 10.1 (e)), private placements (under Section 10.1 (k)) and/or sale to qualified buyers (under Section 10.1 (l)). Confirmation that the offer and sale of the Open Offer Shares are exempt transactions has not been secured from the securities and exchange commission. The Open Offer Shares have not been registered with the securities and exchange commission of the Philippines under the securities regulation code. Any future offer or sale thereof in the Philippines is subject to registration requirements under the code unless such offer or sale qualifies as an exempt transaction.

### **Notice to Qatari Investors**

The Open Offer Shares and the Application Form have not been registered for public offer or distribution in Qatar. The Open Offer Shares and the Application Form must not be distributed within Qatar by way of a public offer, public advertisement or in any similar manner and this Prospectus, the Application Form and any other document relating to the Open Offer Shares, as well as information contained therein, may not be supplied to the public in Qatar or used in connection with any offer for acquisition of the Open Offer Shares to the public in Qatar. This document, the Application Form and other offering materials relating to the offer of the Open Offer Shares are strictly confidential and may not be distributed to any person or entity in Qatar other than the recipients thereof.

### **Notice to Singaporean Investors**

This Prospectus has not been lodged and will not be registered as a prospectus in Singapore with the Monetary Authority of Singapore (the “**Singapore Authority**”). The Singapore Authority assumes no responsibility for the contents of this Prospectus and has not, in any way, considered the merits of the Open Offer, the Company’s Existing HBOS Shares or the Open Offer Shares. As such, Open Offer Shares may not be offered or sold in Singapore, other than to existing HBOS Shareholders in reliance on the exemption under section 273(1)(cd) of the Securities and Futures Act (Chapter 289) of Singapore or to institutional investors, accredited investors and certain other persons within the meaning of the Securities and Futures Act (Chapter 289) of Singapore (the “**SFA**”) and in accordance with the requirements of the SFA or any other applicable legal or regulatory requirements in Singapore.

### **Notice to South African Investors**

Due to restrictions under the securities laws of South Africa, and subject to certain exemptions, no Application Forms will be sent to Qualifying Shareholders with a registered address in South Africa. Subject to certain exemptions, the Application Forms and the Open Offer Shares may not be transferred or sold to or delivered in South Africa. Subject to certain exemptions, no offer of Open Offer Shares is being made into South Africa by virtue of this Prospectus or the Application Forms.

### **Notice to Investors in Thailand**

None of the Open Offer Shares may be offered or sold in Thailand. A prospectus has not been prepared or filed, and will not be prepared or filed with the Office of the Securities and Exchange Commission of Thailand in connection with the Open Offer. Therefore, no part of this document may be reproduced or taken or transmitted into Thailand or to any Thai persons or entities. Failure to comply with these instructions may constitute a violation of Thai Securities laws.

### **Notice to Investors in the United Arab Emirates**

The Open Offer Shares have not been, and are not being, publicly offered, sold, promoted or advertised in the United Arab Emirates (including the Dubai International Financial Centre) other than in compliance with the laws of the United Arab Emirates (and the Dubai International Financial Centre) governing the issue, offering and sale of securities. Further, this Prospectus and the Application Form do not constitute a public offer of securities in the United Arab Emirates (including the Dubai International Financial Centre) and are not intended to be a public offer. The Prospectus and the Application Form have not been approved by or filed with the Central Bank of the United Arab Emirates, the Securities and Commodities Authority or the Dubai Financial Services Authority.

## PART IV

### EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Lloyds TSB General Meeting	11.00 a.m. on 19 November 2008
Open Offer Record Date for entitlement under the Open Offer for Qualifying Shareholders	5.00 p.m. on 5 December 2008
Court Meeting	10.00 a.m. on 12 December 2008
HBOS General Meeting	10.10 a.m. on 12 December 2008 <sup>(1)</sup>
Despatch of Application Forms to Qualifying Non-CREST Shareholders	12 December 2008
Latest date on which Existing HBOS Shares trade cum entitlement under the Open Offer	12 December 2008
Ex-entitlement time and date for the Open Offer	8.00 a.m. on 15 December 2008
Open Offer Entitlements and Excess CREST Open Offer Entitlements credited to stock accounts of Qualifying CREST Shareholders in CREST	By 15 December 2008
Recommended last time and date for withdrawing Open Offer entitlements, and Excess CREST Open Offer Entitlements from CREST	4.30 p.m. on 2 January 2009
Latest time and date for depositing Open Offer Entitlements into CREST	3.00 p.m. on 6 January 2009
Latest time and date for splitting Application Forms (to satisfy bona fide market claims only)	3.00 p.m. on 7 January 2009
Latest time and date for receipt of completed Application Forms and payment in full under the Open Offer and settlement of relevant CREST instructions (as appropriate)	11.00 a.m. on 9 January 2009
Expected date of announcement of results of Open Offer	12 January 2009
Scheme Court Hearing	12 January 2009
Suspension of listing and dealings in and last time for registration of transfers of, HBOS Shares	6.00 p.m. on 14 January 2009 <sup>(2)</sup>
Open Offer Shares in uncertificated form expected to be credited to accounts in CREST	By 15 January 2009
Issue of Open Offer Shares	8.00 a.m. on 15 January 2009
New HBOS Preference Shares to be issued to HM Treasury	8.00 a.m. on 15 January 2009 <sup>(2)</sup>
Scheme Record Time	6.00 p.m. on 15 January 2009
Reduction Court Hearing	16 January 2009
Effective Date of the Scheme	16 January 2009 <sup>(2)</sup>
Issue of Consideration Shares	At or after 5.00 p.m. on 16 January 2009 <sup>(2)</sup>
Cancellation of HBOS listing	8.00 a.m. on 19 January 2009 <sup>(2)</sup>
Admission of and commencement of dealings in Consideration Shares on the London Stock Exchange	8.00 a.m. on 19 January 2009 <sup>(2)</sup>
Consideration Shares in uncertificated form expected to be credited to accounts in CREST	8.00 a.m. on 19 January 2009 <sup>(2)</sup>
Latest date for despatch of share certificates in respect of Consideration Shares to certificated holders	30 January 2009 <sup>(2)</sup>

Notes:

(1) Or as soon thereafter as the Court Meeting shall have concluded or been adjourned.

(2) These dates are indicative only and will depend, among other things, on the date upon which the Court sanctions the Scheme.

All references in this document to times are to UK time unless otherwise stated.

If any of the above times and/or dates change, the revised time and/or dates will be notified by announcement through a Regulatory Information Service.



Different deadlines and procedures may apply in certain cases. For example, HBOS Shareholders that hold their HBOS Shares through a CREST member or other nominee may be set earlier deadlines by the CREST member or other nominee than the times and dates noted above.

If you have any queries on the procedure for acceptance and payment then please call the Shareholder Helpline on 0870 702 0102 (from inside the UK) or +44 870 702 0102 (from outside the UK) between 8.30 a.m. and 5.30 p.m. on any Business Day. Calls cost 6 pence plus up to 6 pence per minute from a BT Together landline. Mobile and other providers' charges may vary. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Open Offer, as to whether applicants should take up their Open Offer Entitlements or to provide legal, financial, tax or investment advice.

## PART V

### PLACING AND OPEN OFFER AND ACQUISITION STATISTICS

Number of HBOS Shares in issue as at the date of this document	5,406,574,275
Number of Open Offer Shares to be issued by HBOS pursuant to the Placing and Open Offer	7,482,394,366
Number of HBOS Shares in issue immediately following completion of the Placing and Open Offer	12,888,968,641
Issue Price per Open Offer Share	113.6 pence
Open Offer Shares as a percentage of enlarged issued ordinary share capital of HBOS immediately following completion of the Placing and Open Offer	58.1 per cent.
Number of Lloyds TSB Shares in issue as at the date of this document	5,972,853,501
Number of Lloyds TSB Shares to be issued by Lloyds TSB pursuant to the Lloyds TSB Placing and Open Offer	2,596,653,203
Number of Lloyds TSB Shares in issue immediately following completion of the Lloyds TSB Placing and Open Offer	8,569,506,704
Maximum number of Consideration Shares to be issued pursuant to the Acquisition	7,873,180,756 <sup>(1)</sup>
Maximum number of Lloyds TSB Shares in issue upon implementation of the Acquisition and following completion of the Lloyds TSB Placing and Open Offer	16,496,330,617 <sup>(1)</sup>
Consideration Shares to be issued by Lloyds TSB as a percentage of the enlarged issued ordinary share capital of Lloyds TSB immediately following the Acquisition becoming Effective (with the Lloyds TSB Placing and Open Offer having completed)	47.6 per cent.
Consideration Shares to be issued by Lloyds TSB in respect of Open Offer Shares as a percentage of enlarged issued ordinary share capital of Lloyds TSB immediately following the Acquisition becoming Effective (with the Lloyds TSB Placing and Open Offer having completed)	27.7 per cent.
Estimated net proceeds of the Placing and Open Offer receivable by HBOS after expenses	£8,345,000,000 <sup>(2)</sup>
Estimated expenses of the Placing and Open Offer (including fees and commissions payable to HM Treasury in respect of the Capital Raising)	£155,000,000

Upon completion of the Placing and Open Offer, the Open Offer Shares will represent approximately 58.1 per cent. of the Enlarged HBOS Issued Share Capital and the Existing HBOS Shares will represent approximately 41.9 per cent. of the Enlarged HBOS Issued Share Capital. However, if no shares were allotted to any placee other than HM Treasury under either the Placing and Open Offer or the Lloyds TSB Placing and Open Offer, following completion of the Recommended Transaction, existing Lloyds TSB Shareholders would own approximately 36.5 per cent. of the issued ordinary share capital of Lloyds TSB as enlarged by the Acquisition and the Lloyds TSB Placing and Open Offer, with existing HBOS Shareholders owning approximately 20 per cent. and HM Treasury owning approximately 43.5 per cent.

Notes:

(1) These figures are calculated assuming that:

- (a) the number of HBOS Shares in issue and to be issued on a fully diluted basis as at close of business on 14 November 2008 (being the latest practicable date prior to the publication of this Prospectus) does not change (other than as described above) and that no other issues of Lloyds TSB Shares, other than as described above, occur between publication of this document and the Effective Date; and
  - (b) the maximum number of HBOS Shares and Lloyds TSB Shares proposed to be issued under the Placing and Open Offer and the Acquisition and the Lloyds TSB Placing and Open Offer respectively, are issued.
- (2) The estimated net proceeds of the Placing and Open Offer of approximately £8.3 billion will be initially included in the HBOS Group's balance sheet as an increase in cash and balances at central banks of approximately £8.3 billion with total assets and shareholders' equity increasing by the corresponding amount. The net proceeds of the Placing and Open Offer should also benefit the Income Statement.

## PART VI

### DIRECTORS, COMPANY SECRETARY, REGISTERED OFFICE AND ADVISERS

<b>Directors</b>	Dennis Stevenson Andy Hornby Peter Cummings Jo Dawson	<i>Chairman</i> <i>Chief Executive</i> <i>Chief Executive, Corporate</i> <i>Chief Executive, Retail</i> <i>Distribution and Insurance &amp;</i> <i>Investment</i>
	Mike Ellis Philip Gore-Randall Colin Matthew	<i>Group Finance Director</i> <i>Chief Operating Officer</i> <i>Chief Executive, Strategy,</i> <i>International and Treasury &amp;</i> <i>Asset Management</i>
	Dan Watkins Richard Cousins Sir Ron Garrick	<i>Chief Executive, Retail Products</i> <i>Non-executive Director</i> <i>Deputy Chairman, Non-</i> <i>executive Director</i>
	Anthony Hobson Karen Jones John E Mack Coline McConville Kate Nealon	<i>Non-executive Director</i> <i>Non-executive Director</i> <i>Non-executive Director</i> <i>Non-executive Director</i> <i>Non-executive Director</i>
<b>Company Secretary:</b>	Harry Baines	
<b>Registered and head office:</b>	The Mound Edinburgh EH1 1YZ	
<b>Joint sponsor, bookrunner and placing agent:</b>	Morgan Stanley & Co. International plc 20 Cabot Square Canary Wharf London E14 4QW	
<b>Joint sponsor:</b>	Dresdner Kleinwort Limited 30 Gresham Street London EC2V 7PG	
<b>Joint book runner and placing agent:</b>	Dresdner Bank AG, London Branch 30 Gresham Street London EC2V 7PG	
<b>Legal adviser to the Company as to English and US law:</b>	Allen & Overy LLP One Bishops Square London E1 6AD	
<b>Legal adviser to the Company as to Scots law:</b>	Dickson Minto W.S. 16 Charlotte Square Edinburgh EH2 4DF	
<b>Legal adviser to the joint sponsors, bookrunners and placing agents as to English and US law:</b>	Freshfields Bruckhaus Deringer LLP 65 Fleet Street London EC4Y 1HS	
<b>Legal adviser to HM Treasury as to English law:</b>	Slaughter and May One Bunhill Row London EC1Y 8YY	
<b>Auditors:</b>	KPMG Audit Plc Saltire Court 20 Castle Terrace Edinburgh EH1 2EG	

**Registrar and Receiving Agent:**

Computershare Investor  
Services PLC  
Project 1  
Bridgwater Road  
Bristol BS99 6AR

## PART VII

### TERMS AND CONDITIONS OF THE PLACING AND OPEN OFFER

#### 1 Introduction

##### *Background*

On 18 September 2008, HBOS and Lloyds TSB announced a recommended acquisition of HBOS by Lloyds TSB. On 13 October 2008, as part of a co-ordinated package of capital and funding measures for the UK banking sector implemented by HM Treasury, HBOS and Lloyds TSB announced that they intended to participate in the Proposed Government Funding and thereby facilitate access to the UK Government backed provision of liquidity and had agreed to proceed with the Acquisition on revised terms.

Pursuant to the Proposed Government Funding, and in order to strengthen their capital position, a combined total of £17 billion of capital (before costs and expenses) will be raised by HBOS and Lloyds TSB, of which £11.5 billion (consisting of £8.5 billion in ordinary shares and £3 billion in preference shares) will be raised by HBOS through the Placing and Open Offer and £5.5 billion (consisting of £4.5 billion in ordinary shares and £1 billion in preference shares) will be raised by Lloyds TSB. As a result of its commitment to strengthen further the HBOS Group's capital position, HBOS also secured access to the UK Government guarantee for short and medium term debt issuance.

Immediately following the Effective Date, if none of the HBOS Shareholders participate in the Placing and Open Offer and none of the Lloyds TSB Shareholders participate in the Lloyds TSB Placing and Open Offer which is expected to complete immediately prior to the Acquisition, it is expected that existing HBOS Shareholders will own approximately 20 per cent. of the ordinary share capital of the Enlarged Group, existing Lloyds TSB Shareholders will own approximately 36.5 per cent. and that HM Treasury will own approximately 43.5 per cent., compared with 47.6 per cent., 52.4 per cent. and 0 per cent. respectively, if HBOS Shareholders and Lloyds TSB Shareholders fully participate in the Open Offer and Lloyds TSB Open Offer respectively.

The Acquisition, the Placing and Open Offer and the New HBOS Preference Share Issue are inter-conditional. If the Acquisition, Placing and Open Offer and New HBOS Preference Share Issue do not complete, HBOS will be required to find alternative methods of increasing its capital base and funding its business. On 11 October 2008, the FSA gave a preliminary indication to HBOS that if the Acquisition were not to occur, it would require HBOS to raise £12 billion of additional capital, made up of £9 billion of HBOS Shares and £3 billion of HBOS Preference Shares. Whilst HBOS would seek to raise additional capital in these circumstances, there can be no certainty that the amount required would not be more than £12 billion or that HBOS would be able to successfully raise capital or as to the terms on which capital could be raised, including the terms of any participation by HM Treasury in any capital raising, or as to whether such fundraising would be on a pre-emptive basis. Guidance provided by the written statement to Parliament issued by the Chancellor of the Exchequer on 18 November 2008 (which sets out the general principles which HM Treasury would expect to apply in dealing with future applications to the UK Government's bank recapitalisation scheme if those UK banks raising capital at the time of the statement sought to negotiate a substantially new proposal or new agreement with HM Treasury about a recapitalisation) confirms, *inter alia*, that on an ordinary equity issue, the price at which the UK Government might be prepared to participate would be the lower of a discount to then prevailing market price or, if applicable, the price agreed on 13 October 2008, and at a discount of not less than the discount agreed in any transaction already announced. Other qualifying criteria, as outlined by the Chancellor in that statement, would also need to be met.

There can also be no assurance that HBOS would be successful in increasing its capital to the levels required to qualify for access to the Proposed Government Funding arrangements or to satisfy the requirements of the FSA on an ongoing basis. Any capital raising might also be more dilutive and is unlikely to be available within the same time period as the Acquisition and Capital Raising.

There can be no certainty as to sources of capital if the HBOS Resolutions are not passed or the Acquisition does not proceed. The HBOS Directors would expect the UK Government to take appropriate action consistent with the policy objectives set out in HM Treasury's announcement of 8 October 2008 on Financial Support to the Banking Industry, which are to ensure stability of the

financial system, and to protect ordinary savers, depositors, businesses and borrowers. Such action may include the issuance to HM Treasury of HBOS Shares on a basis which could be more dilutive to HBOS Shareholders than the Placing and Open Offer and the issuance to HM Treasury of other securities on terms less economically advantageous and more restrictive than the New HBOS Preference Shares or the loss of independent or private sector status for HBOS. The occurrence of any such action may cause the value of HBOS Shares to decline substantially with negative implications for HBOS Shareholders.

Under the terms of the HBOS Preference Share Subscription Agreement, no dividend can be paid on HBOS Shares whilst any New HBOS Preference Share remains outstanding. The New HBOS Preference Shares may not be redeemed until after five years from the date of issue, although they may be repurchased on the open market, in both cases in accordance with the requirements of the FSA. While HBOS has given certain undertakings to HM Treasury, following completion of the Acquisition, it is expected that the undertakings which Lloyds TSB has given to HM Treasury described in Part V (“Conditions Relating to the Proposed Government Funding”) of the Lloyds TSB Circular, which is incorporated by reference into this document (and not the undertakings given by HBOS and which are set out in Part 6 (“Conditions Relating to the Proposed Government Funding”) of the Scheme Document, which is also incorporated by reference into this document) will apply to the Enlarged Group. The Lloyds TSB undertakings relate to such matters as availability and active marketing of competitively priced mortgage lending and lending to SMEs and board remuneration aimed at ensuring that any state aid involved in the potential acquisition of Open Offer Shares, New Lloyds TSB Shares, New HBOS Preference Shares or New Lloyds TSB Preference Shares and the Enlarged Group’s potential participation in the guarantee scheme to be promoted by HM Treasury as part of its support for the UK banking industry is compatible with the common market under EU law. However, further undertakings may be required from the Enlarged Group to ensure such compatibility. The HBOS Board also understands that a restriction on the payment of dividends on the New Lloyds TSB Shares will also apply for so long as any of the Enlarged Group HMT Preference Shares are outstanding. Such a restriction does not preclude the declaration of a capitalisation issue paid out of non-distributable reserves. It is understood that Lloyds TSB intends to issue shares by way of the Capitalisation Issue for the 2008 financial year at a level to be determined by the Lloyds TSB Board at the appropriate time. Details of the Capitalisation Issue are set out in Part VI (“Principal Terms of the Capitalisation Issue”) of the Lloyds TSB Circular which is incorporated by reference into this document.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

#### *Terms of the Acquisition*

Under the terms of the Acquisition, and subject to the Conditions, HBOS Shareholders will be entitled to receive:

#### **0.605 of a Consideration Share                      for every 1 HBOS Share**

Based on the Closing Price of 166 pence per Lloyds TSB Share on 14 November 2008, prior to the completion of the Placing and Open Offer, and the Lloyds TSB Placing and Open Offer, the Acquisition values HBOS at approximately £5.4 billion.

It is intended that the Acquisition will be effected by way of a scheme of arrangement and, subject to the satisfaction, or where appropriate, waiver, of the Conditions, it is expected that the Acquisition will become Effective on 16 January 2009. The Acquisition remains subject to anti-trust review in a number of jurisdictions.

It is proposed that HBOS Preference Shares (including those held by HM Treasury at the relevant time) will be cancelled and that Replacement Lloyds TSB Preference Shares will be issued by Lloyds TSB in exchange.

The terms of the proposed Acquisition give HBOS Shareholders the opportunity to acquire a stake in a merged group that has a strong franchise and considerable scope to generate significant synergies. The Enlarged Group is expected to have excellent breadth and balance, with good positions in Retail, Corporate Banking, SME Business Banking and Long Term Savings.

Further information on the background to and reasons for the recommendation of the Acquisition and the Capital Raising is set out in section 6 of Part 1 (“Letter from the Chairman of HBOS plc”) of the Scheme Document, which is incorporated by reference herein.

A description of the conditions to the implementation of the Scheme and the Acquisition is set out in Part 3 (“Conditions to the implementation of the Scheme and the Acquisition”) of the Scheme Document, which is incorporated by reference herein.

Details of the Implementation Agreement are set out in section 10 of Part 1 (“Letter from the Chairman of HBOS plc”) of the Scheme Document, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

#### *Conditions to the Acquisition and Placing and Open Offer*

The Placing and Open Offer, the Acquisition and New HBOS Preference Share Issue are interconditional. If the HBOS Resolutions on which the Placing and Open Offer, the Acquisition or the New HBOS Preference Issue are conditional are not approved or for some other reason the Placing and Open Offer Agreement or the HBOS Preference Share Subscription Agreement is terminated or the Acquisition does not complete, the Proposed Government Funding would not be available to HBOS.

The Placing and Open Offer, Acquisition and New HBOS Preference Share Issue are conditional on, among other things:

- approval of the Scheme at the Court Meeting and at any required separate class meeting;
- the resolutions required to approve and implement the Scheme being duly passed;
- the sanction of the Scheme by the Court;
- the Lloyds TSB resolutions required to approve, effect and implement the Acquisition being duly passed;
- the Placing and Open Offer Agreement having become unconditional in all respects;
- the Lloyds TSB Placing and Open Offer Agreement not having been terminated prior to the Scheme Court Hearing having been held; and
- the New HBOS Preference Shares having been allotted.

#### *Impact of the Acquisition on the HBOS Placing and Open Offer*

Under the terms of the Placing and Open Offer, HBOS Shareholders have the opportunity to acquire HBOS Shares at 113.6p per HBOS Share.

Under the terms of the Lloyds TSB Placing and Open Offer, Lloyds TSB Shares are being offered to Lloyds TSB Shareholders for subscription at 173.3p per Lloyds TSB Open Offer Share.

Under the terms of the Acquisition each Open Offer Share will be cancelled and exchanged for 0.605 of a Consideration Share.

Qualifying Shareholders who are considering acquiring Open Offer Shares should therefore bear in mind that the Issue Price of 113.6 pence per Open Offer Share is equivalent to the price of 187.77 pence for a Lloyds TSB Share. Under the terms of the Lloyds TSB Open Offer, Lloyds TSB Shareholders will have the opportunity to acquire Lloyds TSB Open Offer Shares at 173.3 pence per Lloyds TSB Open Offer Share. This difference arises because of the fixed discount of 8.5 per cent. to each company’s closing share price as of 10 October 2008 (the last trading date before the announcement of the Capital Raising on 13 October 2008) agreed as a term of the Placing and the Lloyds TSB Placing, and the combined impact of the Placing and Open Offer and the Lloyds TSB Placing and Open Offer. Before making any decision to acquire Open Offer Shares, HBOS Shareholders should, aside from making an assessment of the likely prospects of the Enlarged Group and the potential benefits arising out of the Acquisition, consider both the HBOS share price and the Lloyds TSB share price in the market at the time, in the light of the implied subscription price of 187.77 pence per Lloyds TSB Share.

**If you are in any doubt as to the impact the Acquisition and/or the Lloyds TSB Placing and Open Offer has on your decision to participate in the Placing and Open Offer, you are recommended to immediately seek your own financial advice from your stockbroker, solicitor, accountant or other independent financial adviser duly authorised under the Financial Services and Markets Act 2000 if you are resident in the United Kingdom or, if not, from another appropriately authorised independent financial adviser.**

Based on the HBOS financial statements as at 30 June 2008 (as set out in the unaudited HBOS Interim Results 2008), the HBOS capital ratios before and after the completion of both the Placing

and Open Offer and the New HBOS Preference Share Issue are as follows: a Tier 1 Capital Ratio increase from 8.6 per cent. to 12 per cent.; a Core Tier 1 Ratio increase from 6.5 per cent. to 9 per cent.; a Total Capital Ratio increase from 12.2 per cent. to 15.6 per cent.; and a Tier 1 Gearing increase from 24.1 per cent. to 24.7 per cent. These calculations include the proceeds of the Rights Issue but exclude the impact of the sale of BankWest and St. Andrews as announced by the Company on 7 October 2008.

#### *The Open Offer*

The Company is proposing to issue 7,482,394,366 new HBOS Shares to raise approximately £8.5 billion (before expenses), through the Placing and Open Offer representing approximately 58.1 per cent. of the enlarged issued ordinary share capital of HBOS immediately following completion of the Placing and Open Offer.

The Open Offer Record Date for entitlements under the Open Offer for Qualifying CREST Shareholders and Qualifying Non-CREST Shareholders is expected to be 6.00 p.m. on 5 December 2008, Application Forms are expected to be posted to Qualifying Non-CREST Shareholders on or around 12 December 2008 and Open Offer Entitlements and Excess CREST Open Offer Entitlements are expected to be credited to stock accounts of Qualifying CREST Shareholders in CREST by 15 December 2008. The latest time and date for receipt of completed Application Forms and payment in full under the Open Offer and settlement of relevant CREST instructions (as appropriate) is expected to be 11.00 a.m. on 9 January 2009, with the Open Offer Shares expected to be issued at 8.00 a.m. on 15 January 2009. The Open Offer Shares, which will be cancelled pursuant to the Acquisition, will not be admitted to listing or trading on any exchange. However, it is expected that the Consideration Shares, to be issued by Lloyds TSB to holders of Scheme Shares (including the Open Offer Shares) pursuant to the Acquisition will be issued at 8.00 a.m. on 19 January 2009. Applications will be made by Lloyds TSB to the FSA for the Consideration Shares to be admitted to the Official List and to the London Stock Exchange's main market for listed securities. It is expected that Admission of the Consideration Shares will become effective and that dealings in the Consideration Shares, fully paid, will commence at 8.00 a.m. on 19 January 2009. Because the Scheme will not be fully effective before the Court makes the Reduction Order, and the Open Offer Shares must be issued before the Scheme Record Date so as to be acquired by Lloyds TSB in the Acquisition, there is a theoretical risk that the Open Offer Shares will be issued but the Acquisition will not become Effective. In that event, which HBOS considers to be a highly remote risk, HBOS will apply for the Open Offer Shares to be admitted to the Official List and to trading on the London Stock Exchange's main market for listed securities.

This document and, for Qualifying Non-CREST Shareholders only, the Application Form contain the formal terms and conditions of the Open Offer. Your attention is drawn to paragraph 4 of this Part VII which gives details of the procedure for application and payment for the Open Offer Shares and for any additional shares pursuant to the Excess Application Facility. The attention of Overseas Shareholders is drawn to paragraph 6 of this Part VII.

The Open Offer Shares will, when issued and fully paid, rank equally in all respects with Existing HBOS Shares, including the right to receive all dividends or other distributions made, paid or declared by reference to a record date after the date of their issue.

No dividend may be paid on Lloyds TSB Shares while any of the Enlarged Group HMT Preference Shares are outstanding, unless otherwise agreed by HM Treasury. However, the Lloyds TSB Board has made statements as to its intention to achieve the repurchase of such shares in paragraph 3.1 ("Dividend Terms") of Part XXI ("Additional Information") of the Lloyds TSB Prospectus which is incorporated by reference herein. See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

To the extent Open Offer Shares are not taken up under the Open Offer (whether by way of Qualifying Shareholders' Open Offer Entitlements or through the Excess Application Facility), or placed in the Placing, then, HM Treasury has agreed to acquire the Open Offer Shares at the Issue Price, subject to the terms of the Placing and Open Offer Agreement, the principal terms of which are summarised in paragraph 17.1 of Part XXII ("Additional Information") of this document.

The Open Offer is an opportunity for Qualifying Shareholders to apply for, in aggregate, 7,482,394,366 Open Offer Shares at the Issue Price of 113.6 pence per share in accordance with the terms of the Open Offer.



Any Qualifying Shareholder who sells some or all of their Existing HBOS Shares before 15 December 2008, should contact the buyer or the person/company through whom they sold their shares. The buyer may be entitled to take up Open Offer Shares under the Open Offer. If any Qualifying Shareholder sells any of their Existing HBOS Shares on or after 15 December 2008, they may still take up their Open Offer Entitlement in full and apply for additional Open Offer Shares pursuant to the Excess Application Facility.

## **2 The Open Offer**

Subject to the terms and conditions set out below (and, in the case of Qualifying Non-CREST Shareholders, in the Application Form), Qualifying Shareholders are being given the opportunity to apply for Open Offer Shares at the Issue Price (payable in full on application and free of all expenses) up to a maximum of their *pro rata* Open Offer Entitlement which shall be calculated on the basis of:

### **1.3839 Open Offer Shares for every one Existing HBOS Share**

registered in the name of each Qualifying Shareholder on the Open Offer Record Date and so in proportion for any other number of Existing HBOS Shares then registered.

Entitlements to Open Offer Shares will be rounded down to the nearest whole number and fractional entitlements will not be offered to persons pursuant to the Placing and Open Offer but will be aggregated and sold for the benefit of HBOS.

Applications by Qualifying Shareholders will be satisfied in full up to the amount of their individual Open Offer Entitlement. Qualifying Shareholders are also being given the opportunity to apply for additional Open Offer Shares in excess of their Open Offer Entitlement through the Excess Application Facility.

The Excess Application Facility enables Qualifying Shareholders who have taken up their full Open Offer Entitlement to apply for Open Offer Shares in excess of their Open Offer Entitlement. There is no cap on the amount a Qualifying Shareholder can apply for under the Excess Application Facility, however, for technical reasons, if a Qualifying Shareholder wishes to apply for more than two billion Open Offer Shares under the Excess Application Facility, he will need to contact the Registrar directly.

If the total number of Open Offer Shares applied for by Qualifying Shareholders exceeds 7,482,394,366, applications in excess of Open Offer Entitlements will be scaled back *pro rata* to the number of Open Offer Shares applied for by Qualifying Shareholders under the Excess Application Facility.

Please refer to sections 4.1(d) and 4.2(j) of this Part VII for further details of the Excess Application Facility.

**Holdings of Existing HBOS Shares in certificated and uncertificated form will be treated as separate holdings for the purpose of calculating entitlements under the Open Offer, as will holdings under different designations and in different accounts.**

If you are a Qualifying Non-CREST Shareholder, the Application Form shows the number of Existing HBOS Shares registered in your name on the Open Offer Record Date (in Box 1) and also shows the maximum number of Open Offer Shares for which you are entitled to apply pursuant to your Open Offer Entitlement (in Box 2) and pursuant to the Excess Application Facility (in Box 4).

Qualifying CREST Shareholders will have Open Offer Entitlements and Excess CREST Open Offer Entitlements credited to their stock accounts in CREST and should refer to section 4.2 of this Part VII and also to the CREST Manual for further information on the relevant CREST procedures.

Following the issue of the Open Offer Shares allotted pursuant to the Placing and Open Offer, Qualifying Shareholders who do not take up any of their entitlements in respect of the Open Offer will be diluted by approximately 58.1 per cent. as to their interests in the Company.

**Qualifying Shareholders should be aware that the Open Offer is not a rights issue. As such, Qualifying Non-CREST Shareholders should note that their Application Forms are not negotiable documents and cannot be traded. Qualifying CREST Shareholders should note that, although their Open Offer Entitlement and the Excess CREST Open Offer Entitlement will be credited to their CREST accounts, neither the Open Offer Entitlements nor the Excess CREST Open Offer Entitlements will be tradeable or listed and applications in**

respect of the Open Offer may only be made by the Qualifying Shareholder originally entitled or by a person entitled by virtue of a *bona fide* market claim. Open Offer Shares which are not taken up under the Open Offer will not be sold in the market for the benefit of those who do not apply under the Open Offer and Qualifying Shareholders who do not apply to take up Open Offer Shares will have no rights under the Open Offer. Any Open Offer Shares which are not applied for in respect of the Open Offer, including pursuant to the Excess Application Facility, may be issued to placees (other than HM Treasury) pursuant to a placing, which may or may not take place, failing which to HM Treasury subject to the terms and conditions of the Placing and Open Offer Agreement, with the net proceeds, including any premium on the Issue Price, retained for the benefit of the Company.

Application will be made for the Open Offer Entitlements and the Excess CREST Open Offer Entitlements to be credited to Qualifying CREST Shareholders' CREST accounts. The Open Offer Entitlements and the Excess CREST Open Offer Entitlements are expected to be credited to CREST accounts by 15 December 2008. No further application is required for the Open Offer Shares to be admitted to CREST.

The Open Offer Shares will, when issued, be credited as fully paid and will rank *pari passu* in all respects with the Existing HBOS Shares. The Open Offer Shares will not be made available in whole or in part to the public except under the terms of the Open Offer.

### **3 Conditions and Further Terms of the Open Offer**

The Open Offer and the obligation of HM Treasury to acquire the Open Offer Shares are conditional on the Placing and Open Offer Agreement becoming unconditional in all respects. The conditions to the Placing and Open Offer Agreement are (among other things):

- (i) the obtaining or waiver of such regulatory approvals, authorisations and consents as may be required as a consequence of the activities contemplated by the Placing and Open Offer Agreement and the HBOS Preference Share Subscription Agreement;
- (ii) there having occurred or being reasonably likely to occur, in the opinion of HM Treasury (acting in good faith), no event which has resulted or may result in a material adverse change in or affecting the condition (financial, operational, legal or otherwise), profitability, prospects, solvency, business affairs or operations of the HBOS Group taken as a whole, whether or not arising in the ordinary course of business;
- (iii) the Acquisition having been announced on terms such that, if the Acquisition becomes Effective, the HBOS Shares shall be acquired by Lloyds TSB on terms such that, in consideration of the cancellation or transfer of the HBOS Shares it has acquired pursuant to the Placing and Open Offer, HM Treasury (or its nominee) shall receive Lloyds TSB Shares;
- (iv) the Acquisition being subject only to those conditions which are required for implementation specifically the requisite shareholder approval, Court approval of the Scheme, regulatory clearances without which the proposed Acquisition may not be implemented and Admission of the Consideration Shares; and
- (v) (a) resolutions 1 and 3 (as set out in the notice convening the Lloyds TSB General Meeting) having been approved by Lloyds TSB Shareholders and resolutions necessary to implement the Acquisition having been approved by HBOS Shareholders; (b) the Scheme Court Hearing (but not the Reduction Court Hearing) having been held and the Scheme Court Order having been made; and (c) the Placing and Open Offer Agreement not having terminated in accordance with its terms prior to the Scheme Court Hearing having been held and the Scheme Court Order having been made.

Certain of the Conditions to the Placing and Open Offer Agreement may be waived by HM Treasury at its sole discretion. The condition described in sub-section (v) above is, among others, not capable of waiver by HM Treasury.

Accordingly, if these and the other Conditions to the Open Offer are not satisfied or waived (where capable of waiver), the Placing and Open Offer will not proceed and any applications made by Qualifying Shareholders will be rejected. In these circumstances, application monies will be returned (at the applicant's sole risk), without payment of interest, as soon as reasonably practicable thereafter. Please see paragraph 17 of Part XXII ("Additional Information") of this document, which is incorporated by reference herein, for a summary of the material terms of the

Placing and Open Offer Agreement. See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

No temporary documents of title will be issued in respect of Open Offer Shares held in uncertificated form. Where, at the Scheme Record Time, an HBOS Shareholder holds HBOS Shares (including Open Offer Shares) in certificated form, definitive certificates in respect of the Consideration Shares to which such certificated holders may become entitled pursuant to the Acquisition are expected to be posted by 30 January 2009. In respect of those Qualifying Shareholders who validly elect to hold their Open Offer Shares in uncertificated form, the Open Offer Shares are expected to be credited to their stock accounts maintained in CREST by 15 January 2009 (however, you will not be able to deal in the Open Offer Shares in CREST as dealings will cease at 6.00 p.m. on 14 January 2009 in anticipation of the Scheme becoming Effective on 16 January 2009). Where, at the Scheme Record Time, an HBOS Shareholder holds HBOS Shares (including Open Offer Shares) in uncertificated form, the Consideration Shares to which such uncertificated holder may become entitled pursuant to the Acquisition are expected to be credited to their stock accounts maintained in CREST on 19 January 2009.

If for any reason it becomes necessary to adjust the expected timetable as set out in this document, the Company will make an appropriate announcement via a Regulatory Information Service giving details of the revised dates.

#### **4 Procedure for Application and Payment**

The action to be taken by a Qualifying Shareholder in respect of the Open Offer depends on whether, at the relevant time, such Qualifying Shareholder has received an Application Form in respect of his entitlement under the Open Offer, including the Excess Application Facility, or has had Open Offer Entitlements and Excess CREST Open Offer Entitlements credited to his CREST stock account in respect of such entitlement.

Qualifying Shareholders who hold their Existing HBOS Shares in certificated form on the Open Offer Record Date will be allotted Open Offer Shares in certificated form. Qualifying Shareholders who hold part of their Existing HBOS Shares in uncertificated form on the Open Offer Record Date will be allotted Open Offer Shares in uncertificated form to the extent that their entitlement to Open Offer Shares arises as a result of holding Existing HBOS Shares in uncertificated form. However, it will be possible for Qualifying Shareholders to deposit Open Offer Entitlements into, and withdraw them from, CREST. Further information on deposit and withdrawal from CREST is set out in paragraph 4.2(f) of this Part VII.

CREST sponsored members should refer to their CREST sponsor, as only their CREST sponsor will be able to take the necessary action specified below to apply under the Open Offer in respect of the Open Offer Entitlement and Excess CREST Open Offer Entitlement of such members held in CREST. CREST members who wish to apply under the Open Offer in respect of their Open Offer Entitlements and Excess CREST Open Offer Entitlements in CREST should refer to the CREST Manual for further information on the CREST procedures referred to below.

##### **4.1 If you have an Application Form in respect of your entitlement under the Open Offer**

###### **(a) General**

Subject as provided in section 6 of this Part VII in relation to Overseas Shareholders, Qualifying Non-CREST Shareholders will receive an Application Form. The Application Form shows the number of Existing HBOS Shares registered in their name on the Open Offer Record Date in Box 1. It also shows the maximum number of Open Offer Shares for which they are entitled to apply for pursuant to their Open Offer Entitlement, taking into account that Qualifying Non-CREST Shareholders will not be entitled to take up an Open Offer Share in respect of any fraction of an Open Offer Share arising when their entitlement was calculated, such entitlement being rounded down to the nearest whole number, as shown by the total number of Open Offer Shares allocated to them set out in Box 2. Box 3 shows how much they would need to pay if they wish to apply to take up their Open Offer Entitlement in full (fractions of pence being ignored for the purposes of recording such amount). Qualifying Non-CREST Shareholders may apply for less or more than their Open Offer Entitlement should they wish to do so. Qualifying Non-CREST Shareholders may also hold such an Application Form by virtue of a *bona fide* market claim.

The Excess Application Facility enables Qualifying Shareholders who have taken up their full Open Offer Entitlement to apply for Open Offer Shares in excess of their Open Offer Entitlement. There is no cap on the amount a Qualifying Shareholder can apply for under the Excess Application Facility, however, for technical reasons, if you wish to apply for more than 2 billion Open Offer Shares under the Excess Application Facility, you will need to contact the Registrar directly.

If the total number of Open Offer Shares applied for by Qualifying Shareholders exceeds 7,482,394,366, applications in excess of Open Offer Entitlement will be scaled back *pro rata* to the number of Open Offer Shares applied for by Qualifying Shareholders under the Excess Application Facility.

The instructions and other terms set out in the Application Form form part of the terms of the Open Offer in relation to Qualifying Non-CREST Shareholders.

**(b) *Bona fide market claims***

Applications to acquire Open Offer Shares may only be made on the Application Form and may only be made by the Qualifying Non-CREST Shareholder named in it or by a person entitled by virtue of a *bona fide* market claim in relation to a purchase of Existing HBOS Shares through the market prior to 8.00 a.m. on 15 December 2008, being the date upon which the Existing HBOS Shares will be marked “ex” the entitlement to participate in the Open Offer. Application Forms may not be assigned, transferred or split, except prior to 7 January 2009 to satisfy *bona fide* market claims. The Application Form is not a negotiable document and cannot be separately traded. A Qualifying Non-CREST Shareholder who has sold or otherwise transferred all or part of his holding of Existing HBOS Shares prior to the date upon which the Existing HBOS Shares are marked “ex” the entitlement to participate in the Open Offer, which is expected to be 8.00 a.m. on 15 December 2008, should consult his broker or other professional adviser as soon as possible, as the invitation to acquire Open Offer Shares under the Open Offer may be a benefit which may be claimed by the transferee. Qualifying Non-CREST Shareholders who have sold all of their registered holdings should, if the market claim is to be settled outside CREST, complete Box 8 on the Application Form and immediately send it to the stockbroker, bank or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee. The Application Form should not, however, be forwarded to or transmitted in or into any Restricted Jurisdiction. If the market claim is to be settled outside CREST, the beneficiary of the claim should follow the procedures set out in the accompanying Application Form. If the market claim is to be settled in CREST, the beneficiary of the claim should refer to the procedures set out in paragraphs 4.2(b) and 4.2(f) (as applicable) below.

Qualifying Non-Crest Shareholders who have sold or otherwise transferred part only of their Existing Ordinary Shares shown in Box 1 of their Application Form prior to 8.00 a.m. on 15 December 2008 should, if the market claim is to be settled outside CREST, complete Box 8 on the Application Form and immediately deliver the Application Form, together with a letter stating the number of Application Forms required (being one for the Qualifying Non-CREST Shareholder in question and one for each of the purchasers or transferees), the total number of Existing HBOS Shares to be included in each Application Form (the aggregate of which must equal the number shown in Box 1) and the Open Offer Entitlement to be included in each Application Form (the aggregate of which must equal the number shown in Box 2), to the stockbroker, bank or other agent through whom the sale or transfer was effected or return it by hand (during normal business hours), or by post, to Computershare Investors Services PLC, The Pavillions, Bridgwater Road, Bristol, Avon BS13 8AE. The Receiving Agent will then create new Application Forms, mark the Application Forms “Declaration of sale or transfer duly made” and send them by post to the Qualifying Non-CREST Shareholder submitting the original Application Form.

**(c) *Application procedures***

Qualifying Non-CREST Shareholders wishing to apply to acquire Open Offer Shares (whether in respect of all or part of their Open Offer Entitlement or under the Excess Application Facility) should complete the Application Form in accordance with the instructions printed on it. The Excess Application Facility enables Qualifying

Shareholders who have taken up their full Open Offer Entitlement to apply for Open Offer Shares in excess of their Open Offer Entitlement. There is no cap on the amount a Qualifying Shareholder can apply for under the Excess Application Facility, however, for technical reasons, if you wish to apply for more than 2 billion Open Offer Shares under the Excess Application Facility, you will need to contact the Registrar directly. If the total number of Open Offer Shares applied for by Qualifying Shareholders exceeds 7,482,394,366, applications in excess of Open Offer Entitlements will be scaled back *pro rata* to the number of Open Offer Shares applied for by Qualifying Shareholders under the Excess Application Facility. Completed Application Forms should be returned by post to Computershare Investor Services PLC, Project 1, Bridgwater Road, Bristol, Avon BS99 6AR (who will act as Receiving Agent in relation to the Open Offer) so as to be received by the Receiving Agent by no later than 11.00 a.m. on 9 January 2009, after which time, subject to the limited exceptions below, Application Forms will not be valid. Application Forms delivered by hand will not be checked upon delivery and no receipt will be provided. Within the United Kingdom, Qualifying Non-CREST Shareholders can use the reply-paid envelope accompanying the Application Form. Qualifying Non-CREST Shareholders should note that applications, once made, will be irrevocable and receipt thereof will not be acknowledged. If an Application Form is being sent by first-class post in the UK, Qualifying Non-CREST Shareholders are recommended to allow at least four Business Days for delivery.

Completed Application Forms should be returned with a cheque or banker's draft drawn in pounds sterling on a bank or building society in the UK which is either a member of the Cheque and Credit Clearing Company Limited or the CHAPS Clearing Company Limited or which has arranged for its cheques and banker's drafts to be cleared through facilities provided by any of those companies. Such cheques or banker's drafts must bear the appropriate sort code in the top right-hand corner and must be for the full amount payable on application.

Cheques should be drawn on a personal account in respect of which the Qualifying Non-CREST Shareholder has sole or joint title to the funds and should be made payable to "HBOS Open Offer" and crossed "A/C Payee only". Third party cheques (other than building society cheques or banker's drafts where the building society or bank has confirmed that the relevant Qualifying Non-CREST Shareholder has title to the underlying funds) will be subject to the Money Laundering Regulations which would delay or prevent Qualifying Non-CREST Shareholders receiving their Open Offer Shares (please see section 5 below). Payments via CHAPS, BACS or electronic transfer will not be accepted.

Cheques and banker's drafts will be presented for payment on receipt and it is a term of the Open Offer that cheques and banker's drafts will be honoured on first presentation. The Company may elect to treat as valid or invalid any applications made by Qualifying Non-CREST Shareholders in respect of which cheques are not so honoured. If cheques or banker's drafts are presented for payment before the conditions of the Placing and Open Offer are fulfilled, the application monies will be kept in a separate bank account with interest, if any, being retained for the HBOS Group until all conditions are met. If the Placing and Open Offer do not become unconditional, no Open Offer Shares will be issued and all monies will be returned (at the applicant's sole risk), without payment of interest, to applicants as soon as practicable following the lapse of the Placing and Open Offer.

Subject to the provisions of the Placing and Open Offer Agreement, the Company may in its sole discretion, but shall not be obliged to, treat an Application Form as valid and binding on the person by whom or on whose behalf it is lodged, even if not completed in accordance with the relevant instructions or not accompanied by a valid power of attorney where required, or if it otherwise does not strictly comply with the terms and conditions of the Open Offer. The Company further reserves the right (but shall not be obliged) to accept either:

- (i) Application Forms received after 11.00 a.m. on 9 January 2009; or

- (ii) applications in respect of which remittances are received before 11.00 a.m. on 9 January 2009 from authorised persons (as defined in FSMA) specifying the Open Offer Shares applied for and undertaking to lodge the Application Form in due course but, in any event, within two Business Days.

Multiple applications will not be accepted. All documents and remittances sent by post by or to an applicant (or as the applicant may direct) will be sent at the applicant's own risk.

If Open Offer Shares have already been allotted to a Qualifying Non-CREST Shareholder and such Qualifying Non-CREST Shareholder's cheque or banker's draft is not honoured upon first presentation or such Qualifying Non-CREST Shareholder's application is subsequently otherwise deemed to be invalid, the Receiving Agent shall be authorised (in its absolute discretion as to manner, timing and terms) to make arrangements, on behalf of NewCo Subscriber (as defined in paragraph 4.4 of this Part VII), for the sale of such Qualifying Non-CREST Shareholder's Open Offer Shares and to apply the proceeds of sale (which for these purposes shall be deemed to be payments in respect of successful applications) in acquiring the redeemable preference share capital referred to in paragraph 4.4 of this Part VII. None of the Receiving Agent, Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch, Morgan Stanley or the Company, nor any other person, shall be responsible for, or have any liability for, any loss, expense or damage suffered by such Qualifying Non-CREST Shareholder as a result.

To the extent that (i) Open Offer Shares have already been allotted to a Qualifying Non-CREST Shareholder and such Qualifying Non-CREST Shareholder's cheque or banker's draft is not honoured upon first presentation or such Qualifying Non-CREST Shareholder's application is subsequently otherwise deemed to be invalid, and (ii) such Open Offer Shares have been exchanged for Consideration Shares pursuant to the Acquisition, then Lloyds TSB, or any person(s) nominated by Lloyds TSB, shall be authorised (in its absolute discretion as to manner (in its absolute discretion as to manner, timing and terms) to make arrangements, on behalf of NewCo Subscriber (as defined in paragraph 4.4 of this Part VII), for the sale of such Consideration Shares and to apply the proceeds of sale (which for these purposes shall be deemed to be payments in respect of successful applications) on behalf of the Company in acquiring the redeemable preference share capital referred to in paragraph 4.4 of this Part VII. None of the Receiving Agent, Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch, Morgan Stanley, the Company, Lloyds TSB nor any other person, shall be responsible for, or have any liability for, any loss, expense or damage suffered by such Qualifying Non-CREST Shareholder as a result.

**(d) *The Excess Application Facility***

The Excess Application Facility enables Qualifying Shareholders who have taken up their full Open Offer Entitlement to apply for Open Offer Shares in excess of their Open Offer Entitlement. There is no cap on the amount a Qualifying Shareholder can apply for under the Excess Application Facility, however, for technical reasons, if you wish to apply for more than 2 billion Open Offer Shares under the Excess Application Facility, you will need to contact the Registrar directly. If the total number of Open Offer Shares applied for by Qualifying Shareholders exceeds 7,482,394,366, applications in excess of Open Offer Entitlements will be scaled back *pro rata* to the number of Open Offer Shares applied for by Qualifying Shareholders under the Excess Application Facility.

Qualifying Non-CREST Shareholders who wish to apply for Open Offer Shares in excess of their Open Offer Entitlements must complete the Application Form in accordance with the instructions set out on the Application Form.

Should the Placing and Open Offer become unconditional and applications for Open Offer Shares exceed 7,482,394,366 Open Offer Shares resulting in a scale back of applications, each Qualifying Non-CREST Shareholder who has made a valid application for Open Offer Shares under the Excess Application Facility and from whom payment in full for such Open Offer Shares has been received in cleared funds will receive a pounds sterling amount equal to the number of Open Offer Shares applied and paid for

under the Excess Application Facility but not allocated to the relevant Qualifying Non-CREST Shareholder multiplied by the Issue Price. Monies will be returned as soon as reasonably practicable, without payment of interest and at the applicant's sole risk.

Fractions of Open Offer Shares will not be issued under the Excess Application Facility and fractions of Open Offer Shares will be rounded down to the nearest whole number.

**(e) Effect of application**

By completing and delivering an Application Form, the applicant:

- (i) represents and warrants to HBOS and Computershare Investor Services PLC that he has the right, power and authority, and has taken all action necessary, to make the application under the Open Offer and to execute, deliver and exercise his rights, and perform his obligations under any contracts resulting therefrom and that he is not a person otherwise prevented by legal or regulatory restrictions from applying for Open Offer Shares or acting on behalf of any such person on a non-discretionary basis;
- (ii) agrees that all applications under the Open Offer and contracts resulting therefrom shall be governed by and construed in accordance with the laws of England;
- (iii) confirms that in making the application he is not relying on any information or representation in relation to HBOS, Lloyds TSB or the Enlarged Group other than that contained in, or incorporated by reference into, this document, and the applicant accordingly agrees that no person responsible solely or jointly for this document or any part thereof, or involved in the preparation thereof, shall have any liability for any such information or representation not so contained or incorporated and further agrees that, having had the opportunity to read this document, he will be deemed to have had notice of all information in relation to HBOS, Lloyds TSB and the Enlarged Group contained or incorporated in this document;
- (iv) confirms that in making the application he is not relying and has not relied on Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch, Morgan Stanley or any person affiliated with Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley in connection with any investigation of the accuracy of any information contained in this document or his investment decision;
- (v) warrants that any cheque or banker's draft accompanying his Application Form will be honoured on first presentation and agrees that, if such remittance is not so honoured, notwithstanding that he may have been entered on the register of members of HBOS, he not be entitled to receive a share certificate in respect of the Open Offer Shares applied for or to enjoy or receive any rights, dividend, distribution or other payment in respect of such Open Offer Shares unless and until he makes payment in cleared funds for such Open Offer Shares and such payment is accepted by the Receiving Agent (which acceptance shall be in its absolute discretion and on the basis that he indemnifies HBOS and its agents, including the Receiving Agent, against all costs, damages, losses, expenses and liabilities arising out of, or in connection with, the failure of his remittance to be honoured on first presentation);
- (vi) agrees that, at any time prior to unconditional acceptance by the Receiving Agent of late payment pursuant to sub-paragraph (v) above, the Receiving Agent may (on behalf of HBOS and without prejudice to any other rights) terminate the agreement (if any) to allocate such Open Offer Shares to him without liability to him and may reallocate the Open Offer Shares to some other person, in which case he will not be entitled to any refund or payment in respect of such Open Offer Shares (other than the refund to him of any proceeds or remittance accompanying his Application Form at his own risk, without interest) and, in the event of termination, any Open Offer Shares which have been issued to him, and any Consideration Shares he receives in respect of such Open Offer Shares, will be sold as soon as is reasonably practicable (and for which purpose he hereby irrevocably authorises HBOS, or any person appointed by it for this purpose (including, but not limited to, the Receiving Agent and, once the Acquisition has become effective, Lloyds TSB or any person(s) nominated by Lloyds TSB), to execute on his behalf any

instrument of transfer which may be necessary to effect such sale) and consent to the proceeds of such sale being paid to and retained by HBOS and you will pay the Receiving Agent (on behalf of itself and HBOS), on demand, such amount as may be necessary to compensate the Receiving Agent and HBOS for any losses, costs and expenses incurred or expected to be incurred as a result of the remittance not being honoured on first presentation or as a result of termination of the agreement;

- (vii) confirms that no person other than HBOS has been authorised to give any information or to make any representation concerning HBOS, or its subsidiaries, or Lloyds TSB or the Enlarged Group, or the Open Offer Shares (other than as contained in this document) and, if given or made, any such other information or representation should not be relied upon as having been authorised by HBOS or Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley;
- (viii) represents and warrants to HBOS and Computershare Investor Services PLC that he is the Qualifying Shareholder originally entitled to the Open Offer Entitlement or that he received such Open Offer Entitlements by virtue of a *bona fide* market claim;
- (ix) represents and warrants to HBOS and Computershare Investor Services PLC that if he has received some or all of his Open Offer Entitlement from a person other than HBOS he is entitled to apply under the Open Offer in relation to such Open Offer Entitlement by virtue of a *bona fide* market claim;
- (x) requests that the Open Offer Shares to which he will become entitled be issued to him on the terms set out in this document and the Application Form subject to the Memorandum of Association and Articles of Association of the Company;
- (xi) represents and warrants to HBOS and Computershare Investor Services PLC that he is not, nor is he applying on behalf of any person who is, a citizen or resident, or which is a corporation, partnership or other entity created or organised in or under any laws, of any Restricted Jurisdiction or any jurisdiction in which the application for Open Offer Shares by such person is prevented by law and he is not applying with a view to re-offering, re-selling, transferring or delivering any of the Open Offer Shares which are the subject of his application to, or for the benefit of, a person who is a citizen or resident or which is a corporation, partnership or other entity created or organised in or under any laws of any Restricted Jurisdiction or any jurisdiction in which the application for Open Offer Shares by such person is prevented by law (except where proof satisfactory to the Company has been provided to the Company that he is able to accept the invitation by the Company free of any requirement which it (in its absolute discretion) regards as unduly burdensome), nor acting on behalf of any such person on a non-discretionary basis nor (a) person(s) otherwise prevented by legal or regulatory restrictions from applying for Open Offer Shares under the Open Offer;
- (xii) represents and warrants to HBOS and Computershare Investor Services PLC that he is not, nor is he applying on behalf of, or for the account or benefit of, any person on a non-discretionary basis who is located in the United States or any jurisdiction in which the application for Open Offer Shares is prevented by law (except, in either case, where proof satisfactory to HBOS has been provided to HBOS that he is able to accept the invitation by HBOS free of any requirement which HBOS (in its absolute discretion) regards as unduly burdensome);
- (xiii) represents and warrants to HBOS and Computershare Investor Services PLC that he is not, and nor is he applying as nominee or agent for, a person who is or may be liable to notify and account for tax under the Stamp Duty Reserve Tax Regulations 1986 at any of the increased rates referred to in section 93 (depository receipts) or section 96 (clearance services) of the Finance Act 1986 (a “**Specified Person**”) and that if any stamp duty, stamp duty reserve tax, or any other transfer, issuance tax or related interest and penalties (“**Stamp Tax**”) arises in connection with his acquisition of the Open Offer Shares or any subsequent transfer by him, or



his agent, of such shares to a Specified Person or a nominee or agent for such person, he agrees that he will pay and bear, or procure the payment of, the cost of such Stamp Tax;

- (xiv) agrees to be bound by the Scheme in respect of the Open Offer Shares which he acquires; and
- (xv) gives the instructions to Computershare Investor Services PLC set out in paragraph 4.4 below.

All enquiries in connection with the procedure for application and completion of the Application Form should be addressed to Computershare Investor Services PLC, Project 1, Bridgwater Road, Bristol BS99 6AR (telephone 0870 702 0102, or if calling from overseas +44 870 702 0102). Please note that the Receiving Agent cannot provide financial advice on the merits of the Open Offer or as to whether applicants should take up their Open Offer Entitlements.

For information on how to deposit an Open Offer Entitlement in whole or in part into CREST, please see section 4.2(f) below.

**Qualifying Non-CREST Shareholders who do not want to take up or apply for the Open Offer Shares under the Open Offer should take no action and should not complete or return the Application Form.**

#### **4.2 *If you have Open Offer Entitlements and Excess CREST Open Offer Entitlements credited to your stock account in CREST in respect of your entitlement under the Open Offer***

##### **(a) *General***

Subject as provided in section 6 of this Part VII in relation to certain Overseas Shareholders, each Qualifying CREST Shareholder will receive a credit to his stock account in CREST of his Open Offer Entitlement equal to the number of Open Offer Shares for which he is entitled to apply for under the Open Offer. Qualifying CREST Shareholders may also apply for Open Offer Shares in excess of their Open Offer Entitlement under the Excess Application Facility (see section 4.2 (j) below for further details). Entitlements to Open Offer Shares will be rounded down to the nearest whole number and any fractional Open Offer Entitlement and Excess CREST Open Offer Entitlement will therefore also be rounded down.

The CREST stock account to be credited will be an account under the participant ID and member account ID that apply to the Existing HBOS Shares held on the Open Offer Record Date by the Qualifying CREST Shareholder in respect of which the Open Offer Entitlement and Excess CREST Open Offer Entitlements have been allocated.

If for any reason the Open Offer Entitlements and/or Excess CREST Open Offer Entitlements cannot be admitted to CREST by, or the stock accounts of Qualifying CREST Shareholders cannot be credited by, 5.00 p.m. on 15 December 2008, or such later time and/or date as the Company may decide, an Application Form will be sent to each Qualifying CREST Shareholder in substitution for their Open Offer Entitlement and Excess CREST Open Offer Entitlement which should have been credited to his stock account in CREST. In these circumstances, the expected timetable as set out in this document will be adjusted as appropriate and the provisions of this document applicable to Qualifying Non-CREST Shareholders who have received Application Forms will apply to Qualifying CREST Shareholders who receive such Application Forms.

CREST members who wish to apply to acquire some or all of their pro-rata entitlements to Open Offer Shares and their Excess CREST Open Offer Entitlements should refer to the CREST Manual for further information on the CREST procedures referred to below. Should you need advice with regard to these procedures, please contact the Receiving Agent on telephone number 0870 702 0102 or, if calling from overseas +44 870 702 0102, between the hours of 8.30 a.m. and 5.30 p.m. on any Business Day. Please note that the Receiving Agent cannot provide financial advice on the merits of the Open Offer or as to whether applicants should take up their Open Offer Entitlement or apply for their Excess CREST Open Offer Entitlement. If you are a CREST sponsored member,

you should consult your CREST sponsor if you wish to take up and apply for Open Offer Shares as only your CREST sponsor will be able to take the necessary action to make this application in CREST.

**(b) *Bona fide market claims***

Each of the Open Offer Entitlements and the Excess CREST Open Offer Entitlements will have a separate ISIN and constitute a separate line for the purposes of CREST. Although the Open Offer Entitlement and the Excess CREST Open Offer Entitlement will be admitted to CREST and be enabled for settlement, applications in respect of the Open Offer Entitlement and the Excess CREST Open Offer Entitlement may only be made by the Qualifying Shareholder originally entitled or by a person entitled by virtue of a *bona fide* market claim transaction. Transactions identified by the CREST Claims Processing Unit as “cum” the Open Offer Entitlement and the Excess CREST Open Offer Entitlement will generate an appropriate market claim transaction and the relevant Open Offer Entitlement(s) and Excess CREST Open Offer Entitlement(s) will thereafter be transferred accordingly.

**(c) *USE instructions***

Qualifying CREST Shareholders who are CREST members and who want to apply for Open Offer Shares in respect of all or some of their Open Offer Entitlement and their Excess CREST Open Offer Entitlement in CREST must send (or, if they are CREST sponsored members, procure that their CREST sponsor sends) an Unmatched Stock Event (“**USE**”) instruction to Euroclear which, on its settlement, will have the following effect:

- (i) the crediting of a stock account of the Receiving Agent under the participant ID and member account ID specified below, with a number of Open Offer Entitlements and, where applicable, Excess CREST Open Offer Entitlements corresponding to the number of Open Offer Shares applied for; and
- (ii) the creation of a CREST payment, in accordance with the CREST payment arrangements in favour of the payment bank of the Receiving Agent in respect of the amount specified in the USE instruction which must be the full amount payable on application for the number of Open Offer Shares referred to in (i) above.

**(d) *Content of USE instruction in respect of Open Offer Entitlements***

The USE instruction must be properly authenticated in accordance with Euroclear’s specifications and must contain, in addition to the other information that is required for settlement in CREST, the following details:

- (i) the number of Open Offer Shares for which application is being made (and hence the number of the Open Offer Entitlement(s) being delivered to the Receiving Agent);
- (ii) the ISIN of the Open Offer Entitlement. This is GB00B3DVP054;
- (iii) the CREST participant ID of the accepting CREST member;
- (iv) the CREST member account ID of the accepting CREST member from which the Open Offer Entitlements are to be debited;
- (v) the participant ID of the Receiving Agent in its capacity as a CREST receiving agent. This is 3RA19;
- (vi) the member account ID of the Receiving Agent in its capacity as a CREST receiving agent. This is HBOS;
- (vii) the amount payable by means of a CREST payment on settlement of the USE instruction. This must be the full amount payable on application for the number of Open Offer Shares referred to in (i) above;
- (viii) the intended settlement date. This must be on or before 11.00 a.m. on 9 January 2009; and
- (ix) the Corporate Action Number for the Open Offer. This will be available by viewing the relevant corporate action details in CREST.

In order for an application under the Open Offer to be valid, the USE Instruction must comply with the requirements as to authentication and contents set out above and must settle on or before 11.00 a.m. on 9 January 2009.

In order to assist prompt settlement of the USE Instruction, CREST members (or their sponsors, where applicable) may consider adding the following non-mandatory fields to the USE Instruction:

- (i) a contact name and telephone number (in the free format shared note field); and
- (ii) a priority of at least 80.

CREST members and, in the case of CREST sponsored members, their CREST sponsors, should note that the last time at which a USE instruction may settle on 9 January 2009 in order to be valid is 11.00 a.m. on that day.

**(e) Contents of USE Instruction in respect of the Excess CREST Open Offer Entitlement**

The USE Instruction must be properly authenticated in accordance with Euroclear's specifications and must contain, in addition to the other information that is required for settlement in CREST, the following details:

- (i) the number of Open Offer Shares for which application is being made (and hence the number of the Excess CREST Open Offer Entitlements being delivered to the Receiving Agent);
- (ii) the ISIN of the Excess CREST Open Offer Entitlement. This is GB00B3FKDG29;
- (iii) the CREST participant ID of the accepting CREST member;
- (iv) the CREST member account ID of the accepting CREST member from which the Excess CREST Open Offer Entitlement are to be debited;
- (v) the participant ID of the Receiving Agent in its capacity as a CREST receiving agent. This is 3RA19;
- (vi) the member account ID of the Receiving Agent in its capacity as a CREST receiving agent. This is HBOS;
- (vii) the amount payable by means of a CREST payment on settlement of the USE Instruction. This must be the full amount payable on application for the number of Open Offer Shares referred to in (i) above;
- (viii) the intended settlement date. This must be on or before 11.00 a.m. on 9 January 2009; and
- (ix) the Corporate Action Number for the Open Offer. This will be available by viewing the relevant corporate action details in CREST.

In order for an application in respect of an Excess CREST Open Offer Entitlement under the Open Offer to be valid, the USE Instruction must comply with the requirements as to authentication and contents set out above and must settle on or before 11.00 a.m. on 9 January 2009.

In order to assist prompt settlement of the USE Instruction, CREST members (or their sponsors, where applicable) should add the following non-mandatory fields to the USE Instruction:

- (i) a contract name and telephone number (in the free format shared note field); and
- (ii) a priority of at least 80.

CREST members and, in the case of CREST sponsored members, their CREST sponsors, should note that the last time at which a USE Instruction may settle on 9 January 2009 in order to be valid is 11.00 a.m. on that day. **Please note that automated CREST generated claims and buyer protection will not be offered on the Excess CREST Open Offer Entitlement security.**

**(f) Deposit of Open Offer Entitlement into, and withdrawal from, CREST**

A Qualifying Non-CREST Shareholder's Open Offer Entitlement and entitlement to apply under the Excess Application Facility as set out in his Application Form may be deposited into CREST (either into the account of the Qualifying Non-CREST Shareholder named in the Application Form or into the name of a person entitled by virtue of a *bona*

*fide* market claim). Similarly, an Open Offer Entitlement and Excess CREST Open Offer Entitlement held in CREST may be withdrawn from CREST so that the entitlement under the Open Offer and entitlement to apply under the Excess Application Facility is reflected in an Application Form. Normal CREST procedures (including timings) apply in relation to any such deposit or withdrawal, subject (in the case of a deposit into CREST) as set out in the Application Form.

A Qualifying Non-CREST Shareholder who wishes to make such a deposit should sign Box 8 and complete Box 11 of their Application Form, entitled "CREST Deposit Form" and then deposit their Application Form with the CREST Courier and Sorting Service. In addition, the normal CREST stock deposit procedures will need to be carried out, except that (a) it will not be necessary to complete and lodge a separate CREST transfer form (as prescribed under the Stock Transfer Act 1963) with the CREST Courier and Sorting Service and (b) only the Open Offer Entitlement shown in Box 2 of the Application Form and the entitlement to apply under the Excess Application Facility shown in Box 4 of the Application Form may be deposited into CREST.

If you have received your Application Form by virtue of a *bona fide* market claim, the declaration in Box 8 must have been completed or (in the case of an Application Form which has been split) marked "Declaration of sale duly made". If you wish to take up your Open Offer Entitlement, the CREST Deposit Form in Box 11 of your Application Form must be completed and deposited with the CREST Courier and Sorting Service in accordance with the instructions above. A holder of more than one Application Form who wishes to deposit the Open Offer Entitlement shown on those Application Forms into CREST must complete Box 11 of each Application Form.

A holder of an Application Form who is proposing to deposit the entitlement set out in such form into CREST is recommended to ensure that the deposit procedures are implemented in sufficient time to enable the person holding or acquiring the Open Offer Entitlement and the entitlement to apply under the Excess Application Facility following their deposit into CREST to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on 9 January 2009. After depositing their Open Offer Entitlement into their CREST account, CREST holders will shortly thereafter receive a credit for their Excess CREST Open Offer Entitlement, which will be managed by the Receiving Agent.

In particular, having regard to normal processing times in CREST and on the part of the Receiving Agent, the recommended latest time for depositing an Application Form with the CREST Courier and Sorting Service, where the person entitled wishes to hold the entitlement under the Open Offer set out in such Application Form as an Open Offer Entitlement and an Excess CREST Open Offer Entitlement in CREST, is 3.00 p.m. on 6 January 2009 and the recommended latest time for receipt by Euroclear of a dematerialised instruction requesting withdrawal of an Open Offer Entitlement or an Excess CREST Open Offer Entitlement from CREST is 4.30 p.m. on 2 January 2009 in either case so as to enable the person acquiring or (as appropriate) holding the Open Offer Entitlement and the Excess Open Offer Entitlement following the deposit or withdrawal (whether as shown in an Application Form or held in CREST) to take all necessary steps in connection with applying in respect of the Open Offer Entitlement and Excess Open Offer Entitlement or Excess CREST Open Offer Entitlement, as the case may be, prior to 11.00 a.m. on 9 January 2009.

Delivery of an Application Form with the CREST deposit form duly completed whether in respect of a deposit into the account of the Qualifying Shareholder named in the Application Form or into the name of another person, shall constitute a representation and warranty to the Company and the Receiving Agent by the relevant CREST member(s) that it/they is/are not in breach of the provisions of the notes under the paragraph headed "Instructions for depositing entitlements under the Open Offer into CREST" of the Application Form, and a declaration to the Company and the Receiving Agent from the relevant CREST member(s) that it/they is/are not citizen(s) or resident(s) of any Restricted Jurisdiction or any jurisdiction in which the application for Open Offer Shares is prevented by law and, where such deposit is made by a beneficiary of a market claim, a representation and warranty that the relevant CREST member(s) is/are entitled to apply under the Open Offer by virtue of a *bona fide* market claim.

**(g) Validity of application**

A USE instruction complying with the requirements as to authentication and contents set out above which settles by no later than 11.00 a.m. on 9 January 2009 will constitute a valid application under the Open Offer.

**(h) CREST procedures and timings**

CREST members and (where applicable) their CREST sponsors should note that Euroclear does not make available special procedures in CREST for any particular corporate action. Normal system timings and limitations will therefore apply in relation to the input of a USE instruction and its settlement in connection with the Open Offer. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST sponsored member, to procure that his CREST sponsor takes) such action as shall be necessary to ensure that a valid application is made as stated above by 11.00 a.m. on 9 January 2009. In this connection, CREST members and (where applicable) their CREST sponsors are referred in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

**(i) Incorrect or incomplete applications**

If a USE instruction includes a CREST payment for an incorrect sum, the Company, through the Receiving Agent, reserves the right:

- (i) to reject the application in full and refund the payment to the CREST member in question without interest;
- (ii) in the case that an insufficient sum is paid, to treat the application as a valid application for such lesser whole number of Open Offer Shares as would be able to be applied for with that payment at the Issue Price, refunding any unutilised sum to the CREST member in question (without interest); and
- (iii) in the case that an excess sum is paid, to treat the application as a valid application for all the Open Offer Shares referred to in the USE instruction, refunding any unutilised sum to the CREST member in question (without interest).

**(j) The Excess Application Facility**

The Excess Application Facility enables Qualifying Shareholders who have taken up their full Open Offer Entitlements to apply for Open Offer Shares in excess of their Open Offer Entitlements. There is no cap on the amount a Qualifying Shareholder can apply for under the Excess Application Facility, however, for technical reasons, if you wish to apply for more than two billion Open Offer Shares under the Excess Application Facility, you will need to contact the Registrar directly. If the total number of Open Offer Shares applied for by Qualifying Shareholders exceeds 7,482,394,366, applications in excess of Open Offer Entitlements will be scaled back *pro rata* to the number of Open Offer Shares applied for by Qualifying Shareholders under the Excess Application Facility.

An Excess CREST Open Offer Entitlement will not be listed and may not be sold or otherwise transferred. Subject as provided in section 6 of this Part VII in relation to certain Overseas Shareholders, the CREST accounts of Qualifying CREST Shareholders are being credited with an Excess CREST Open Offer Entitlement in order for any applications for excess Open Offer Shares to be settled through CREST. The credit of such Excess CREST Open Offer Entitlement does not in any way give you a right to the Open Offer Shares attributable to the Excess CREST Open Offer Entitlements as all applications for Excess CREST Open Offer Entitlement are subject to scaling back in accordance with the terms of this document.

To apply for excess Open Offer Shares pursuant to the Open Offer, Qualifying CREST Shareholders should follow the instructions above and **must not return a paper form, cheque or other means of application or payment.**

Should a transaction be identified by the CREST Claims Processing Unit as “cum” the Open Offer Entitlement and the relevant Open Offer Entitlement(s) be transferred, the Excess CREST Open Offer Entitlements will not transfer with the Open Offer Entitlement(s) claim, but will be transferred as a separate claim. Should a Qualifying CREST Shareholder cease to hold all of his Existing HBOS Shares as a result of one or

more *bona fide* market claims, the Excess CREST Open Offer Entitlements credited to CREST and allocated to the relevant Qualifying Shareholder will be transferred to the purchaser. **Please note that an additional USE Instruction must be sent in respect of any application under the Excess CREST Open Offer Entitlements.**

Should the Placing and Open Offer become unconditional and applications for Open Offer Shares by Qualifying Shareholders under the Open Offer exceed 7,482,394,366 Open Offer Shares, resulting in a scale back of applications under the Excess Application Facility, each Qualifying CREST Shareholder who has made a valid application for Open Offer Shares pursuant to his Excess CREST Open Offer Entitlement and from whom payment in full for such Open Offer Shares has been received in cleared funds, will receive a pounds sterling amount equal to the number of Open Offer Shares validly applied and paid for under the Excess Application Facility but which are not allocated to the relevant Qualifying CREST Shareholder, multiplied by the Issue Price. Monies will be returned as soon as reasonably practicable following the completion of the scale back, without payment of interest and at the applicant's sole risk.

Fractions of Open Offer Shares will not be issued under the Excess Application Facility and fractions of Open Offer Shares will be rounded down to the nearest whole number.

**(k) Effect of valid application**

A CREST member who makes or is treated as making a valid application in accordance with the above procedures as regards an Open Offer Entitlement and, where applicable, an Excess CREST Open Offer Entitlement thereby:

- (i) represents and warrants to HBOS and the Registrar that he has the right, power and authority, and has taken all action necessary, to make the application under the Open Offer and to execute, deliver and exercise his rights, and perform his obligations, under any contracts resulting therefrom and that he is not a person otherwise prevented by legal or regulatory restrictions from applying for Open Offer Shares or acting on behalf of any such person on a non-discretionary basis;
- (ii) agrees to pay the amount payable on application in accordance with the above procedures by means of a CREST payment in accordance with the CREST payment arrangements (it being acknowledged that the payment to the Receiving Agent's payment bank in accordance with the CREST payment arrangements shall, to the extent of the payment, discharge in full the obligation of the CREST member to pay to the Company the amount payable on application);
- (iii) agrees that all applications and contracts resulting therefrom under the Open Offer shall be governed by, and construed in accordance with, the laws of England;
- (iv) confirms that in making the application he is not relying on any information or representation in relation to HBOS, Lloyds TSB or the Enlarged Group other than that contained in this document, and the applicant accordingly agrees that no person responsible solely or jointly for this document or any part thereof, or involved in the preparation thereof, shall have any liability for any such information or representation not so contained and further agrees that, having had the opportunity to read this document, he will be deemed to have had notice of all the information in relation to HBOS, Lloyds TSB or the Enlarged Group contained in this document (including information incorporated by reference);
- (v) confirms that in making the application he is not relying and has not relied on Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch, Morgan Stanley or any person affiliated with Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley in connection with any investigation of the accuracy of any information contained in this document or his investment decision;
- (vi) confirms that no person other than HBOS has been authorised to give any information or to make any representation concerning HBOS, or its subsidiaries, or Lloyds TSB and the Enlarged Group, or the Open Offer Shares (other than as contained in this document) and, if given or made, any such other information or representation should not be relied upon as having been authorised by HBOS, Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch or Morgan Stanley;

- (vii) represents and warrants to HBOS and the Registrar that he is the Qualifying Shareholder originally entitled to the Open Offer Entitlements or that he has received such Open Offer Entitlement by virtue of a *bona fide* market claim;
- (viii) represents and warrants to HBOS and the Registrar that if he has received some or all of his Open Offer Entitlements from a person other than HBOS, he is entitled to apply under the Open Offer in relation to such Open Offer Entitlement by virtue of a *bona fide* market claim;
- (ix) requests that the Open Offer Shares to which he will become entitled be issued to him on the terms set out in this document, subject to the Memorandum of Association and Articles of Association of the Company;
- (x) represents and warrants to HBOS and the Registrar that he is not, nor is he applying on behalf of any person who is, a citizen or resident, or which is a corporation, partnership or other entity created or organised in, or under any laws of, any Restricted Jurisdiction or any jurisdiction in which the application for Open Offer Shares by such person is prevented by law and he is not applying with a view to re-offering, re-selling, transferring or delivering any of the Open Offer Shares which are the subject of his application to, or for the benefit of, a HBOS Shareholder who is a citizen or resident or which is a corporation, partnership or other entity created or organised in, or under any laws of, any Restricted Jurisdiction or any jurisdiction in which the application for Open Offer Shares by such person is prevented by law (except where proof satisfactory to the Company has been provided to the Company that he is able to accept the invitation by the Company free of any requirement which it (in its absolute discretion) regards as unduly burdensome), nor acting on behalf of any such person on a non-discretionary basis nor (a) person(s) otherwise prevented by legal or regulatory restrictions from applying for Open Offer Shares under the Open Offer;
- (xi) represents and warrants that (i) it is not, nor is it applying on behalf of, or for the account or benefit of, a person who is located in the United States; or (ii) if it is, or is applying on behalf of or for the account or benefit of, a person located in the United States, it, or such person on whose behalf or account or benefit it is applying, is a QIB that has executed an investor representation letter containing the representations, warranties, agreement and confirmations set out in paragraph 6.1 of this Part VII confirming, among other things, its status as a QIB and its ability to rely on an exemption from the registration requirements of the Securities Act in connection with its participation in the Placing and Open Offer;
- (xii) represents and warrants to HBOS and the Registrar that he is not, and nor is he applying as nominee or agent for, a person who is or may be liable to notify and account for tax under the Stamp Duty Reserve Tax Regulations 1986 at any of the increased rates referred to in section 93 (depository receipts) or section 96 (clearance services) of the Finance Act 1986 (a "**Specified Person**") and that if any stamp duty, stamp duty reserve tax, or any other transfer, issuance tax or related interest and penalties ("**Stamp Tax**") arises in connection with his acquisition of the Open Offer Shares or any subsequent transfer by him, or his agent, of such shares to a Specified Person or a nominee or agent for such person, he agrees that he will pay and bear, or procure the payment of, the cost of such Stamp Tax; and
- (xiii) gives the instructions to Computershare Investor Services PLC set out in paragraph 4.4 below.

**(I) Company's discretion as to the rejection and validity of applications**

Subject to the provisions of the Placing and Open Offer Agreement, the Company may in its sole discretion:

- (i) treat as valid (and binding on the CREST member concerned) an application which does not comply in all respects with the requirements as to validity set out or referred to in this Part VII; accept an alternative properly authenticated dematerialised instruction from a CREST member or (where applicable) a CREST

sponsor as constituting a valid application in substitution for or in addition to a USE instruction and subject to such further terms and conditions as the Company may determine;

- (ii) treat a properly authenticated dematerialised instruction (in this sub-paragraph the “first instruction”) as not constituting a valid application if, at the time at which the Receiving Agent receives a properly authenticated dematerialised instruction giving details of the first instruction or thereafter, either the Company or the Receiving Agent has received actual notice from Euroclear of any of the matters specified in Regulation 35(5)(a) of the CREST Regulations in relation to the first instruction. These matters include notice that any information contained in the first instruction was incorrect or notice of lack of authority to send the first instruction; and
- (iii) accept an alternative instruction or notification from a CREST member or CREST sponsored member or (where applicable) a CREST sponsor, or extend the time for settlement of a USE instruction or any alternative instruction or notification, in the event that, for reasons or due to circumstances outside the control of any CREST member or CREST sponsored member or (where applicable) CREST sponsor, the CREST member or CREST sponsored member is unable validly to apply for Open Offer Shares by means of the above procedures. In normal circumstances, this discretion is only likely to be exercised in the event of any interruption, failure or breakdown of CREST (or any part of CREST) or on the part of the facilities and/or systems operated by the Receiving Agent in connection with CREST.

**(m) Lapse of the Open Offer**

In the event that the Placing and Open Offer does not become unconditional by 8.00 a.m. on 19 January 2009 or such later time and date as HM Treasury may agree, the Placing and Open Offer will lapse, the Open Offer Entitlements and Excess CREST Open Offer Entitlements admitted to CREST will be disabled and the Receiving Agent will refund the amount paid by a Qualifying CREST Shareholder by way of a CREST payment, without interest, as soon as practicable thereafter. The interest earned on such monies, if any, will be retained for the benefit of the HBOS Group.

**4.3 Withdrawal rights**

Persons wishing to exercise or direct the exercise of statutory withdrawal rights pursuant to section 87Q(4) of the FSMA after the issue by the Company of a prospectus supplementing this document must do so by lodging a written notice of withdrawal within two Business Days of the date on which the supplementary prospectus is published. The withdrawal notice must include the full name and address of the person wishing to exercise statutory withdrawal rights and, if such person is a CREST member, the participant ID and the member account ID of such CREST member. The notice of withdrawal must be deposited by post with the Receiving Agent to Computershare Investor Services PLC, Project 1 Bridgwater Road, Bristol BS99 6AR or by hand (during normal business hours only) to Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS13 8AE or by facsimile to the Receiving Agent on 0870 703 6101, if sending from within the UK, or on +44 870 703 6101, if sending from overseas, (please call the Receiving Agent on 0870 702 0102, if calling from within the UK, or, if calling from overseas on +44 870 702 0102, between the hours of 8.30 a.m. and 5.30 p.m.) so as to be received before the end of the withdrawal period. Notice of withdrawal given by any other means or which is deposited with the Receiving Agent after such expiry of such period will not constitute a valid withdrawal. The Company will not permit the exercise of withdrawal rights after payment by the relevant person for the Open Offer Shares to which they are entitled in full, save to the extent required by statute. In such event, such persons are advised to seek independent legal advice.

**4.4 Payment Instructions**

For technical reasons, at the conclusion of the Placing and Open Offer the Company will issue the Open Offer Shares in consideration for the transfer to it by Dresdner Bank AG, London Branch, Morgan Stanley or a third party nominated by the Company (the “**NewCo Subscriber**”) of certain issued ordinary shares and preference shares in the Jersey NewCo, which will result in the Company owning the entire issued share capital of Jersey NewCo, the



only assets of which will be its cash resources. These resources will represent the net proceeds of the Placing and Open Offer. The Company will be able to utilise this amount by redeeming the redeemable preference shares it will then hold in Jersey NewCo.

Accordingly, by applying for Open Offer Shares in the Open Offer and submitting a valid payment in respect thereof, a Qualifying Shareholder instructs the Receiving Agent to (i) hold such payments on the applicant's behalf on a non-interest bearing basis until the allotment and issue of the Open Offer Shares and, if allotment and issue does not take place, to return such payment without interest to the applicant, (ii) following allotment and issue and to the extent of a successful application under the Open Offer, to apply such payment (after deduction of certain agreed fees, costs and expenses) on behalf of the NewCo Subscriber solely for the purposes of acquiring redeemable preference shares in Jersey NewCo and (iii) to the extent of an unsuccessful application under the Open Offer, to return the relevant payment without interest to the applicant.

## **5 Money Laundering Regulations**

### **5.1 Holders of Application Forms**

To ensure compliance with the Money Laundering Regulations, the Receiving Agent may require, at its absolute discretion, verification of the identity of the person by whom or on whose behalf an Application Form is lodged with payment (which requirements are referred to below as the "verification of identity requirements"). If the Application Form is submitted by a UK regulated broker or intermediary acting as agent and which is itself subject to the Money Laundering Regulations, any verification of identity requirements are the responsibility of such broker or intermediary and not of the Receiving Agent. In such case, the lodging agent's stamp should be inserted on the Application Form.

The person lodging the Application Form with payment and in accordance with the other terms as described above (the "acceptor"), including any person who appears to the Receiving Agent to be acting on behalf of some other person, accepts the Open Offer in respect of such number of Open Offer Shares as is referred to therein (for the purposes of this section 5, the "relevant Open Offer Shares") shall thereby be deemed to agree to provide the Receiving Agent with such information and other evidence as the Receiving Agent may require to satisfy the verification of identity requirements.

If the Receiving Agent determines that the verification of identity requirements apply to any acceptor or application, the relevant Open Offer Shares (notwithstanding any other term of the Open Offer) will not be issued to the relevant acceptor unless and until the verification of identity requirements have been satisfied in respect of that acceptor or application. The Receiving Agent is entitled, in its absolute discretion, to determine whether the verification of identity requirements apply to any acceptor or application and whether such requirements have been satisfied, and neither the Receiving Agent nor the Company will be liable to any person for any loss or damage suffered or incurred (or alleged), directly or indirectly, as a result of the exercise of such discretion.

If the verification of identity requirements apply, failure to provide the necessary evidence of identity within a reasonable time may result in delays in the despatch of share certificates or in crediting CREST accounts. If, within a reasonable time following a request for verification of identity, and, in any case by 11.00 a.m. on 9 January 2009, the Receiving Agent has not received evidence satisfactory to it as aforesaid, HBOS may, in its absolute discretion, treat the relevant application as invalid, in which event the monies payable on acceptance of the Open Offer will be returned (at the acceptor's risk) without interest to the account of the bank or building society on which the relevant cheque or banker's draft was drawn.

**Submission of an Application Form with the appropriate remittance will constitute a warranty from the applicant that the Money Laundering Regulations will not be breached by application of such remittance.**

The verification of identity requirements will not usually apply:

- (i) if the applicant is an organisation required to comply with the Money Laundering Directive (the Council Directive on prevention of the use of the financial system for the purpose of money laundering (no.91/308/EEC));

- (ii) if the acceptor is a regulated United Kingdom broker or intermediary acting as agent and is itself subject to the Money Laundering Regulations;
- (iii) if the applicant (not being an applicant who delivers his application in person) makes payment by way of a cheque drawn on an account in the applicant's name; or
- (iv) if the aggregate price for the Open Offer Shares is less than €15,000 (approximately £12,000).

In other cases the verification of identity requirements may apply. Satisfaction of these requirements may be facilitated in the following ways:

- (a) if payment is made by cheque or banker's draft in pounds sterling drawn on a branch in the United Kingdom of a bank or building society which bears a UK bank sort code number in the top right hand corner the following applies. Cheques, should be made payable to "HBOS Open Offer" in respect of an application by a Qualifying Shareholder and crossed "A/C Payee Only". Third party cheques may not be accepted with the exception of building society cheques or banker's drafts where the building society or bank has confirmed the name of the account holder by stamping or endorsing the cheque/banker's draft to such effect. However, third party cheques will be subject to the Money Laundering Regulations which would delay Shareholders receiving their Open Offer Shares. The account name should be the same as that shown on the Application Form; or
- (b) if the Application Form is lodged with payment by an agent which is an organisation of the kind referred to in (i) above or which is subject to anti-money laundering regulation in a country which is a member of the Financial Action Task Force (the non-European Union members of which are Argentina, Australia, Brazil, Canada, China, Gibraltar, Hong Kong, Iceland, Japan, Mexico, New Zealand, Norway, Russian Federation, Singapore, South Africa, Switzerland, Turkey, UK Crown Dependencies and the US and, by virtue of their membership of the Gulf Cooperation Council, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates), the agent should provide, with the Application Form, written confirmation that it has that status and a written assurance that it has obtained and recorded evidence of the identity of the person for whom it acts and that it will on demand make such evidence available to the Receiving Agent. If the agent is not such an organisation, it should contact the Receiving Agent at the address set out on page 35 of this document.

To confirm the acceptability of any written assurance referred to in (b) above, or in any other case, the acceptor should contact the Receiving Agent. The telephone number of the Receiving Agent is 0870 702 0102, or +44 870 702 0102 if calling from outside the United Kingdom, between the hours of 8.30 a.m. and 5.30 p.m. on any Business Day.

If the Application Form(s) is/are in respect of Open Offer Shares with an aggregate price of €15,000 (approximately £12,000) or more and is/are lodged by hand by the acceptor in person, or if the Application Form(s) in respect of Open Offer Shares is/are lodged by hand by the acceptor and the accompanying payment is not the acceptor's own cheque, he or she should ensure that he or she has with him or her evidence of identity bearing his or her photograph (for example, his or her passport) and separate evidence of his or her address.

If, within a reasonable period of time following a request for verification of identity, and in any case by no later than 11.00 a.m. on 9 January 2009, the Receiving Agent has not received evidence satisfactory to it as aforesaid, the Receiving Agent may, at its discretion, as agent of the Company, reject the relevant application, in which event the monies submitted in respect of that application will be returned without interest to the account at the drawee bank from which such monies were originally debited (without prejudice to the rights of the Company to undertake proceedings to recover monies in respect of the loss suffered by it as a result of the failure to produce satisfactory evidence as aforesaid).

## **5.2 Open Offer Entitlements in CREST**

If you hold your Open Offer Entitlement and Excess CREST Open Offer Entitlement in CREST and apply for Open Offer Shares in respect of all or some of your Open Offer Entitlement and Excess CREST Open Offer Entitlement as agent for one or more persons and you are not a UK or EU regulated person or institution (e.g. a UK financial institution), then, irrespective of the value of the application, the Receiving Agent is obliged to take

reasonable measures to establish the identity of the person or persons on whose behalf you are making the application. You must therefore contact the Receiving Agent before sending any USE or other instruction so that appropriate measures may be taken.

Submission of a USE instruction which on its settlement constitutes a valid application as described above constitutes a warranty and undertaking by the applicant to provide promptly to the Receiving Agent such information as may be specified by the Receiving Agent as being required for the purposes of the Money Laundering Regulations. Pending the provision of evidence satisfactory to the Receiving Agent as to identity, the Receiving Agent may in its absolute discretion take, or omit to take, such action as it may determine to prevent or delay issue of the Open Offer Shares concerned. If satisfactory evidence of identity has not been provided within a reasonable time, then the application for the Open Offer Shares represented by the USE instruction will not be valid. This is without prejudice to the right of the Company to take proceedings to recover any loss suffered by it as a result of failure to provide satisfactory evidence.

## **6 Overseas Shareholders**

This document has been approved by the FSA, being the competent authority in the United Kingdom. The Open Offer is being made to Qualifying Shareholders. The Company has requested that the FSA provides a certificate of approval and a copy of this document to the relevant competent authorities in Austria, Belgium, Cyprus, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, Netherlands, Norway, Portugal, Romania, Spain and Sweden pursuant to the passporting provisions of FSMA.

Accordingly, the making of the proposed offer of Open Offer Shares to persons located or resident in or who have a registered address in countries other than the United Kingdom, Austria, Belgium, Cyprus, Denmark, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Malta, Netherlands, Norway, Portugal, Romania, Spain or Sweden may be affected by the law or regulatory requirements of the relevant jurisdiction. Any HBOS Shareholder who is in any doubt as to his position should consult an appropriate professional adviser without delay.

The Company reserves the right to treat as invalid any application or purported application for Open Offer Shares that appears to the Company or its agents to have been executed, effected or dispatched from Restricted Jurisdictions or in a manner that may involve a breach of the laws or regulations of any jurisdiction or if the Company or its agents believe that the same may violate applicable legal or regulatory requirements or if it provides an address for delivery of the share certificates of Open Offer Shares or in the case of a credit of Open Offer Entitlements or Excess CREST Open Offer Entitlements to a stock account in CREST, to a CREST member whose registered address would be, in a Restricted Jurisdiction or any other jurisdiction outside the United Kingdom in which it would be unlawful to deliver such share certificates or make such a credit.

Notwithstanding any other provision of this document or the Application Form, the Company reserves the right to permit any person to apply for Open Offer Shares if the Company and joint sponsors are satisfied that the transaction in question is exempt from, or not subject to, the legislation or regulations giving rise to the restrictions in question.

Overseas Shareholders who wish, and are permitted, to apply for Open Offer Shares should note that payment must be made in sterling denominated cheques or bankers' drafts.

Due to restrictions under the securities laws of the Restricted Jurisdictions, and subject to certain exemptions, Qualifying Shareholders who have registered addresses in, or who are resident or ordinarily resident in, or citizens of, any Restricted Jurisdiction will not qualify to participate in the Open Offer and will not be sent an Application Form nor will their stock accounts in CREST be credited with Open Offer Entitlements or Excess CREST Open Offer Entitlements.

The Open Offer Shares have not been and will not be registered under the relevant laws of any Restricted Jurisdictions or any state, province or territory thereof and may not be offered, sold, resold, delivered or distributed, directly or indirectly, in or into any Restricted Jurisdictions or to, or for the account or benefit of, any person with a registered address in, or who is resident or ordinarily resident in, or a citizen of, any Restricted Jurisdictions except pursuant to an applicable exemption.

No offer of Open Offer Shares is being made by virtue of this document or the Application Forms into any Restricted Jurisdictions.

## 6.1 **United States**

The Open Offer Shares have not been and will not be registered under the Securities Act or under any other relevant securities laws of any state or other jurisdiction of the United States and may not be offered, sold, taken up, exercised, resold, renounced, transferred or delivered, directly or indirectly, in or into the United States at any time without registration or an applicable exemption from the registration requirements of the Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States.

Prospective investors are hereby notified that sellers of the Open Offer Shares may be relying on the exemption from registration provisions under Section 5 of the Securities Act, as amended, provided by Rule 144A thereunder.

Accordingly, subject to certain exceptions, the Open Offer is not being made in the United States and none of this Prospectus, the Application Form nor the crediting of Open Offer Entitlements or Excess CREST Open Offer Entitlements to a stock account in CREST constitutes or will constitute an offer, or an invitation to apply for, or an offer or invitation to acquire any Open Offer Shares in the United States. Subject to certain exceptions, neither this Prospectus nor an Application Form will be sent to, and no Open Offer Entitlements or Excess CREST Open Offer Entitlements will be credited to, a stock account in CREST with a bank or financial institution of any person with a registered address in the United States, and such documents must not be transferred to any such prospective purchaser unless such a person satisfies HBOS and the Placing Agents that a relevant exemption from the Securities Act is available. Application Forms or renunciations thereof sent from or post-marked in the United States will be deemed to be invalid and all persons acquiring Open Offer Shares and wishing to hold such Open Offer Shares in registered form must provide an address for registration of the Open Offer Shares outside the United States.

Subject as provided below, HBOS and the Placing Agents reserve the right to treat as invalid any Application Form (or renunciation thereof) that appears to HBOS or the Placing Agents or their respective agents to have been executed in or despatched from the United States, or that provides an address in the United States, or which does not make the warranty to the effect that the person does not have a registered address and is not otherwise located in the United States, and is not acquiring the Open Offer Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Open Offer Shares in the United States or where HBOS or the Placing Agents believes acceptance of such Application Form may infringe applicable legal or regulatory requirements. Subject as provided below, HBOS and the Placing Agents will not issue or distribute any Open Offer Shares to any person who is acting on behalf of, or for the account of, any person on a non-discretionary basis with an address in, or who is otherwise located in, the United States. In addition, HBOS and the Placing Agents reserve the right to reject any MTM instruction sent by or on behalf of any CREST member that does not make the above warranty or is applying for the Open Offer Shares on behalf of, or for the account or benefit of, a person in the United States.

Notwithstanding the foregoing, HBOS and the Placing Agents reserve the right to make the Open Offer Shares available to HBOS Shareholders that are, or who are acting on behalf of, or for the account or benefit of, QIBs pursuant to an available exemption from the registration requirements of the Securities Act. Any such transactions shall be at the sole discretion of HBOS and the Placing Agents. Any person reasonably believed to be a QIB to whom Open Offer Shares are offered and by whom Open Offer Shares are acquired will be required to execute and deliver to HBOS, the Placing Agents and/or one or more of their respective designees an investor letter satisfactory to HBOS and the Placing Agents setting forth certain restrictions and procedures regarding the Open Offer Shares, which contain, amongst other things, the following representations, warranties, agreements and confirmations:

- (i) it is an institution which (a) has such knowledge and experience in financial and business matters as to be capable of evaluation of the merits and risks of its investment in the Open Offer Shares, and (b) it and any accounts for which it is acting are each able to bear the economic risk of such investment, and are each able to sustain a complete loss of any investment in the Open Offer Shares;

- (ii) prior to taking up the Open Offer Shares, it received and read a copy of this Prospectus, the investor letter and the documents and information incorporated by reference into this Prospectus and will have had access to financial and any other information regarding HBOS and the Open Offer Shares as it has requested in connection with any investment decision to acquire the Open Offer Shares. If the acquirer has had any queries regarding this acquisition of the Open Offer Shares or HBOS and its affairs or the terms of the Open Offer Shares, it has had the opportunity to and has asked these questions of and received answers satisfactory to it from the representatives of HBOS or the Placing Agents. In making any acquisition of Open Offer Shares, it is relying on this Prospectus and not any other information or representation concerning HBOS. It agrees that it has held and will hold this Prospectus and any Application Form in confidence, it being understood that this Prospectus and any Application Form that have been or will be received by the acquirer are solely for its use and that it has not duplicated, distributed, forwarded, transferred or otherwise transmitted this Prospectus, any Application Form or any other presentational or other materials concerning the Open Offer (including electronic copies thereof) to any persons within the United States, and agrees that such material shall not be duplicated, distributed, forwarded, transferred or otherwise transmitted by it. It has made its own assessment concerning the relevant tax, legal and other economic considerations relevant to its investment in the Open Offer Shares;
- (iii) it acknowledges that the HBOS Shares are admitted to the Official List and admitted to trading on the London Stock Exchange and that HBOS is therefore required to publish certain business and financial information in accordance with the rules and practices of the FSA and the London Stock Exchange (“**Exchange Information**”) and that the acquirer is able to obtain or access such information without undue difficulty. It acknowledges that neither HBOS nor any of its affiliates has made any representation to the acquirer with respect to HBOS, other than the information contained in this Prospectus. It acknowledges that neither the Placing Agents nor any of their affiliates have made any representation with respect to HBOS or the Open Offer Shares. It is understood that the Exchange Information has been prepared in accordance with UK format, style and content, which differs from US format, style and content;
- (iv) it is a QIB and that if it is acquiring the Open Offer Shares as a fiduciary or agent for one or more investor accounts, each such account is a QIB, it has investment discretion with respect to each such account and has full power and authority to make, and does make, the acknowledgements, representations and agreements herein on behalf of each such account;
- (v) it is acquiring the Open Offer Shares for its own account (or the account as to which it has full investment discretion) for investment purposes, and not with a view to distribution within the meaning of the US securities laws;
- (vi) it understands and acknowledges that the Open Offer Shares are being offered in a transaction not involving any public offering in the United States within the meaning of the Securities Act and that the Open Offer Shares have not been and will not be registered under the Securities Act or any state securities laws. It agrees that the Open Offer Shares may not be reoffered, sold, pledged or otherwise transferred, and that it will not directly or indirectly reoffer, sell, pledge or otherwise transfer the Open Offer Shares, except in an offshore transaction in accordance with Rule 904 of Regulation S under the Securities Act;
- (vii) it understands that the Open Offer Shares are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act and that, for so long as they remain “restricted securities”, they may not be deposited into any unrestricted ADS facility established or maintained by a depositary bank;
- (viii) it understands that, following approval of the Acquisition, whereby the Open Offer Shares will be exchanged for Consideration Shares, the Consideration Shares will not be registered under the Securities Act or any state securities laws. It agrees that the Consideration Shares may not be reoffered, sold, pledged or otherwise transferred, and that we will not directly or indirectly reoffer, sell, pledge or otherwise transfer the Consideration Shares, except in an offshore transaction in accordance with Rule 904 of

Regulation S under the Securities Act. Furthermore, it agrees that the Consideration Shares will be “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act and that, for so long as they remain “restricted securities”, the Consideration Shares may not be deposited into any unrestricted ADS facility established or maintained by a depositary bank;

- (ix) it acknowledges and agrees that if the Open Offer Shares are in certificated form, the certificates representing the Open Offer Shares will contain substantially the following legend:

THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OR ANY OTHER APPLICABLE SECURITIES LAW. BY ITS ACCEPTANCE OF THE SHARES THE PURCHASER REPRESENTS THAT IT IS A QUALIFIED INSTITUTIONAL BUYER AS DEFINED IN RULE 144A OF THE US SECURITIES ACT (“**QIB**”) AND THAT IT IS EITHER PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF OTHER PURCHASERS WHO ARE QIBS AND AGREES (A) THAT THE SECURITIES ARE NOT BEING ACQUIRED WITH A VIEW TO DISTRIBUTION AND ANY RESALE OF SUCH SECURITIES WILL BE MADE ONLY IN ACCORDANCE WITH RULE 904 OF REGULATION S OF THE SECURITIES ACT AND (B) THAT SO LONG AS THE SHARES ARE “**RESTRICTED SECURITIES**” WITHIN THE MEANING OF RULE 144(A)(3) OF THE US SECURITIES ACT, THEY MAY NOT BE DEPOSITED INTO ANY UNRESTRICTED DEPOSITARY RECEIPT FACILITY.

A RESALE IN ACCORDANCE WITH RULE 904 OF THE US SECURITIES ACT MAY INCLUDE A TRANSACTION WHERE NO DIRECTED SELLING EFFORTS ARE MADE IN THE UNITED STATES, THE OFFER IS NOT MADE TO A PERSON IN THE UNITED STATES AND EITHER (A) AT THE TIME THE BUY ORDER IS ORIGINATED, THE BUYER IS OUTSIDE THE UNITED STATES, OR THE SELLER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE THAT THE BUYER IS OUTSIDE THE UNITED STATES, OR (B) THE TRANSACTION IS EXECUTED IN, OR THROUGH THE FACILITIES OF THE LONDON STOCK EXCHANGE AND NEITHER THE SELLER NOR ANY PERSON ACTING ON ITS BEHALF KNOWS THAT THE TRANSACTION HAS BEEN PRE-ARRANGED WITH A BUYER IN THE UNITED STATES.

- (x) it understands and acknowledges that HBOS and Lloyds TSB each may make notations on their respective records or give instructions to their respective registrars and any transfer agent of the Open Offer Shares or Consideration Shares, as the case may be, and to the depositary under HBOS’s ADS facility and the depositary under the Lloyds TSB ADS facility in order to implement the restrictions on transfer set forth and described herein; and
- (xi) any information that it has hereto furnished to HBOS with respect to its financial position is correct and complete in all material respects as of the date of this Prospectus, and if there should be any material change in such information prior to the consummation of the transactions contemplated hereby, it will promptly furnish such revised or corrected information to HBOS.

Prospective purchasers in the United States that satisfy HBOS and the Placing Agents as to their status may deliver a properly completed Application Form to the Receiving Agent in accordance with the procedures set out in paragraph 4 of this Part VII. Prospective purchasers who are in the United States must also complete, and return to HBOS, an investor letter in the appropriate form as described in paragraph 6.1 of this Part VII, with a copy to the Placing Agents. Prospective purchasers who plan to purchase Open Offer Shares through a bank, a broker or other financial intermediary, should procure that the relevant bank, broker or financial intermediary submits an investor letter on their behalf. HBOS and the Receiving Agent have the discretion to refuse to accept any Application Form that is incomplete, unexecuted or not accompanied by an executed investor letter or any other required additional documentation.

Any person in the United States who obtains a copy of this Prospectus or an Application Form and who is not a QIB is required to disregard them.

Potential purchasers of the Open Offer Shares in the US are advised to consult legal counsel prior to making any offer for, resale, pledge or other transfer of such Open Offer Shares.

Until 40 days after the commencement of the Open Offer, an offer, sale or transfer of the Open Offer Shares within the United States by a dealer (whether or not participating in the Open Offer) may violate the registration requirements of the Securities Act.

## **6.2 Other Restricted Jurisdictions**

Due to restrictions under the securities laws of the Restricted Jurisdictions, and subject to certain exemptions, Qualifying Shareholders who have registered addresses in, or who are resident or ordinarily resident in, or citizens of, any Restricted Jurisdictions will not qualify to participate in the Open Offer and will not be sent an Application Form nor will their stock accounts in CREST be credited with Open Offer Entitlements or Excess CREST Open Offer Entitlements.

## **6.3 Representations and warranties relating to Overseas Shareholders**

### **(a) Qualifying Non-CREST Shareholders**

Any person completing and returning an Application Form or requesting registration of the Open Offer Shares comprised therein represents and warrants to HBOS and/or the Registrar that, except where proof has been provided to HBOS's satisfaction that such person's use of the Application Form will not result in the contravention of any applicable legal requirements in any jurisdiction: (i) such person is not requesting registration of the relevant Open Offer Shares from within the United States or any Restricted Jurisdiction; (ii) such person is not in any territory in which it is unlawful to make or accept an offer to acquire Open Offer Shares in respect of the Open Offer or to use the Application Form in any manner in which such person has used or will use it; (iii) such person is not acting on a non-discretionary basis on behalf of, or for the account or benefit of, a person located within the United States or any Restricted Jurisdiction or any territory referred to in (ii) above at the time the instruction to accept was given; and (iv) such person is not acquiring Open Offer Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Open Offer Shares into the United States or any Restricted Jurisdiction or any territory referred to in (ii) above. HBOS and/or the Registrar may treat as invalid any acceptance or purported acceptance of the allotment of Open Offer Shares comprised in an Application Form if it: (i) appears to HBOS or its agents to have been executed, effected or dispatched from the United States or an Restricted Jurisdiction or in a manner that may involve a breach of the laws or regulations of any jurisdiction or if HBOS or its agents believe that the same may violate applicable legal or regulatory requirements; or (ii) provides an address in the United States or an Restricted Jurisdiction for delivery of the share certificates of Open Offer Shares (or any other jurisdiction outside the United Kingdom in which it would be unlawful to deliver such share certificates); or (iii) purports to exclude the warranty required by this sub-paragraph (a).

### **(b) Qualifying CREST Shareholders**

A CREST member who makes a valid acceptance either on its own behalf or on behalf of one of its clients in accordance with the procedures set out in this Part VII represents and warrants to HBOS that, except where proof has been provided to HBOS's satisfaction that such person's acceptance will not result in the contravention of any applicable legal requirement in any jurisdiction: (i) neither it nor its client is within the United States or any Restricted Jurisdiction; (ii) neither it nor its client is in any territory in which it is unlawful to make or accept an offer to acquire Open Offer Shares; (iii) it is not accepting on a non-discretionary basis on behalf of, or for the account or benefit of, a person located within the United States or any Restricted Jurisdiction or any territory referred to in (ii) above at the time the instruction to accept was given; and (iv) neither it nor its client is acquiring any Open Offer Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Open Offer Shares into the United States or any Restricted Jurisdiction, or any territory referred to in (ii) above. HBOS reserves the right to reject any USE Instruction from the United States or any Restricted Jurisdiction or any territory referred to in (ii) above or by a CREST Member who is acting on a non-discretionary basis for the account or benefit of a person located within the United States or any Restricted Jurisdiction or any territory referred to in (ii) above.

## **7 Admission, Settlement and dealings**

The result of the Open Offer is expected to be announced on 12 January 2009.

The Existing HBOS Shares are already admitted to CREST. No further application for admission to CREST is accordingly required for the Open Offer Shares. All such shares, when issued and fully paid, may be held and transferred by means of CREST.

It is expected that Open Offer Shares will be issued at 8.00 a.m. on 15 January 2009. The Open Offer Shares, which will be cancelled pursuant to the Acquisition, will not be admitted to listing or trading on any exchange. However, it is expected that the Consideration Shares, to be issued by Lloyds TSB to holders of Scheme Shares (including the Open Offer Shares) pursuant to the Acquisition will be issued on or after 5.00 p.m. on 16 January 2009. Applications will be made to the FSA for the Consideration Shares to be admitted to the Official List and to the London Stock Exchange for them to be admitted to trading on the London Stock Exchange's main market for listed securities. It is expected that Admission of the Consideration Shares will become effective and that dealings in the Consideration Shares, fully paid, will commence at 8.00 a.m. on 19 January 2009. If the Open Offer Shares are issued but the Acquisition does not subsequently become Effective then HBOS will apply for the Open Offer Shares to be admitted to the Official List and to trading on the London Stock Exchange's main market for listed securities.

The Existing Lloyds TSB Shares are already admitted to CREST. No further application for admission to CREST is accordingly required for the Consideration Shares. All such shares, when issued and fully paid, may be held and transferred by means of CREST.

Open Offer Entitlements held in CREST and Excess CREST Open Offer Entitlements are expected to be disabled in all respects after 11.00 a.m. on 9 January 2009 (the latest date for applications under the Open Offer). If the condition(s) to the Open Offer described above are satisfied, Open Offer Shares will be issued in uncertificated form to those persons who submitted a valid application for Open Offer Shares by utilising the CREST application procedures and whose applications have been accepted by the Company. The stock accounts to be credited will be accounts under the same CREST participant IDs and CREST member account IDs in respect of which the relevant USE instruction was given.

Notwithstanding any other provision of this document, the Company reserves the right to send Qualifying CREST Shareholders an Application Form instead of crediting the relevant stock account with an Open Offer Entitlement and an Excess CREST Open Offer Entitlement, and to allot and/or issue any Open Offer Shares in certificated form. In normal circumstances, this right is only likely to be exercised in the event of any interruption, failure or breakdown of CREST (or of any part of CREST) or on the part of the facilities and/or systems operated by the Receiving Agent in connection with CREST.

No temporary or definitive documents of title are expected to be issued in respect of the Open Offer Shares prior to the completion of the Acquisition. Pending completion of the Acquisition, transfers will be certified against the UK share register of the Company. For HBOS Shareholders holding HBOS Shares (including Open Offer Shares) in uncertificated form as at the Scheme Record Time, share certificates in respect of the Consideration Shares issued to such HBOS Shareholders pursuant to the Acquisition are expected to be despatched by Lloyds TSB by post by 30 January 2009. All documents or remittances sent by or to applicants, or as they may direct, will be sent through the post at their own risk. For more information as to the procedure for application, Qualifying Non-CREST Shareholders are referred to paragraph 4.1 above and their respective Application Form.

## **8 Taxation**

Certain statements regarding United Kingdom and United States taxation in respect of Open Offer Shares and the Open Offer are set out in Part XXI ("Taxation Considerations") of this document. Persons who are in any doubt as to their tax position in relation to taking up their Open Offer Entitlement or applying for any excess Open Offer Shares under the Excess Application Facility (as applicable) under the Open Offer, or who are subject to tax in any jurisdiction other than the United Kingdom or the United States should immediately consult a suitable professional adviser.



## **9 Times and Dates**

The Company shall, in its discretion and after consultation with its financial and legal advisers, be entitled to amend the dates that Application Forms are despatched or amend or extend the latest date for acceptance under the Open Offer and all related dates set out in this document and in such circumstances shall notify the UK Listing Authority, and make an announcement on a Regulatory Information Service approved by the UK Listing Authority and, if appropriate, by HBOS Shareholders but Qualifying Shareholders may not receive any further written communication.

## **10 Governing Law and Jurisdiction**

The terms and conditions of the Open Offer as set out in this document, the Application Form and any non-contractual obligation related thereto shall be governed by, and construed in accordance with, English law. The courts of England and Wales are to have exclusive jurisdiction to settle any dispute which may arise out of or in connection with the Open Offer, this document or the Application Form. By taking up Open Offer Shares, whether by way of their Open Offer Entitlement or through the Excess Application Facility (as applicable) under the Open Offer in accordance with the instructions set out in this document and, where applicable, the Application Form and the Shareholder Guide, Qualifying Shareholders irrevocably submit to the jurisdiction of the courts of England and Wales and waive any objection to proceedings in any such court on the ground of venue or on the ground that proceedings have been brought in an inconvenient forum.

## **11 HBOS Share Schemes**

HBOS operates the HBOS Share Schemes under which employees may acquire HBOS Shares.

Where participants have a conditional right to acquire HBOS Shares under the HBOS Share Schemes (i.e. an option or a conditional share award), such rights may be adjusted in such a way as the HBOS Directors (or a committee of the HBOS Directors) consider appropriate to take account of the Placing and Open Offer. In the case of some of the HBOS Share Schemes such adjustments, if any, will be subject to the approval of HMRC or the tax authorities in jurisdictions outside of the UK. Participants may be contacted separately with further information on how their options and awards may be affected by the Placing and Open Offer.

Where participants in the HBOS Share Schemes have a beneficial interest in HBOS Shares, and the legal ownership of such HBOS Shares is held by a trustee, participants may, subject to any relevant securities laws, be entitled to participate in the Open Offer on the same basis as other Qualifying Shareholders. Participants in those HBOS Share Schemes will be contacted separately with further information on how they can instruct the trustee to apply for Open Offer Shares.

## **12 HBOS ADSs**

Subject to certain exceptions, the Open Offer is not being made to holders of HBOS ADSs.

## **13 Further Information**

Your attention is drawn to the further information set out in this document and also, in the case of Qualifying Non-CREST Shareholders and any other Qualifying Shareholders to whom the Company has sent Application Forms, to the terms, conditions and other information contained in the Application Form and the Shareholder Guide.

## **PART VIII**

### **INFORMATION ON THE ACQUISITION**

A description of the principal terms of the Acquisition is set out in Part III (“Principal Terms of the Acquisition”) on pages 47 to 52 of the Lloyds TSB Circular and is incorporated by reference herein.

A description of the conditions relating to the Proposed Government Funding is set out in Part V (“Conditions relating to the Proposed Government Funding”) on pages 57 to 58 of the Lloyds TSB Circular, which is incorporated by reference herein.

Further information on the Acquisition is set out in Part VI, Part B (“Information on the Acquisition - Further Information on the Acquisition”) on pages 62 to 69 of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## PART IX

### HBOS TRADING UPDATE

The Company issued an interim management statement on 3 November 2008 commenting on trading since the interim results of the current financial year. This is set out in full below.

#### **“HBOS Interim Management Statement 3 November 2008**

##### ***Group Overview***

The Group is operating in difficult market conditions. Relative to 2007, in the nine months to the end of September 2008, profitability has been impacted by higher impairments, negative fair value adjustments to the Treasury Portfolio, the sale of BankWest and short term fluctuations in investment returns. However, despite higher funding costs, net interest income from our banking businesses has increased and our Insurance & Investment business has made a good contribution. This, together with tight Group cost control, demonstrates the strength of our core business.

HBOS's capital ratios benefit from the proceeds of the Rights Issue and capitalisation of the interim dividend for 2008. As at 30 September 2008, our Tier 1 ratio was 8.1% and our Core Tier 1 ratio 6.0%.

The proposed placing of £8.5bn additional equity and £3bn 12% preference shares in January 2009, subject to shareholder approval, would be equivalent to an increase in the relevant capital ratios at that time of some 340bps for Tier 1 and 250bps for Core Tier 1. Most importantly, this injection of capital is linked to the provision of Government guarantees for certain wholesale funding issuance. This materially strengthens the Group's funding position following deposit outflows in September and in the first half of October, which have now slowed significantly.

The proposed acquisition of the HBOS Group by Lloyds TSB is proceeding according to plan. As announced today, the Lloyds TSB meeting to approve the acquisition of HBOS will be held on 19 November 2008. HBOS expects to hold a General Meeting to approve the acquisition by Lloyds TSB, and the placing of equity and preference shares, in December 2008. Subject to shareholder approval and legal and regulatory clearances, HBOS expects the transaction to complete in January 2009.

##### ***Divisional Review***

###### ***Retail***

The Retail business is proving resilient in difficult market conditions. The strength of Retail net interest income underpins profitability. The Retail net interest margin for the year as a whole is expected to be broadly stable relative to the margin reported for the first half of 2008, benefiting from the extended life and re-pricing of mortgages, despite higher funding costs. Costs remain firmly under control. The HBOS multi-brand franchise remains strong; both new business sales and brand tracking among customers remain robust.

Secured lending arrears have risen broadly in line with our expectations. This, together with the decline in house prices, has resulted in an increase in the secured impairment charge to £440 million for the nine month period to 30 September 2008 (£213 million 30 June 2008). Unsecured lending arrears are as expected, giving rise to an impairment charge of £806 million for the period to 30 September 2008 (£509 million 30 June 2008). As previously indicated, this is below the level reported for the same period in 2007.

###### ***Residential Mortgages and Arrears Trends***

At the end of September 2008, mainstream mortgages accounted for 71.9% of balances (72.1% 30 June 2008), Buy-to-Let (BTL) 13.3% (12.8% 30 June 2008), Self Certified 12.6% (12.9% 30 June 2008) and other Lending 2.2% (2.2% 30 June 2008).

Mortgage book Loan to Value (LTV) ratios are based on mortgage balances at the relevant month end and the most recent quarterly regional house price data (currently end September 2008). On this basis, the average LTV ratio of our mortgage book was 52% at the end of September 2008 (48% 30 June 2008). On the same basis the average LTV of the impaired book was 69% at the end of September 2008 (63% 30 June 2008). The equivalent figures for impaired mainstream and specialist mortgages were 62% (57% 30 June 2008) and 77% (71% 30 June 2008) respectively.

Total secured impaired loans increased to £5,623m (£5,138m 30 June 2008), 2.37% of end September 2008 balances (2.16% 30 June 2008).

The analysis of mortgage arrears at the end of September 2008, excluding repossessions, is shown in Table 1 below:

<i>Table 1</i>	<i>Cases as a % of total mortgages</i>			<i>Value of debt as a % of total mortgages</i>		
	<i>End Sep 2008</i>	<i>End Jun 2008</i>	<i>End Dec 2007</i>	<i>End Sep 2008</i>	<i>End Jun 2008</i>	<i>End Dec 2007</i>
Mainstream	1.26	1.23	1.16	1.51	1.44	1.33
Specialist *	2.80	2.49	1.97	3.69	3.27	2.59
<b>Total</b>	<b>1.55</b>	<b>1.46</b>	<b>1.30</b>	<b>2.12</b>	<b>1.95</b>	<b>1.67</b>

\*Specialist includes BTL where arrears cases, excluding repossessions, were 1.60% of total BTL mortgages at the end of September 2008 (1.33% 30 June 2008) and 2.08% of value of debt on BTL mortgages (1.73% 30 June 2008). Self Certified arrears cases, excluding repossessions, were 3.59% of total Self Certified mortgages at the end of September 2008 (3.22% 30 June 2008) and 4.61% of value of debt on Self Certified mortgages (4.12% 30 June 2008).

### **Corporate**

While Corporate performance has been impacted by higher impairments and lower non interest income, we have seen a modest increase in net interest income, notwithstanding higher funding costs. Costs remain firmly under control.

Since the half year, the Corporate credit environment has deteriorated, with an increasing number of customers operating under stressed conditions. The construction and real estate sectors have been impacted more severely than other sectors where current performance indicates lower levels of stress. We have been actively managing the increasing proportion of credits moving into the high risk category and will continue to do so.

The total impairment charge for the nine month period to 30 September 2008 has increased to £1,721 million (£469 million 30 June 2008). The third quarter charge reflects a significant increase in the collective provision in view of the worsening economic outlook. Corporate's exposure to property-related sectors accounts for around 60% of the individual provision charge. The third quarter charge also reflects certain risk concentrations and the impact of falling asset values on likely recoveries, both on existing and newly impaired assets.

The Corporate investment portfolio for the period to 30 September 2008 showed a loss of £93m (£134 million profit 30 June 2008), taking into account profits on the sale of investment securities, other operating income, and share of profits/losses of associates and jointly controlled entities, less impairment on investment securities. Losses from associates and jointly controlled entities were £105 million in the period to 30 September (£34 million loss 30 June 2008) and impairment of investment securities increased to £284 million (£145 million 30 June 2008). As at 30 September 2008, the book value of the investment portfolio was £4.8 billion (£4.9 billion 30 June 2008).

### **Insurance & Investment**

Our Insurance & Investment division continues to make a good contribution to Group profitability. New insurance sales continue to show good growth in both household and motor, offset by lower repayment business. Lower weather-related claims experience compared to 2007 continues to support underlying profit performance. Trends in investment sales seen in the first half of 2008 have continued in the second half reflecting both market volatility and investor confidence with increased demand for both capital-guaranteed and cash-based products. Solvency ratios remain strong notwithstanding market falls, reflecting ongoing risk mitigation activity.

### **International**

As previously announced, the sale of BankWest and St. Andrew's Insurance in Australia is scheduled to complete before the end of 2008 and result in a pre-tax loss of some £690m (including goodwill written-off) but is positive in terms of the effect on capital ratios. The net interest margin benefits from some asset re-pricing but, in the short term, this is more than offset by higher funding costs. Cost growth reflects the investment we have made in our International operations. The International credit environment has deteriorated and while there is some upward pressure on

impairments, this is from a low base. Progress in European Financial Services (EFS) is satisfactory, although investment sales in Germany have slowed in current market conditions.”

### **Treasury Portfolio**

As at 30 September, losses due to market dislocation totalled £1,827 million (£1,095 million 30 June 2008), including £457 million impairment losses on the Banking Book relating to Lehmans and Washington Mutual (£Nil 30 June 2008). Further impairment losses of around £150m are expected to be taken in relation to Icelandic banks.

Following the International Accounting Standards Board's (IASB) decision to permit the reclassification of assets held in the Trading Book, HBOS has transferred out of the Trading Book into the Banking Book Asset Backed Securities (ABS) and FRNs with fair values of £9.1 billion and £3.1 billion respectively, with effect from 1 July 2008. This leaves ABS and FRNs with fair values of £2.1 billion and £1.5 billion still held on the Trading Book. Negative fair value adjustments (FVAs) to securities held in the Banking Book in the period to 30 September totalled on a post tax basis £3.8 billion (£1.9 billion 30 June 2008), including £588 million in respect of securities transferred from the Trading Book.

FVAs reflect increasing illiquidity in the securities markets and recent credit rating downgrades to the investment portfolio. At 30 September, 88.3% of our ABS portfolio by nominal value was rated AAA, 6.4% AA and 2% A, compared to 93%, 3.9% and 1.3% respectively at 30 June 2008. Our Alt-A portfolio at 30 September had an average mark to market of 65%, with 75.3% by nominal value being AAA rated, 14.6% being AA rated and 2.4% A rated, compared to 97.4%, 2.3% and nil respectively at 30 June 2008. Exposure to monolines calculated on our own internal methodology totalled £1.1 billion at 30 September (£0.7 billion 30 June 2008).

### **Outlook**

While the credit environment will remain challenging, HBOS's robust capital position, to be further enhanced by the injection of capital and liquidity facilitated by the UK Government, reinforces the Group to meet such challenges. HBOS's strong brands and leadership positions in UK Retail banking, its multi-brand approach and distribution strength in the insurance and investment markets and more selective approach to corporate and international markets, offer good growth opportunities when the current cycle turns. These opportunities will be further advanced as HBOS joins the enlarged Lloyds TSB Group in January 2009, subject to shareholder and regulatory approvals.

Certain statements made in this announcement constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995.

Forward looking statements can be identified by the use of words such as “may”, “will”, “expect”, “intend”, “estimate”, “anticipate”, “believe”, “plan”, “seek”, “continue” or similar expressions and relate to, among other things, the performance of the various business units of HBOS in the near to medium term, the amount by which HBOS expects to write down the value of certain of its assets, the expectations of HBOS in respect of the rights issue, its capital ratios and its dividend payout ratio, the business strategy of HBOS and its plans and objectives for future operations. Such statements are based on current expectations and, by their nature, are subject to a number of risks and uncertainties that could cause actual results and performance to differ materially from any expected future results or performance, expressed or implied, by the forward-looking statement. Factors that might cause forward looking statements to differ materially from actual results, include among other things, general economic conditions in the European Union, in particular in the United Kingdom, and in other countries in which HBOS has business activities or investments, including the United States; the inability of HBOS to hedge certain risks economically; the adequacy of its impairment provisions and loss reserves; and the potential exposure of HBOS to various types of market risk, such as interest rate risk, foreign exchange rate risk, credit risk and commodity and equity price risk. These forward-looking statements speak only as of the date of this announcement. The information and opinions contained in this announcement are subject to change without notice and, subject to compliance with applicable law, HBOS assumes no responsibility or obligation to update publicly or review any of the forward-looking statements contained herein.”

## PART X

### INFORMATION ON THE HBOS GROUP

#### 1. Introduction

HBOS was incorporated and registered in Scotland in the Register of Companies on 3 May 2001, with registered number SC218813, as a public limited company under the Companies Act 1985.

As a consequence of the approval of schemes of arrangement for Bank of Scotland and Halifax, which became effective in 2001, HBOS became the holding company of the Group. The principal legislation under which HBOS operates is the Companies Act. The registered office and head office of HBOS is at The Mound, Edinburgh EH1 1YZ, telephone number +44 (0) 870 600 5000.

On 17 September 2007, the Governor and Company of the Bank of Scotland was registered as a public limited company under the Companies Act 1985 in the name of "Bank of Scotland plc", with registered number SC327000. On the same day, under the HBOS Group Reorganisation Act 2006, the entire business activities, assets and liabilities of Capital 1945 Limited (formerly known as Capital Bank plc), Halifax and HBOS Treasury Services Limited were transferred to Bank of Scotland.

#### 2 Overview

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 United Kingdom and internationally (Ireland, Europe, North America and Australia). The HBOS Group's products and services can be categorised into the following business divisions:

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

As at 30 June 2008, the HBOS Group was the largest retail mortgage provider in the UK with a market share (in terms of gross lending) of 19 per cent. and outstanding mortgage balances of approximately £237 billion. As at 30 June 2008, the HBOS Group was the largest liquid savings provider in the UK with a market share of 15.4 per cent.

As set out in the HBOS Group audited accounts for the financial year ended 31 December 2007, and extracted without material adjustment therefrom, HBOS reported net operating income of £21.3 billion and generated profit before taxation of £5.5 billion. For the six months ended 30 June 2008, HBOS reported net operating income of approximately £2.4 billion and generated profit before taxation of £848 million. HBOS reported total assets of £681.4 billion and shareholders' equity of £21.1 billion as at 30 June 2008.

#### 3 Principal Activities

This section 3 sets out the principal activities of the HBOS Group since 1 January 2005.

##### ***Retail***

The Retail division provides financial services in the UK through a broad distribution base (ranging from branches to direct mail, telephone, internet services and third party intermediaries). Its range of multi-branded products includes personal banking services providing mortgages, savings, bank accounts, personal loans and credit cards.

The Retail division currently provides mortgages in the UK under four mortgage brands: Halifax; Bank of Scotland; Intelligent Finance; and Birmingham Midshires.

Savings products are offered in the UK 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. Bank accounts offered by the HBOS Group range from full facility current accounts to basic social banking facilities.

Personal loans and credit cards are offered in the UK through the HBOS Group's Halifax, Bank of Scotland and Intelligent Finance brands. Credit cards are also provided through a number of

affinity-brands such as charity cards, where a proportion of income earned is donated to the charity. The Retail division also distributes the HBOS Group's insurance and investment products on behalf of the Insurance & Investment division and participates in a number of joint ventures, such as Sainsbury's Bank.

### ***Corporate***

The Corporate division provides a range of banking services to the corporate business sector. Its principal market is UK and Europe-based businesses with a turnover in excess of £1 million. 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 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. The integrated, structured and acquisition finance teams operate in the leveraged buy-out market, providing a range of financing products to their customers. The private equity business has a reputation for innovative deal making and invests in a number of private equity funds. The Asset Solutions team focuses on a number of market sectors including: consumer point of sale, contract hire, public sector and specialist leasing. The specialised Industry Finance teams cover five discrete asset classes: housing finance; infrastructure finance; energy; telecoms & media; and transport.

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

The HBOS Group's Insurance & Investment division is one of the UK's largest providers of general insurance and investment products, offering multi-brand life, pensions, mutual funds and general insurance products. The division uses a multi-channel, multi-brand operating model which the HBOS Group 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 and pension products. It has chosen not to actively market annuities, given the longevity risk and capital requirements of such products. 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 financial 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.

The General Insurance business focuses on household, repayment and motor insurance. In addition to the Retail division's branch network, 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 distribution network as well as a number of third-party relationships.

The esure joint venture manufactures and distributes all motor insurance products under the esure, Sheilas' Wheels, First Alternative, Halifax and Sainsbury's Bank brands. Distribution takes place largely through esure's direct channels as well as in Sainsbury's supermarkets. HBOS owns a 70 per cent. stake in esure.

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. Further details as to the investigations are set out in Part XII ("Regulation and Supervision") in this document.

## ***International***

The International division consists of three distinct businesses in (i) Ireland, (ii) Europe and North America, and (iii) Australia. 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 almost completed the roll out of its nationwide branch network that now supports the delivery of a full range of retail banking products including current accounts.

In Europe and North America, Corporate North America focuses on sectors in which the HBOS Group has experience, including the oil and gas, gaming and real estate sectors. The retail activities of Europe and North America consist of Banco Halifax Hispania 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.

As announced by HBOS on 8 October 2008, the HBOS Group has agreed the sale of part of its Australian operations, namely Bank of Western Australia Ltd and St Andrews Australia Pty Ltd, to Commonwealth Bank of Australia Limited for the equivalent of approximately A\$2.5 billion (£1.2 billion). In addition to A\$2.1 billion (£1.0 billion) of cash consideration for the sale, HBOS will receive a return of excess capital in Bank of Western Australia Ltd of approximately A\$360 million, together comprising A\$2.5 billion (£1.2 billion) of proceeds. The purchaser will also redeem preferred shares issued to the HBOS Group equivalent to their par value of A\$530 million (£250 million). The businesses pending sale comprise the HBOS Group's Australian retail and business banking operations as well as its insurance and wealth management businesses. These businesses generated profits before taxation of A\$300 million (£126 million) for the year ended 31 December 2007 and A\$126 million (£59 million) for the six months ended 30 June 2008. The total asset value of these businesses as at 30 June 2008 was approximately A\$64 billion (£31 billion).<sup>(1),(2)</sup> Completion is subject to certain regulatory approvals in Australia. A summary of the terms of the sale agreement relating to these businesses is set out in paragraph 17.1.3 Part XXII ("Additional Information") in this document.

Following the sale, HBOS will retain a presence in Australia through Bank of Scotland International (Australia) Limited and Capital Finance Australia Limited which are engaged in corporate banking and asset finance activities respectively, together with the Bank of Scotland Treasury branch. The corporate banking business, based in Sydney, operates under the BOS International brand and provides acquisition finance, real estate lending and infrastructure/project finance. The division's asset finance business operates under the Capital Finance brand.

## ***Treasury and Asset Management***

Bank of Scotland Treasury is the centralised treasury function for the HBOS Group and manages prudential and regulatory liquidity and wholesale multi-currency funding. 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") (55 per cent. owned) and their respective subsidiary companies, is the investment management business within the HBOS Group.

Insight 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 management division of Insight and is a UK-listed real estate fund manager. 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.

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(1) Exchange rates used in conversion are based on 30 June 2008, except for those relating to profits before taxation. As at 30 June 2008, £1 : A\$2.08; average for year ended 31 December 2007, £1 : A\$2.39; average for half year ended 30 June 2008, £1 : A\$2.14.

(2) Extracted without material adjustment from unaudited management accounts.



#### **4 Current Trading, Trends and Prospects**

HBOS on 3 November 2008 announced an interim management statement, the text of which is set out in Part IX (“HBOS Trading Update”) of this document.

## PART XI

### INFORMATION ON THE LLOYDS TSB GROUP

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

For the six months ended 30 June 2008<sup>(1)</sup>, Lloyds TSB had revenues of £4.6 billion and net income of £0.6 billion (compared with £5.6 billion and £1.6 billion, respectively, for the six months ended 30 June 2007). As at 30 June 2008, Lloyds TSB had total assets of £367.8 billion and shareholders' equity of £10.8 billion (as compared to total assets of £353.1 billion and shareholders' equity of £11.4 billion at 30 June 2007). As at 30 June 2008, the risk asset ratios were 11.3 per cent. for total capital, 8.6 per cent. for Tier 1 capital and 6.2 per cent. for core Tier 1 capital.

The Lloyds TSB Group continues to trade well and deliver good income growth from its relationship businesses in an immensely challenging period for financial services companies. Excluding the impact of market dislocation, insurance-related volatility and higher impairments which have led to a substantial reduction in statutory profit before tax in the first nine months of the year, each division has achieved revenue growth in excess of cost growth. Notwithstanding the continued deterioration in the UK economy, Lloyds TSB has continued to capture market share in a number of key areas, maintained its strong liquidity and funding position and remains on track to deliver a good trading performance in 2008.

Further information on the Lloyds TSB Group is set out in Part VII ("Information on the Lloyds TSB Group") on pages 61 to 71 of the Lloyds TSB Circular and in the business review at pages 6 to 11 of the Lloyds TSB Annual Report on Form 20-F, for the year ended 31 December 2007, each of which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

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(1) This unaudited data has been extracted from the Lloyds TSB Interim Results 2008.

## PART XII

### REGULATION AND SUPERVISION

#### **Overview of UK Regulation**

The HBOS Group and the Lloyds TSB Group are subject to the financial regulation and supervisory regime in the United Kingdom. Non-financial companies within the HBOS Group and the Lloyds TSB Group (such as investment and insurance companies) are also subject to their appropriate regulatory and supervisory regimes. Responsibility for banking, insurance, investment and other financial services supervision in the United Kingdom rests with the FSA. The FSA's powers and responsibilities are derived from the Financial Services and Markets Act 2000 (**FSMA**). The FSA has responsibility for: (i) regulating and authorising all businesses carrying on regulated activities (as defined under FSMA 2000 (Regulated Activities) Order 2001 (the **RAO**)) in the UK (which currently includes all forms of deposit taking, investment activity, mortgages and insurance business); (ii) regulating and authorising unit trusts and open ended investment companies; and (iii) recognising and supervising markets and investment exchanges. The HBOS Group's ability to conduct its business is dependent upon its retention of its regulatory licences with the FSA.

The FSA is required to observe and pursue four statutory objectives: (i) to maintain confidence in the UK financial system; (ii) to promote public understanding of the financial system; (iii) to secure the right degree of protection for consumers; and (iv) to reduce financial crime.

#### ***Banking supervision in the UK***

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

The FSA may also obtain independent confirmation from skilled persons as to the accuracy of accounting records and prudential returns and the adequacy of internal controls.

#### ***European Commission Directive on Consumer Credit***

In September 2002, the European Commission published a proposal for a directive of the European Parliament and of the Council of the European Union on the harmonisation of the laws, regulations and administrative provisions of the member states concerning credit for consumers.

This proposal has now become the Consumer Credit Directive, the text of which was finally approved by the European Parliament in January 2008 after many years of negotiation. The Directive was approved by the European Council in April 2008 and published in the Official Journal on 22 May 2008. The UK Government has a period of two years in which to implement the Directive, meaning that it is currently estimated that this will happen sometime in the spring of 2010.

The UK department for Business Enterprise and Regulatory Reform is not proposing to start its consultation regarding the Directive's implementation until November 2008; until the outcome of this consultation is known it is not possible to say how the Directive will be incorporated into UK law.

The directive, once implemented, will amend the regulation of consumer credit which is currently regulated under the Consumer Credit Act 1974 (as amended from time to time).

#### ***Insurance business supervision***

Effecting and carrying out contracts of insurance is a regulated activity under FSMA. The FSA's powers in regulating insurance business are similar to those described in relation to the supervision of banking business.

#### ***Financial services supervision***

Aspects of the HBOS Group's and the Lloyds TSB Group's business activities such as advising on, dealing in or managing investments such as bonds, money market derivative products and equities

and also the sale of personal financial services and investments, undertaken through bank branches and other business channels (e.g. telephone and online banking), are regulated by the FSA.

Accordingly, companies within the HBOS Group and the Lloyds TSB Group carrying on these businesses are subject to the regulation of the FSA. FSA regulation on mortgages and mortgage advice was introduced on 31 October 2004, with sales of general insurance by intermediaries coming under FSA regulation on 14 January 2005.

### ***Financial Services Compensation Scheme***

FSMA introduced the Financial Services Compensation Scheme which combines the functions of previous compensation schemes. From 7 October 2008, under this compensation scheme and subject to the rules of the scheme, eligible deposit claimants have been entitled to receive 100 per cent. compensation for financial loss up to £50,000. The limits in respect of investment business and mortgage advice and arranging claims are £48,000 (100 per cent. of the first £30,000 and 90 per cent. of the next £20,000), and in respect of insurance claims are 100 per cent. of the first £2,000 and 90 per cent. of the remainder of the claim (except compulsory insurance for which it is 100 per cent. of the claim). These level of compensation may vary over time and may differ from those applicable to claims in respect of firms in other jurisdictions.

The European Commission has proposed to amend the Directive on Deposit Guarantee Schemes (1994/19/EC) to increase the minimum level of coverage for deposits from €20,000 to €100,000 within one year, and initially to €50,000 in the intervening period. The payout period in the event of bank failure will be reduced from three months to three days. The coverage level of €50,000 would apply from 15 October 2008 and all other provisions will be effective as of 31 December 2008.

### ***Capital adequacy***

HBOS, Lloyds TSB and certain members of the HBOS Group and the Lloyds TSB Group respectively, are 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.

The risk-adjusted capital guidelines (the “**Basel Accord**”) promulgated by the Basel Committee on Banking Supervision (the “**Basel Committee**”), 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 (“**Basel II**”) under the General Prudential sourcebook (GENPRU) and the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU). 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) with effect from 1 January 2008, following a year of parallel running of these approaches. Lloyds TSB have adopted the Foundation Internal Ratings Based approach for its non retail exposures and the Advanced (Retail) Internal Ratings Based approach for its retail exposures and, with effect from 1 January 2008, the Advanced Measurement Approach for Operational Risk. Certain HBOS portfolios remain on the standardised approach with agreement with the FSA of a timetable for further roll out of credit risk models over the next two years. Under Basel II, capital requirements are inherently more volatile than under previous regimes and will increase if economic conditions or default trends worsen.

The HBOS Group’s and the Lloyds TSB Group’s banking and investment businesses outside the UK are subject to the capital adequacy regimes of those jurisdictions, some of which will implement Basel II on a longer time frame.

The HBOS Group’s and the Lloyds TSB Group’s life insurance and general insurance businesses in the UK are also subject to the risk-based capital requirements prescribed by the FSA under the Prudential sourcebook for Insurers (INSPRU), and the HBOS Group’s life and general insurance companies outside the UK are subject to local regulatory capital requirements. In July 2007, the European Commission published a draft proposal for primary legislation to define broad “framework” principles for Solvency II, a fundamental review of the capital adequacy regime for the European insurance industry. Solvency II aims to establish a revised set of EU-wide capital requirements where the required regulatory capital will be dependent upon the risk profile of the entities, together with risk management standards, that will replace the current Solvency I requirements. At this early stage of development, it is not possible to predict the ultimate impact of this proposed regime on the HBOS Group’s, the Lloyds TSB Group’s or the Enlarged Group’s

capital. However, the final regime could significantly impact the capital the HBOS Group's and the Lloyds TSB Group's life assurance and general insurance businesses are required to hold.

In case the HBOS Groups' and the Lloyds TSB Groups' fail to maintain adequate capital ratios, this may result in administrative actions or sanctions against the HBOS Group, the Lloyds TSB Group or the Enlarged Group which may have a material adverse impact on the HBOS Group's, the Lloyds TSB Group's and/or the Enlarged Group's business, financial position and results of operations.

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

The Bank of England has the task of ensuring stability in the financial markets which it undertakes in co-operation with the FSA. The agreed framework for co-operation in the field of financial stability is set out in detail in the Memorandum of Understanding published jointly by HM Treasury, the FSA and the Bank of England at the end of October 1997 and updated in March 2006. The Bank of England is responsible for the overall stability of the financial system as a whole, including: (i) ensuring the stability of the monetary system; (ii) oversight of the financial system infrastructure, in particular payment systems at home and abroad; and (iii) maintaining a broad overview of the financial system through its monetary stability role and the deputy governor's membership of the FSA's Board.

### ***UK Government***

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

In order to deal with the crisis caused by the failure of Northern Rock, the BSP Act was enacted on an expedited basis in February 2008, when it became apparent that it would not be possible to achieve a private sector sale of Northern Rock plc which would adequately protect taxpayers' and consumers' interests. The key provisions of the BSP Act are subject to a sunset clause and are due to expire in February 2009. The BSP Act confers on HM Treasury various powers including, for example, the power to take UK deposit-taking institutions into temporary public ownership by way of the compulsory transfer of the securities or property of such UK deposit-taker to the Bank of England, a nominee of HM Treasury, a company wholly owned by the Bank of England or HM Treasury, or to any other company. The powers under the BSP Act have been exercised in relation to Northern Rock, Bradford and Bingley, Heritable Bank and Kaupthing, Singer and Friedlander.

HBOS understands that HM Treasury has been working with the Bank of England and the FSA (collectively, the "**Tripartite Authorities**") in developing proposals for a permanent set of measures to replace the BSP Act. In October 2008, following a process of consultation, the Banking Bill was introduced to Parliament. The Bill sets out the permanent measures which are designed to achieve a number of key policy priorities, including reducing the likelihood, and impact, of individual banks failing.

In particular, the measures include a special resolution regime (the "**SRR**"), which will provide the Tripartite Authorities with significant new tools for facilitating the resolution of a failing bank before it becomes insolvent. These tools consist of three "stabilisation options", which are designed to address a distressed bank which is failing or is likely to fail to meet the threshold conditions set out in the FSA Handbook and cannot be assisted through normal regulatory action or market-based solutions. The stabilisation options comprise powers to transfer the property, assets and liabilities ("**property**") or the securities of a failing bank to a private sector purchaser; the property of a bank to a "bridge bank" controlled by the Bank of England; or the securities of a bank into temporary public ownership. In addition, the Bill provides for a special bank insolvency procedure, which may be triggered at existing insolvency thresholds and provides a mechanism to enable fast and orderly Financial Services Compensation Scheme payments and minimise the risk of a run on a bank. The Bill also makes provision for the "bank administration procedure" which is a special form of insolvency which may be used where only part of a failing bank is transferred to a bridge bank, a private sector purchaser or by way of an onwards transfer from temporary public ownership, leaving behind an insolvent "residual company".

The details of this regime and possible other proposals have not been fully developed and so it is not clear how they would operate in practice and how they would impact the relationship between the Bank of England, HM Treasury and the FSA. Changes to the Memorandum of Understanding referred to above may also be required.

Further information relating to the BSP Act and the proposed Banking Bill is set out in section 3.6 in Part II (“Risk Factors”) of the Lloyds TSB Prospectus which is incorporated by reference into this document. See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

### ***Data protection***

Members of the HBOS Group and the Lloyds TSB Group in the UK which hold, control and/or process data relating to identifiable individuals are subject to the UK data protection regime, consisting principally of the Data Protection Act 1998 and subordinate legislation made thereunder. The UK data protection regime is supervised by the Information Commissioner. The regime imposes limitations on the manner in which, and the extent to which, persons controlling personal data can hold, process and transfer that data to third parties, including between members of the same group of companies. Similar data protection and security requirements apply to members of the respective groups carrying on business in EEA member states other than the UK.

### ***Retail Distribution Review***

As a part of its Treating Customers Fairly broad initiative, the FSA announced a Retail Distribution Review (“RDR”) in June 2006 with the aim of identifying measures that would increase consumer confidence in the retail market and encourage more frequent use of its products and services. Following discussions with stakeholders, the FSA published a Discussion Paper in June 2007, followed by an Interim Report in April 2008. The FSA intends to continue to develop its thinking in this area in consultation with all relevant stakeholders. No firm proposals will be known for at least several months and no assessment of the ultimate potential outcome for the HBOS Group or the Lloyds TSB Group is possible at this time.

### ***UK Competition Commission investigation of payment protection insurance (PPI)***

The Competition Commission is formally investigating the supply of PPI services (except store card PPI) to non-business customers in the UK. Various members of the HBOS Group and the Lloyds TSB Group underwrite PPI, while other members of the HBOS Group and the Lloyds TSB Group distribute PPI, by offering it for sale with various of the credit products which they supply.

On 5 June 2008, the Competition Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with resulting detriments to consumers.

The Competition Commission has therefore also considered what remedies should be adopted to regulate the future supply of PPI and, on 13 November 2008, published for consultation its provisional decision on remedies. The Competition Commission’s proposed package of remedies includes (i) a prohibition on the sale of PPI by a distributor to a customer within 14 days of the distributor selling credit to that customer (although the customer would be able proactively to contact the distributor and purchase a PPI policy 24 hours after the credit sale); (ii) a requirement on credit providers to provide a ‘personal PPI quote’ to customers; (iii) a requirement on PPI providers to provide certain information and messages in PPI marketing materials, and a requirement on distributors to advertise PPI on personal loans and second-charge mortgages in close proximity to their personal loan advertisements; (iv) a requirement on PPI providers to provide certain information on PPI policies to the FSA and a recommendation to the FSA that it uses this information for its PPI price comparison tables; (v) a requirement that distributors of PPI should provide an annual statement to customers and (vi) a prohibition on the sale of single premium PPI policies.

The Competition Commission has invited comments on the proposed remedies. The Competition Commission expects to issue its final report in mid-January 2009. Its final report will include its decision on the remedy measures to be introduced.

On 30 September 2008, the FSA published a statement arising from its ongoing thematic review of PPI sales. In the statement, which was directed at the industry generally, the FSA highlighted certain concerns and indicated that it was escalating its regulatory intervention and considering

appropriate action to deal with on-going non-compliant sales practices and to remedy non-compliant past sales. The FSA plans to publish an update on the third phase of the thematic work in the first quarter of 2009. The ultimate impact on the HBOS Group and, after the Effective Date, the Enlarged Group can only be known at the conclusion of the Competition Commission's investigations and the FSA's review, respectively.

### ***UK Office of Fair Trading***

#### ***Fairness of current account overdraft charges***

In April 2007, the OFT commenced an investigation into the fairness of current account overdraft charges. At the same time it commenced a market study into wider questions about competition and price transparency in the provision of personal current accounts.

On 27 July 2007, following agreement between the OFT and eight UK financial institutions, the OFT issued High Court legal proceedings against those institutions, including the HBOS Group and the Lloyds TSB Group, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to requests for unarranged overdrafts. On 24 April 2008, the High Court ruled on the preliminary issues of whether the financial institutions' terms and conditions in relation to unarranged overdraft charges are capable of being assessed for fairness under the Unfair Terms in Consumer Contracts Regulations 1999 (Regulations) or are capable of amounting to penalties at common law. The High Court determined, in relation to the financial institutions' current terms and conditions, that the relevant charges are not capable of amounting to penalties but that they are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. On 22 May 2008, the HBOS Group and the Lloyds TSB Group along with the other relevant financial institutions, were given permission to appeal the finding that unarranged overdraft charges are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. The appeal hearing commenced on 28 October 2008 and concluded on 5 November 2008. The judgment is awaited.

A further hearing was held on 7 to 9 July 2008 to consider whether the financial institutions' historical terms and conditions are similarly not capable of being penalties, and to consider whether their historic terms are assessable for fairness. On 8 October 2008 the High Court issued its group judgment broadly holding that these unarranged overdraft charges are not capable of being penalties, although it has invited further clarification from a number of banks, including Lloyds TSB Group, before making any formal ruling on their historical terms and conditions.

The FSA has agreed, subject to certain conditions, that the handling of customer complaints on this issue can be suspended until the earlier of either conclusion of the proceedings or 26 January 2009, subject to any renewal or extension which the FSA may agree. Cases before the Financial Ombudsman Service and the County Courts are also currently stayed pending the outcome of the legal proceedings initiated by the OFT.

It is expected that there will be further substantive hearings to establish whether the changes are fair. If various appeals are pursued, the proceedings may take a number of years to conclude. The HBOS Group intends to continue to defend its position strongly. Accordingly, no provision in relation to the outcome of this litigation has been made. Depending on the High Court's determinations and any determinations on appeal, a range of outcomes is possible, some of which could have a significant financial impact on the HBOS Group, the Lloyds TSB Group and/or the Enlarged Group. The ultimate impact of the litigation on the HBOS Group, the Lloyds TSB Group or the Enlarged Group can only be known at its conclusion.

### ***Interchange Fees***

The European Commission has adopted a formal decision finding that an infringement of EC competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the EEA. This decision has been appealed to the European Court of First Instance. The HBOS Group and the Lloyds TSB Group (along with certain other MasterCard issuers) have applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with EC competition laws. The European Commission has objected to these proposed interventions. The Court of First Instance has not yet decided whether to allow the proposed interventions to proceed. Meanwhile, the European Commission and the UK's Office

of Fair Trading are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions also infringe EC and/or UK competition laws. The ultimate impact of the investigations on the HBOS Group or the Enlarged Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

### ***Personal current accounts***

In April 2007, the OFT launched a market study into personal current accounts, which resulted in a report that was published on 16 July 2008. The OFT stated that it had found evidence of competition in the personal current account market. Banks could also demonstrate high consumer satisfaction and low fees on the more visible elements of current accounts – such as withdrawals from ATMs. Internet and telephone banking have also made it easier for consumers to manage their accounts. However, the OFT concluded that the personal current account market as a whole is not working well for consumers. A combination of complexity and a lack of transparency means that consumers and competition are focused almost exclusively on more visible fees and not on the less visible elements, such as insufficient funds charges and foregone interest – despite the fact that these make up the vast bulk of banks' revenues. For insufficient fund charges, this effect is exacerbated by a lack of simple mechanisms to control, or opt out of, an unarranged overdraft. Furthermore, a significant proportion of consumers believe that it is complex and risky to switch accounts, with the result that switching rates are very low.

The OFT invited comments from interested parties, with a deadline for responses of 31 October 2008. It has in particular highlighted the low levels of transparency and switching and complexity of charges as issues upon which it would welcome comments together with potential measures to address those issues. The OFT has indicated that, depending upon the outcome of the consultation, it may publish a further or final report early in 2009. Its objective is to produce recommendations that the banking industry, in consultation with government and other relevant stakeholders, will take forward. Failing resolution of its concerns by that means, the OFT has indicated that it would consider alternative remedies including changes to the Banking Code, recommendations to government or regulatory bodies or a market reference to the Competition Commission.

### ***Continuing review of certain markets***

In the Secretary of State's announcement on 31 October 2008 that the Acquisition would not be referred to the Competition Commission, he said that, in view of the fact that there were some concerns about the possible effects of the Acquisition on competition, he was asking the OFT to keep the relevant markets under review in order to protect the interests of UK consumers and the British economy.

The concerns to which the Secretary of State referred are identified in the OFT's report to him on the effects of the Acquisition on competition. The OFT's concerns relate to three markets, namely personal current accounts, SME banking (primarily in Scotland) and mortgages. The OFT stated that it was not required to reach a definite conclusion as to the competitive effects of the Acquisition. Rather, it was only required to conclude whether the test for reference of the Acquisition to the Competition Commission was satisfied. Applying that test, the OFT concluded that it believed there to be a realistic prospect that the Acquisition may give rise to a substantial lessening of competition in the three markets identified. It was by no means a foregone conclusion, the OFT said, that, in the event of a reference, the Competition Commission would find that, on a balance of probabilities, the Acquisition would give rise to a substantial lessening of competition in any of those markets.

In relation to the personal current account market, the OFT's assessment follows closely the analysis and conclusions in the market study that it published in July 2008 (see preceding section). In the context of a market that, in the OFT's opinion, is not working well for consumers. The OFT said that there was a realistic prospect that, by reason of the enlarged Group's greater market share, it would have a lesser incentive to reduce prices or raise standards of quality and service to established customers.

In relation to SME banking, the OFT's assessment mirrored that applied to the personal current account market. It was particularly concerned about the possible effects of the Acquisition in Scotland, where the Enlarged Group and RBS would together account for a substantial proportion



of SME banking. The OFT also said that it could not exclude the risk of adverse effects in other local markets.

In relation to mortgages, the OFT said that its concerns were more marginal. Prior investigations (notably the Competition Commission's investigation of Lloyds TSB's proposed acquisition of Abbey National in 2001) had concluded that the mortgage market was competitive. However, the OFT observed that, under current conditions, the mortgage market may be tighter than it was with higher barriers to entry and greater obstacles to customer switching: under such conditions, the combination of the largest and third largest mortgage providers was significant enough to cause concern.

The OFT also assessed the impact of the Acquisition on other markets (wealth management, savings, personal loans, credit cards, pensions, banking services to large corporations, treasury and capital markets, asset finance/fleet car hire, life insurance and general insurance) and concluded that it did not raise competition concerns in any of those markets. The market for payment protection insurance is currently under investigation by the Competition Commission, which has proposed a number of possible remedies to address adverse effects on competition that it has identified in the market. The OFT concluded that, given the present factual situation and the uncertain effect of the Competition Commission's possible remedies, it could not be said that there was a reasonable prospect that the Acquisition would result in a substantial lessening of competition in that market.

The OFT has not yet indicated what steps it will take to keep the relevant markets under review. In relation to personal current accounts, however, it is to be expected that those steps will consist in a continuation of the process initiated by the market study (discussed above).

### ***The European Commission***

On 10 January 2007, the European Commission published the Final Report of its sector inquiry into European retail banking markets covering payment cards and (non-card) payment systems and current accounts and related services. The Commission found that markets were fragmented along national lines, limiting consumer choice and leading to higher costs for current accounts, loans or payments. High degrees of variation of prices, profit margins and selling patterns between Member States and high degrees of homogeneity within Member States were found to be indicative of persisting regulatory or behavioural barriers to competition.

The Final Report identified competition concerns in several areas of retail banking, including:

- the combination of sustained high profitability, high market concentration and evidence of entry barriers in some Member States raise concerns about banks' ability to influence the level of prices for consumers and small firms;
- large variations in merchant and interchange fees between banks across the EU may indicate competition barriers;
- the existence of high joining fees for payment cards, co-branding, surcharging and the practice of "blending" card fees where a retailer is charged the same merchant fee, irrespective of the different costs of card types;
- some credit registers, holding confidential data that lenders use to set loan rates, may be used to exclude new entrants to retail banking markets;
- some aspects of co-operation among banks, including savings and co-operative banks, can reduce competition and deter market entry;
- product tying by banks is widespread in Member States and can reduce consumer choice and increase banks' power in the market place to influence prices; and
- obstacles to customer mobility in banking, notably the inconvenience of changing a current account, are high.

Some of these concerns have already been addressed, at least in part. For example, following the interim report being published, the Commission met with Austrian banks, who agreed to review arrangements for setting interchange fees and announced that a reduction can be expected. In Portugal, issuers and acquirers have met some of the concerns raised in the report by reducing domestic interchange fees and removing preferential bilateral domestic interchange fees. The establishment of a Single Euro Payments Area ("**SEPA**") is also seen as a method of remedying some of the competition concerns raised in the report. Since 1 January 2008, banks have been

able to make the first SEPA products available and are aiming to make SEPA a reality for all customers by the end of 2010.

The Final Report also listed the following specific areas where enforcement action by the European Commission and the national competition authorities is appropriate:

- high interchange fees and merchant fees in some payment card networks;
- access barriers and discriminatory rules in relation to credit registers;
- tying of products by some banks; and
- bank co-operation (in respect to which the Commission indicated that it intended to gather more information before acting).

Since the Final Report was published, the Commission has adopted three decisions affecting payment card services. On 3 October 2007, the Commission fined Visa International and Visa Europe €10.2 million for refusing to admit Morgan Stanley as a member from March 2000 to September 2006. In a decision of 17 October 2008, the Commission concluded that the Groupement des Cartes Bancaires infringed Article 81 of the Treaty by adopting price measures hindering the issuing of cards in France at competitive rates by certain member banks, thereby keeping the price of payment cards artificially high and thus favouring the major French banks. On 19 December 2007, the Commission adopted a decision prohibiting MasterCard's multilateral interchange fees for cross-border card payments with MasterCard and Maestro consumer credit and debit cards between Member States of the European Economic Area (intra-EEA MIFs).

In addition, the Consumer Protection from Unfair Trading Regulations 2008 (implementing the Unfair Commercial Practices Directive) came into force in the UK on 26 May 2008 and a number of other EU directives, including the Acquisitions Directive and the Payment Services Directive are currently being implemented in the UK. The EU is also considering regulatory proposals for, *inter alia*, Consumer Credit, Mortgage Credit, Single European Payments Area, Retail Financial Services Review and capital adequacy requirements for insurance companies (Solvency II).

### ***International Regulation***

Certain entities within the HBOS Group and the Lloyds TSB Group are also subject to the supervision of international regulators, including the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and various state regulators in the United States, the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority in Australia, the Irish Financial Regulator in the Republic of Ireland and the Irish Financial Regulator and the FSA in Northern Ireland.

### ***Recapitalisation of financial institutions***

The global financial system has recently experienced an unprecedented degree of volatility. The UK Government has announced recently a package of measures to address the current instability in the financial markets, which include a recapitalisation scheme for the UK banking sector. As part of the recapitalisation scheme, HM Treasury is underwriting, and may acquire, a significant shareholding in certain financial institutions issued under placings and open offers. HM Treasury has announced that its intention is to return to the private sector its holdings in the financial institutions participating in the recapitalisation scheme as soon as feasibly possible.

Details on the regulation and supervision in the United Kingdom in relation to Lloyds TSB are set out in Part XI ("Regulation and Supervision in the United Kingdom") of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## PART XIII

### OPERATING AND FINANCIAL REVIEW RELATING TO HBOS

*The following review of the HBOS Group's financial condition and operating results should be read in conjunction with financial information on the HBOS Group referred to in Part IX ("HBOS Trading Update"), Part XVII ("Historical Financial Information relating to HBOS Part A – Audited Financial Information" and "Historical Financial Information relating to HBOS Part B – Unaudited Interim Information") and the other financial information included, incorporated by reference or referred to elsewhere in this Prospectus. This review contains forward-looking statements based on current expectations and assumptions about the HBOS Group's future business. The HBOS Group's actual results could differ materially from those contained in the forward-looking statements as a result of a number of factors including, but not limited to, those discussed in Part II ("Risk Factors") and in Part III ("Other Important Information"). Certain risk factors also affect the HBOS Group's results of operations and are described in Part XVI ("Risk Management").*

*A review of the HBOS Group's financial condition and operating results for the financial years ended 31 December 2007, 2006 and 2005 can be found on pages 73 to 116 of the HBOS Rights Issue Prospectus and is incorporated by reference herein.*

*Certain additional statistical and other information relating to the HBOS Group can be found on pages 117 to 121 of the HBOS Rights Issue Prospectus and is incorporated by reference herein.*

*See Part XXIV for further details about information that has been incorporated by reference into this document.*

#### **Accounting Policies and Use of Underlying Data**

The Consolidated Financial Statements for 2005 to 2007 and the Interim Consolidated Financial Statements as at and for the six months ended 30 June 2008 and 2007 were prepared in accordance with IFRS and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") as adopted by the European Union. The HBOS Group has not utilised the "carve-out" provisions in respect of full fair value and portfolio hedging of core deposits in IAS 39 "Financial Instruments: Recognition and Measurement" as adopted by the European Union, and, consequently, the financial statements also comply with IFRS.

However, as indicated below, the HBOS Group also reports its financial performance using a number of additional supplementary non-statutory "underlying" measures. References to "underlying" incorporate the following adjustments:

- Excluding regulatory provisions, the impact of the change in corporation tax rates, the profit on sale of Drive Financial Services ("**Drive**"), as applicable, goodwill impairment, policyholder tax payable, the impact of short term fluctuations ("**STFs**") and changes to economic assumptions for Long Term Assurance Business accounted for on an embedded value basis;
- Netting against income of operating lease depreciation, impairment on investment securities, changes in insurance and investment contract liabilities, change in unallocated surplus and net claims incurred on insurance contracts; and
- Including share of profits of associates and jointly controlled entities within underlying non-interest income.

The following discussion is based, where indicated, on the 2007, 2006, 2005 and the six months ended 30 June 2008 and 2007 non-statutory "underlying" information.

#### **Overview**

The HBOS Group reports its financial performance on both a HBOS Group and a divisional basis, and, accordingly, the review of operations and financial results in this Part XIII includes the paragraphs "HBOS Group Overview", "Divisional Overview", "Results of Operations (HBOS Group)" and "Results of Operations (Divisional)" below.

A discussion of the HBOS Group's current trading for the period from 1 July 2008 to 3 November 2008 can be found in Part IX ("HBOS Trading Update").

The following tables summarise the differences between underlying profit before tax and profit before tax for the six months ended 30 June 2008 and 2007 and the years ended 31 December 2007 and 2006:

	<i>Six months ended</i>		<i>Year ended</i>	
	<i>30 June</i>		<i>31 December</i>	
	<i>2008</i>	<i>2007</i>	<i>2007</i>	<i>2006</i>
	<i>(£m)</i>			
<b>Underlying profit before tax</b>	<b>1,451</b>	2,962	5,708	5,537
Regulatory provisions charge <sup>(1)</sup>		(79)	(122)	(95)
Impact of the 2008 change in corporation tax rate on the value of leasing assets <sup>(2)</sup>		(18)	(10)	
Profit on sale of Drive				180
Goodwill impairment	(2)	(2)	(5)	(55)
Policyholder tax payable	(451)	167	18	220
Short term fluctuations <sup>(3)</sup>	(150)	(33)	(115)	(81)
<b>Profit before tax</b>	<b>848</b>	<b>2,997</b>	<b>5,474</b>	<b>5,706</b>

(1) The regulatory provisions charge in 2007 covers retail banking ex gratia refunds and associated administration costs in relation to current accounts. HBOS is one of eight major UK current account providers involved in test case proceedings to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges. Further details of the test case are set out in paragraph 18 of Part XVIII ("Additional Information") of the HBOS Rights Issue Prospectus and is incorporated by reference herein. The total costs incurred in 2007 have amounted to £122 million (£85 million after tax), which has been reported outside of underlying results as they relate predominantly to fees charged in prior years. In 2006, this provision covered mortgage endowment compensation.

(2) In 2007 there were reductions in the corporation tax rates in the UK and Germany which have resulted in a net benefit to profit attributable to ordinary shareholders of £97 million in the six months ended 30 June 2007. The net benefit comprises a £110 million reduction in deferred tax net liabilities and a £13 million (£18 million pre-tax) reduction to the value of leasing assets which contain tax variation clauses that pass on the benefit of tax changes to customers. For the year ended 31 December 2007, the reductions in the corporation tax rates in the UK and Germany resulted in a net benefit to profit attributable to ordinary shareholders of £171 million. The net benefit comprises a £178 million reduction in deferred tax net liabilities and a £7 million (£10 million pre-tax) reduction to the value of leasing assets which contain tax variation clauses that pass on the benefit of tax changes to customers.

(3) Short term fluctuations represent the impact of fluctuations in investment returns relative to those based on longer term assumptions and variances in charges for policyholder tax payable from an expected charge for the period.

The following tables summarise the movements between profit attributable to shareholders and underlying profit attributable to ordinary shareholders for the six months ended 30 June 2008 and 2007 and the years ended 31 December 2007 and 2006:

	<i>Six months ended</i>		<i>Year ended</i>	
	<i>30 June</i>		<i>31 December</i>	
	<i>2008</i>	<i>2007</i>	<i>2007</i>	<i>2006</i>
	<i>(£m)</i>			
<b>Profit attributable to shareholders</b>	<b>931</b>	2,114	4,045	3,879
Preference dividends	(51)	(51)	(80)	(59)
<b>Profit attributable to ordinary shareholders</b>	<b>880</b>	2,063	3,965	3,820
Regulatory provisions charge <sup>(1)</sup>		55	85	67
Impact of the 2008 change in corporation tax rate on:				
the value of leasing assets <sup>(2)</sup>		13	7	
deferred tax net liabilities <sup>(2)</sup>		(110)	(178)	
Profit on sale of Drive				(180)
Goodwill impairment	2	2	5	55
Short term fluctuations <sup>(3)</sup>	107	23	81	57
Profit of disposal group classified as held for sale attributable to ordinary shareholders				(3)
<b>Underlying profit attributable to ordinary shareholders</b>	<b>989</b>	2,046	3,965	3,816

(1) The regulatory provisions charge in 2007 covers retail banking ex gratia refunds and associated administration costs in relation to current accounts. HBOS is one of eight major UK current account providers involved in test case proceedings to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges. Further details of the test case are set out in paragraph 18 of Part XVIII (“Additional Information”) of the HBOS Rights Issue Prospectus and is incorporated by reference herein. The total costs incurred in 2007 have amounted to £122 million (£85 million after tax), which has been reported outside of underlying results as they relate predominantly to fees charged in prior years. In 2006, this provision covered mortgage endowment compensation.

(2) In 2007 there were reductions in the corporation tax rates in the UK and Germany which have resulted in a net benefit to profit attributable to ordinary shareholders of £97 million in the six months ended 30 June 2007. The net benefit comprises a £110 million reduction in deferred tax net liabilities and a £13 million (£18 million pre-tax) reduction to the value of leasing assets which contain tax variation clauses that pass on the benefit of tax changes to customers. For the year ended 31 December 2007, the reductions in the corporation tax rates in the UK and Germany resulted in a net benefit to profit attributable to ordinary shareholders of £171 million. The net benefit comprises a £178 million reduction in deferred tax net liabilities and a £7 million (£10 million pre-tax) reduction to the value of leasing assets which contain tax variation clauses that pass on the benefit of tax changes to customers.

(3) Short term fluctuations represent the impact of fluctuations in investment returns relative to those based on longer term assumptions and variances in charges for policyholder tax payable from an expected charge for the period.

## **HBOS Group Overview**

The following is a summary of the HBOS Group’s consolidated results of operations for the six months ended 30 June 2008 compared with the six months ended 30 June 2007. An update on the HBOS Group’s current trading for the period from 1 July 2008 to 3 November 2008 is set out in Part IX (“HBOS Trading Update”) of this document.

### **Six months ended 30 June 2008 Overview**

#### *Profit Growth*

For the six months ended 30 June 2008, the HBOS Group’s profit before tax fell by 72% to £848 million (as compared to £2,997 million in the first half of 2007), predominantly reflecting the significant effect of the £1.1 billion of negative fair value adjustments (“**NFVA**”) taken to the income statement in respect of debt securities held in the Treasury’s trading books. In addition, £1.9 billion of NFVA on a post tax basis for the first half of 2008 as compared to the first half of 2007 were taken through equity in the available for sale reserve, which were not reflected in reported profit or regulatory capital.

The HBOS Group’s underlying profit before tax (including NFVA) decreased by 51% to £1,451 million (as compared to £2,962 million in the first half of 2007). Underlying earnings per share (including NFVA) were down by 52% for the six months ended 30 June 2008 to 26.4p (as compared to 54.6p in the first half of 2007).

The HBOS Group's underlying profit before tax (excluding NFVA) decreased by 14% to £2,546 million (as compared to £2,962 million in the first half of 2007). Underlying earnings per share (excluding NFVA) were down by 13% for the six months ended 30 June 2008 to 47.4p (as compared to 54.6p in the first half of 2007).

#### *Capital and Basel II*

As from 1 January 2008, the HBOS Group is operating under the Basel II capital ratio regime. This advanced capital regime has redefined both the size and nature of the capital resources available to HBOS as well as the level of risk weighted assets.

At 30 June 2008, the *pro forma* Basel II capital ratios (calculated to include the £4.0 billion of capital raised from the Rights Issue that closed on 21 July 2008) were Tier 1 8.6%, Core Tier 1 6.5% and Total Capital 12.2%. These ratios are in the middle of the HBOS Group's revised target ranges of 8%-9% for Tier 1 and 6%-7% for Core Tier 1.

At 30 June 2008, the HBOS Group's actual Basel II capital ratios (calculated to exclude the Rights Issue) were Tier 1 7.3% (as compared to 7.7% as at 31 December 2007), Core Tier 1 5.3% (as compared to 5.7% as at 31 December 2007) and Total Capital 10.9% (as compared to 11.0% as at 31 December 2007).

#### *Lending Growth*

As of 30 June 2008, loans and advances to customers increased to £456.0 billion (as compared to £430.0 billion at 31 December 2007), reflecting the annualised growth in Corporate (14%) and International (34%), with lower growth in Retail (2%).

#### *Margins*

The HBOS Group's net interest margin fell in the first half of 2008 by just 3bps to 1.55% (as compared to 1.58% in the second half of 2007). The main driver of this reduction was in the Corporate division where the net interest margin declined by 5bps, despite wider spreads being achieved on new lending, reflecting slower turnover of the existing book. In the International division, the net interest margin declined by 7bps, primarily as a result of increased funding costs, while in the Retail division the net interest margin increased by 3bps as asset spreads improved, more than offsetting the increased costs of both customer deposits and wholesale funding.

#### *Efficiency*

Underlying net operating income (excluding NFVA) was broadly stable at £6,467 million (as compared to £6,427 million in the first half of 2007). Underlying net interest income increased in the first half of 2008 by 6% to £3,861 million due to growth in lending. Underlying non-interest income (excluding NFVA) decreased in the first half of 2008 by 7% to £2,606 million, primarily reflecting lower revenues from the investment portfolio in the Corporate division.

Underlying operating expenses increased in the first half of 2008 by 4% to £2,667 million (as compared to £2,563 million in the first half of 2007).

In the first half of 2008, the underlying cost:income ratio (including NFVA) increased to 49.6% (as compared to 39.9% in the first half of 2007). In the first half of 2008, the underlying cost:income ratio (excluding NFVA) increased to 41.2% (as compared to 39.9% in the first half of 2007).

#### *Credit Quality*

Consistent with a slowing economy, credit experience has seen some deterioration in the first half of 2008. Impaired loans as a percentage of advances increased to 2.35% in the first half of 2008 (as compared to 2.03% at 31 December 2007). Impairment losses increased in the first half of 2008 by 36% to £1,310 million (as compared to £963 million in the first half of 2007), representing 0.59% of average advances in 2007 (as compared to 0.50% in the first half of 2007).

### **Divisional Overview**

The following is a summary of the divisional results of operations for the six months ended 30 June 2008, compared with the six months ended 30 June 2007.

#### ***Retail***

Underlying profit before tax in the Retail division decreased in the first half of 2008 by 5% to £992 million (as compared to £1,043 million in the first half of 2007), predominantly reflecting the deterioration in the secured credit risk environment. Underlying net operating income and

underlying operating expenses in the Retail division remained stable in the first half of 2008 as compared to the same period in 2007, resulting in the underlying cost:income ratio in the Retail division being broadly unchanged at 38.9% (as compared to 38.8% in the first half of 2007).

Underlying non-interest income in the Retail division increased in the first half of 2008 by 3% to £650 million (as compared to £630 million in the first half of 2007).

Underlying operating expenses in the Retail division remained stable in the first half of 2008 at £1,056 million (as compared to £1,053 million in the first half of 2007).

Overall, loans and advances in the Retail division grew in the first half of 2008 by an annualised 2% to £255.8 billion (as compared to £253.4 billion at 31 December 2007).

The UK mortgage market gross lending in the first half of 2008 is estimated at £151 billion (compared to £178 billion in the first half of 2007), 15% lower than the same period last year. The lower gross market reflects the decline in the house purchase market, partially offset by a sustained remortgage market. The HBOS Group's gross lending market share for the first half of 2008 remained at 19% in the UK (as compared to the first half of 2007) and this together with a reduction in principal repaid market share to 22% (as compared to 24% in the first half of 2007), resulted in the HBOS Group's net lending market share in the UK remaining broadly in line for the first half of 2008 at an estimated 7% (as compared to 8% for the first half of 2007).

Customer deposits increased in the first half of 2008 by an annualised 2% to £160.0 billion (as compared to £158.3 billion at 31 December 2007) reflecting strong competition for retail deposits in the market.

Gross lending in the unsecured personal loan market has shown an 8% contraction year-on-year. In this environment the HBOS Group has continued the cautious approach adopted in recent years and has selectively tightened risk criteria, focusing on existing customers with known behaviour, credit history and other product relationships. The HBOS Group has progressively improved margins during the first half of 2008 with the margin improvement seen across all acquisition channels. Balances have reduced by 3% to £6.4 billion (as compared to £6.6 billion at 31 December 2007), with the market share remaining at 10%.

For a discussion of credit quality and provisions and secured and unsecured impairments, see "Results of Operations and Related Financial Information (Divisional) – Retail" below.

### **Corporate**

Underlying profit before tax in the Corporate division decreased in the first half of 2008 by 39% to £753 million (as compared to £1,243 million in the first half of 2007). Underlying net operating income in the Corporate division decreased in the first half of 2008 by 15% to £1,626 million (as compared to £1,914 million in the first half of 2007), with underlying net interest income in the Corporate division up 15% to £1,140 million (as compared to £992 million in the first half of 2007). The Corporate division's margin narrowed to 196bps in the half year ended 30 June 2008, from 201bps in the half year ended 31 December 2007.

Underlying non-interest income in the Corporate division decreased in the first half of 2008 by 47% to £486 million (as compared to £922 million in the first half of 2007) as a result of a decrease in revenues from the Corporate investment portfolio (*i.e.*, profit on the sale of investment securities, other operating income, share of profits of associates and jointly controlled entities, less impairment on investment securities), down by 75% in the first half of 2008 to £134 million (as compared to £543 million in the first half of 2007).

Profits on the sale of investment securities decreased by 65% to £88 million (as compared to £253 million in the first half of 2007), reflecting fewer significant exits under current market conditions, and reduced income from the investment portfolio. Other operating income increased by 20% to £225 million (as compared to £187 million in the first half of 2007), reflecting the fair value uplift on Infrastructure equity investments, offset by lower realisations from the HBOS Group's Joint Venture Portfolio. Losses from associates and jointly controlled entities decreased by 69% to £34 million (as compared to profits of £108 million in the first half of 2007) due to weaker trading performance. Impairment on investment securities increased to £145 million (as compared to £5 million in the first half of 2007).

As at 30 June 2008, the book value of the investment portfolio in the Corporate division had increased by 17% to £4.9 billion (as compared to £4.2 billion as at 31 December 2007).

Underlying operating expenses decreased in the first half of 2008 by 7% to £404 million (compared to £436 million in the first half of 2007) reflecting lower levels of performance based remuneration. The Corporate division's continued focus on cost discipline has mitigated the impact of the reduction in net operating income and has resulted in a weakening in the underlying cost:income ratio in the Corporate division to 24.8% (as compared to 22.8% in the first half of 2007).

During the first half of 2008, Corporate have set a strategy of slower and highly selective growth, continuing to concentrate on markets where the HBOS Group has real expertise and can generate superior returns. As a result, however, of a significant pipeline of business at the end of 2007 and limited activity in the syndications market, pre-sell down lending increased in the first half of 2008 by an annualised 17% (as compared to 31 December 2007) and post-sell down lending increased by an annualised 14% (as compared to 31 December 2007).

Customer deposits increased in the first half of 2008 by an annualised 3% to £44.7 billion (as compared to £44.1 billion as at 31 December 2007) due to strong competition for corporate deposits.

For a discussion of credit quality and provisions, see "Results of Operations and Related Financial Information (Divisional) – Corporate" below.

### **Insurance & Investment**

Underlying profit before tax in the Insurance & Investment division increased in the first half of 2008 by 27% to £402 million (as compared to £316 million in the first half of 2007).

Underlying profit before tax for the General Insurance business increased in the first half of 2008 by 64% to £176 million (as compared to £107 million in the first half of 2007), in part, reflecting severe flooding in the first half of 2007. Underlying profit before tax for the division's Investment business increased in the first half of 2008 by 8% to £226 million (as compared to £209 million for the first half of 2007), reflecting the emergence of in-force profits.

Underlying non-interest income in the General Insurance business increased 69% in the first half of 2008 to £283 million (as compared to £167 million in the first half of 2007) with income in the first half of 2007 being reduced by the cost of the June floods. Underlying operating expenses increased in the first half of 2008 by 65% to £117 million (as compared to £71 million in the first half of 2007) due to additional marketing spend in HBOS's motor business to drive sales momentum.

General Insurance sales, as measured by gross written premiums ("**GWP**"), increased in the first half of 2008 by 3% to £892 million (as compared to £868 million in the first half of 2007). Despite strong performances in the first half of 2008 by Motor (up 43% as compared to the first half of 2007) and Household (up 7% as compared to the first half of 2007), these gains were partially offset by lower sales in Repayment Insurance (down 13% as compared to the first half of 2007).

Underlying net operating income in the Investment business increased in the first half of 2008 by 3% to £565 million (as compared to £547 million in the first half of 2007), while underlying operating expenses remained stable in the first half of 2008 at £339 million (as compared to £338 million in the first half of 2007).

To aid comparability with competitors, sales are reported on a Present Value of New Business Premiums basis ("**PVNB**P"). Investment sales decreased in the first half of 2008 by 5% to £7,201 million PVNB (as compared to £7,574 million PVNB (excluding sales of the discontinued Guaranteed Growth Bond ("**GGB**") product) in the first half of 2007), reflecting a 13% increase in Intermediary (£2,283 million compared to £2,012 million in the first half of 2007) and an increase in Wealth Management of 1% to £1,848 million (as compared to £1,827 million in the first half of 2007), which was offset by a fall in Bancassurance sales, down 18% to £3,070 million (as compared to £3,735 million in the first half of 2007) as a result of lower bond sales.

To assist in the understanding of the underlying performance and value generation of the HBOS Group's UK Investment Business, financial results for the HBOS Group's UK Investment Business are presented as if both insurance and investment contracts (including mutual funds) were accounted for on an EV basis. This is referred to as the "Full EV" basis. The Full EV basis uses the same methodology as that which is applied to the calculation of EV on insurance contract business under IFRS. When accounting for insurance and investment contracts, consistently on a full EV basis, profit before tax for the Investment business would have decreased by 1% to £342 million. The contribution from new UK investment business in the first half of 2008 on a Full EV basis (*i.e.*, assuming all investment business is EV accounted) was £195 million (as compared to



£273 million in the first half of 2007), £218 million higher than the reported IFRS result. On the same basis, the contribution from existing UK investment business was lower, resulting in a net increase to underlying profit before tax in the first half of 2008, £116 million higher than the reported IFRS result.

### ***International***

Underlying profit before tax in the International division in the first half of 2008 was slightly lower as compared with the same period in 2007, at £323 million (as compared to £327 million in the first half of 2007).

Underlying profit before tax in Australia decreased in the first half of 2008 by 6% to £135 million (as compared to £144 million in the first half of 2007) reflecting increased costs as a result of the national expansion, combined with higher impairment charges. Net interest income in Australia increased in the first half of 2008 by 33% to £385 million (as compared to £290 million in the first half of 2007) driven by asset growth with relatively stable margins, reflecting the HBOS Group's careful management of funding costs. Underlying operating expenses in Australia increased in the first half of 2008 by 40% to £264 million (as compared to £188 million in the first half of 2007), largely as a result of the significant investment in physical distribution (in particular, the initial phase of the national retail branch expansion and the continuing roll out of Business Banking centres), brand recognition, staffing, new products and back office infrastructure that is expected to underpin the HBOS Group's growth in the future. Lending and deposits in Australia grew by an annualised rate of 39% and 19%, respectively, relative to 2007. Impaired loans in Australia as an annualised percentage of closing advances increased to 1.40% (as compared to 0.99% in the first half of 2007), reflecting a small number of high value impaired corporate loans. Impairment losses in Australia as a percentage of average advances increased to 0.41% (as compared to 0.27% in the first half of 2007).

In Ireland, underlying profit before tax increased by 6% in the first half of 2008 to £85 million (as compared to £80 million in the first half of 2007). Net interest income increased in the first half of 2008 by 20% to £196 million (as compared to £163 million in the first half of 2007). Underlying operating expenses increased by 26% to £92 million in the first half of 2008 (as compared to £73 million in the first half of 2007) reflecting continued investment in both people and infrastructure as the roll out of offerings to the Irish marketplace was completed. In the first six months of 2008, lending grew by an annualised rate of 34% and deposits were broadly flat relative to 31 December 2007. Impairment losses as an annualised percentage of average advances increased to 0.16% (compared to 0.12% in the first half of 2007). As a percentage of closing advances, impaired loans showed an increase in the first half of 2008 to 1.46% (as compared to 1.08% as at 31 December 2007).

In Europe and North America, underlying profit before tax was unchanged in the first half of 2008 at £103 million (as compared to the first half of 2007). Net interest income in Europe and North America increased by 41% to £89 million (as compared to £63 million in the first half of 2007) reflecting growth in customer advances in both the European and North American corporate and retail banking businesses. The net interest margin in Europe and North America remains broadly in line with 2007 levels at 1.46% (as compared to 1.47% in the first half of 2007). Underlying non-interest income in Europe and North America increased 8% to £126 million in the first half of 2008 (as compared to £117 million in the first half of 2007). Underlying operating expenses in Europe and North America grew in the first half of 2008 by 19% to £87 million (as compared to £73 million in the first half of 2007). This increase reflects continuing investment to expand Europe and North America's product range and distribution channels and to meet ongoing substantive legislation changes in key markets such as Germany.

In Europe and North America, while overall credit quality remains robust across the corporate US portfolio, a small number of individual credits have been taken under intensive management as a result of current conditions. Impaired loans as a percentage of closing advances have increased from historically low levels to 2.36% (as compared to 0.59% as at 31 December 2007) driven largely by a small number of impaired corporate credit exposures. Impairment losses as an annualised percentage of average advances also show an increase from a low base to 0.40% (as compared to 0.09% in the first half of 2007).

## Treasury & Asset Management

Underlying loss before tax in the Treasury & Asset Management division for the first half of 2008 was £871 million, reflecting a NFVA relating to certain debt securities of £1,095 million. Underlying profit before tax excluding NFVA increased in the first half of 2008 by 15% to £224 million (as compared to £194 million in the first half of 2007). Net interest income in the Treasury and Asset Management division decreased by 58% to £39 million (as compared to £93 million in the first half of 2007), primarily due to the impact of higher funding costs.

Underlying non-interest income including NFVA in the Treasury & Asset Management division in the first half of 2008 experienced a loss of £750 million. Underlying non-interest income excluding NFVA increased in the first half of 2008 by 29% to £345 million (as compared to £267 million in the first half of 2007) driven by sales and trading operations. Underlying operating expenses decreased in the first half of 2008 by 6% to £160 million (as compared to £170 million in the first half of 2007), which reflects a reduction in performance related staff costs and a number of cost savings initiatives implemented in the HBOS Group's Asset Management businesses.

During the first half of 2008, Treasury continued to support the HBOS Group's capital and funding plans.

In respect of funding, the HBOS Group continued to fund successfully in global money markets and raised some £8.7 billion in the (over one year) term capital markets, including £5.7 billion senior debt issuance, a £0.6 billion issuance of covered bonds, a £0.5 billion securitisation, £750 million innovative Tier 1 securities and a £1.1 billion lower Tier 2 subordinated debt issuance.

## Results of Operations and Related Financial Information (HBOS Group)

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

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<i>2007</i>
	<i>(£m, except %)</i>	
Operating profit (before impairment losses on loans and advances) (excluding NFVA) <sup>(1)</sup>	<b>3,800</b>	3,864
Profit before taxation	<b>848</b>	2,997
Post tax return on mean equity (excluding NFVA) <sup>(1)</sup>	<b>16.6%</b>	21.0%
Post tax return on mean equity <sup>(1)</sup>	<b>10.3%</b>	21.0%
Underlying cost:income ratio (excluding NFVA) <sup>(2)</sup>	<b>41.2%</b>	39.9%
Underlying cost:income ratio <sup>(2)</sup>	<b>49.6%</b>	39.9%
	<b>As at</b>	<i>As at</i>
	<b>30 June</b>	<i>31 December</i>
	<b>2008</b>	<i>2007</i>
	<i>(£m, except %)</i>	
Total assets	<b>681,404</b>	666,947
Total shareholders' equity	<b>21,133</b>	22,234
<b>Capital Adequacy (Basel II)</b>		
<i>Including the Rights Issue</i>		
Tier 1 capital ratio	<b>8.6%</b>	
Core Tier 1 ratio	<b>6.5%</b>	
Total capital ratio	<b>12.2%</b>	
<i>Excluding the Rights Issue</i>		
Tier 1 capital ratio	<b>7.3%</b>	7.7%
Core Tier 1 ratio	<b>5.3%</b>	5.7%
Total capital ratio	<b>10.9%</b>	11.0%

(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 cost: income ratio is calculated on an underlying operating expenses to underlying net operating income basis as follows:

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	<i>2007</i>
	<i>(£m, except %)</i>	
Underlying operating expenses	<b>2,667</b>	2,563
Underlying net interest income	<b>3,861</b>	3,626
Underlying non-interest income (excluding NFVA)	<b>2,606</b>	2,801
Underlying net operating income (excluding NFVA)	<b>6,467</b>	6,427
Negative fair value adjustments (NFVA)	<b>(1,095)</b>	
Underlying net operating income	<b>5,372</b>	6,427
Underlying cost:income ratio (excluding NFVA)	<b>41.2%</b>	39.9%
Underlying cost:income ratio	<b>49.6%</b>	39.9%

The HBOS Group's underlying operating profit before impairment losses on loans and advances decreased in the first half of 2008 by 2% to £3,800 million, as compared to £3,864 million for the first half of 2007.

Total assets increased by 2% in the first half of 2008 to £681 billion, (as compared to £667 billion as at 31 December 2007).

Including NFVA, the HBOS Group's post-tax return on mean equity for the first half of 2008 was 10.3% (as compared to 21.0% in the first half of 2007). The HBOS Group's post-tax return on mean equity (excluding NFVA) for the first half of 2008 was 16.6%, (as compared to 21.0% in the first half of 2007).

Including NFVA, the HBOS Group's underlying cost:income ratio for the first half of 2008 was 49.6% (as compared to 39.9% for the first half of 2007). The HBOS Group's underlying cost:income ratio (excluding NFVA) for the first half of 2008 was 41.2%, (as compared to 39.9% for the first half of 2007).

On a Basel II basis, the HBOS Group's Tier 1 and total capital, including the Rights Issue, was £28,434 million and £40,300 million, respectively, in the first half of 2008 (compared to £23,731 million and £33,858 million, respectively, at 1 January 2008). Excluding the Rights Issue, the HBOS Group's Tier 1 and total capital was £24,044 million and £36,300 million, respectively. The Basel II Tier 1 and core Tier 1 ratios, including the Rights Issue, were 8.6% and 6.5%, respectively, in the first half of 2008 (compared to 7.7% and 5.7%, respectively, at 1 January 2008). Excluding the Rights Issue, the Basel II Tier 1 and core Tier 1 ratios were 7.3% and 5.3%, respectively.

### ***Underlying Net Interest Income***

The following table shows the underlying net interest income of the HBOS Group for the periods stated.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	<i>2007</i>
	<i>(£m)</i>	
Retail	<b>2,064</b>	2,087
Corporate	<b>1,140</b>	992
Treasury & Asset Management	<b>39</b>	93
Insurance & Investment	<b>(52)</b>	(50)
International	<b>670</b>	504
Underlying net interest income	<b>3,861</b>	3,626

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

	<b>Six months ended 30 June 2008</b>	<i>Six months ended 31 December 2007</i>
	(%)	
Retail	<b>1.62</b>	1.59
Corporate	<b>1.96</b>	2.01
International	<b>1.84</b>	1.91
Underlying net interest margin	<b>1.55</b>	1.58

Underlying net interest income increased in the first half of 2008 by 6% to £3,861 million (as compared to £3,626 million in the first half of 2007). This reflects good interest income growth in Corporate and International. The HBOS Group's net interest margin reduced slightly by 3bps to 155bps in the first half of 2008 (as compared to 158bps for the six months ended 31 December 2007). This reflects a change in business mix across the divisions with reductions of 7bps and 5bps in International and Corporate respectively, more than offsetting an increase of 3bps in Retail.

The improvement in the Retail margin was driven by reduced unsecured lending and improved mortgage pricing which more than offset the increased costs of funding. Corporate's margin fell despite the introduction of a number of new repricing initiatives due to the slower turnover of the current lending book. Changes in business mix contributed to the fall in the International margin.

The following table shows the average balances of interest earning assets of the HBOS Group for the periods stated.

	<b>Six months ended 30 June 2008</b>	<i>Six months ended 31 December 2007</i>
	(£m)	
<b>Average balances</b>		
Interest earning assets:		
Loans and advances	<b>457,105</b>	432,440
Securities and other liquid assets	<b>42,984</b>	30,169
	<b>500,089</b>	462,609

#### ***Underlying Non-Interest Income***

The HBOS Group's non-interest income consists of net fees and commissions, net earned premiums on insurance contracts, net trading income, change in value of in-force Long Term Assurance Business, net investment income related to insurance and investment business and other operating income.

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

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m)</i>	
Fees and commissions receivable	<b>1,149</b>	1,193
Fees and commissions payable	<b>(546)</b>	(539)
Net earned premiums on insurance contracts	<b>2,276</b>	3,051
Net trading income (excluding NFVA)	<b>185</b>	141
Change in value of in-force Long Term Assurance Business	<b>36</b>	159
Other operating income:		
Profit on sale of investment securities	<b>165</b>	316
Operating lease rental income	<b>665</b>	655
Net investment income related to insurance and investment business	<b>(3,970)</b>	3,481
Other	<b>225</b>	178
	<hr/>	<hr/>
Total non-interest income	<b>185</b>	8,635
Impairment on investment securities	<b>(145)</b>	(27)
Operating lease depreciation	<b>(508)</b>	(500)
Change in investment contract liabilities	<b>2,734</b>	(2,423)
Net claims incurred on insurance contracts	<b>(1,721)</b>	(1,433)
Net change in insurance contract liabilities	<b>1,854</b>	(1,388)
Change in allocated surplus	<b>231</b>	(169)
Share of (losses)/profits of associates and jointly controlled entities	<b>(24)</b>	106
	<hr/>	<hr/>
Underlying non-interest income (excluding NFVA)	<b>2,606</b>	2,801
	<hr/>	<hr/>
Negative fair value adjustments (NFVA) <sup>(1)</sup>	<b>(1,095)</b>	
Underlying non-interest income	<b>1,511</b>	2,801
	<hr/> <hr/>	<hr/> <hr/>

(1) NFVA were incurred in the Treasury division.

Including NFVA, the HBOS Group's underlying non-interest income in the first half of 2008 decreased 46% to £1,511 million compared to the first half of 2007. In the first half of 2008, the HBOS Group's underlying non-interest income (excluding NFVA) decreased 7% to £2,606 million (as compared to £2,801 million for the first half of 2007).

### ***Underlying Operating Expenses***

The HBOS Group's operating expenses consist of staff costs, expenditures on premises and equipment, depreciation and amortisation, professional services (including auditors' remuneration, legal and professional and consultancy services fees), and other costs (including advertising and marketing, computer software and services, telephone, postage and stationery, irrecoverable VAT and other miscellaneous expenditures).

The following table shows the operating expenses of the HBOS Group for the periods stated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m)</i>	
Staff costs	<b>1,455</b>	1,404
Expenditure on premises and equipment	<b>378</b>	358
Depreciation and amortisation	<b>208</b>	210
Other	<b>(1,964)</b>	6,504
	<b>77</b>	8,476
Regulatory provisions charge		79
Goodwill impairment	<b>2</b>	2
Total operating expenses	<b>79</b>	8,557

The HBOS Group's operating expenses decreased in the first half of 2008 by 99% to £79 million, (as compared to £8,557 million for the first half of 2007).

The following table shows the underlying operating expenses of the HBOS Group for the periods stated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m)</i>	
Operating expenses (per above)	<b>79</b>	8,557
Regulatory provisions charge		(79)
Goodwill impairment	<b>(2)</b>	(2)
	<b>77</b>	8,476
Operating lease depreciation	<b>(508)</b>	(500)
Change in investment contract liabilities	<b>2,734</b>	(2,423)
Net claims incurred on insurance contracts	<b>(1,721)</b>	(1,433)
Net change in insurance contract liabilities	<b>1,854</b>	(1,388)
Change in unallocated surplus	<b>231</b>	(169)
Underlying operating expenses	<b>2,667</b>	2,563

#### ***Provisions for Impairment Losses on Loans and Advances***

The HBOS Group's accounting policy in respect of the six months ended 30 June 2008 and 2007 is to assess impairment individually for financial assets that are significant and individually or collectively for assets that are not significant.

Individual impairment is identified at a counterparty specific level following objective evidence that a financial asset is impaired. This may be after an interest or principal payment is missed or when a banking covenant is breached. The present value of estimated cash flows recoverable is determined after taking into account any security held. The amount of any impairment is calculated by comparing the present value of the cash flows discounted at the loan's original effective interest rate with the balance sheet carrying value. If impaired, the carrying value is adjusted and the difference charged to the income statement.

The written down value of the impaired loan is compounded back to the net realisable balance over time using the original effective interest rate. This is reported through interest receivable within the income statement and represents the unwinding of the discount.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement.

In circumstances where an asset has been individually assessed for impairment and no objective evidence of impairment exists, then it will be subject to a collective assessment.

Collective impairment is identified for groups of assets that share similar risk characteristics. Collective impairment is assessed using a methodology based on existing risk conditions or events that have a strong correlation with a tendency to default.

For the impact of this policy on the HBOS Group's divisions, see "Results of Operations and Related Financial Information (Divisional)" below.

### Results of Operations and Related Financial Information (Divisional)

The following table provides the underlying profit before taxation for each of the listed divisions for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m)</i>	
Retail	<b>992</b>	1,043
Corporate	<b>753</b>	1,243
Insurance & Investment	<b>402</b>	316
International	<b>323</b>	327
Treasury & Asset Management (excluding NFVA)	<b>224</b>	194
HBOS Group Items <sup>(1)</sup>	<b>(148)</b>	(161)
	<hr/>	<hr/>
HBOS Group underlying profit before tax (excluding NFVA)	<b>2,546</b>	2,962
Negative fair value adjustments (NFVA) <sup>(2)</sup>	<b>(1,095)</b>	
	<hr/>	<hr/>
HBOS Group underlying profit before tax (including NFVA)	<b>1,451</b>	2,962
	<hr/> <hr/>	<hr/> <hr/>

(1) HBOS Group items comprise costs incurred in the management of the HBOS Group as a whole.

(2) NFVA in the first half of 2008 were incurred in the Treasury & Asset Management division.

Including NFVA, the HBOS Group's underlying profit before tax decreased in the first half of 2008 by 51% to £1,451 million, compared to £2,962 million in the same period of 2007. The HBOS Group's underlying profit before tax (excluding NFVA) decreased in the first half of 2008 by 14% to £2,546 million, compared to £2,962 million for the six months ended 30 June 2007.

#### **Retail**

Underlying profit before tax in the Retail division decreased in the first half of 2008 by 5% to £992 million (as compared to £1,043 million in the first half of 2007). Underlying net operating income and underlying operating expenses remained stable in the first half of 2008. As a consequence, the underlying cost:income ratio for the first half of 2008 was broadly unchanged at 38.9% (as compared to 38.8% in the first half of 2007).

Impairment losses increased by 6% to £722 million (as compared to £678 million in the first half of 2007) reflecting an increased charge in respect of secured loan impairments, offset by a reduction in the level of unsecured impairment losses.

In the UK mortgage market, the HBOS Group's share of new lending was unchanged from the first half of 2007 which, after allowing for the smaller markets and repayments, resulted in a reduced level of net lending. Competition for new retail deposits has been strong. Whilst total balance growth was limited by this in the first quarter of 2008, the HBOS Group's second quarter performance shows strong evidence of a return to a deposit growth trend. Bank account and credit card sales in the first half of 2008 are broadly in line with those achieved in the first half of 2007 whilst contraction in the consumer credit market, and the HBOS Group's own risk appetite, has seen a commensurate reduction in new business written within its personal loan business.

### Underlying Financial Performance (Retail)

The following table sets out the Retail income statement for the periods indicated.

	Six months ended 30 June	
	<b>2008</b>	2007
	(£m, except %)	
Underlying net interest income	<b>2,064</b>	2,087
Underlying non-interest income	<b>650</b>	630
Mortgages & Saving	<b>231</b>	256
Banking	<b>241</b>	220
Business Banking	<b>22</b>	20
Personal Loans	<b>48</b>	66
Credit Cards	<b>135</b>	116
Other	<b>20</b>	22
Fees and commission income	<b>697</b>	700
Fees and commission expense	<b>(74)</b>	(55)
Other operating income	<b>27</b>	14
Share of losses of associates and jointly controlled entities		(7)
Impairment on investment securities		(22)
<b>Underlying net operating income</b>	<b>2,714</b>	2,717
<b>Underlying operating expenses</b>	<b>(1,056)</b>	(1,053)
Staff	<b>(543)</b>	(524)
Accommodation, repairs and maintenance	<b>(4)</b>	(4)
Technology	<b>(26)</b>	(25)
Marketing and communication	<b>(93)</b>	(87)
Depreciation:		
Property and equipment and intangible assets	<b>(32)</b>	(37)
Other	<b>(19)</b>	(43)
Sub total	<b>(717)</b>	(720)
Recharges:		
Technology	<b>(120)</b>	(129)
Accommodation	<b>(145)</b>	(137)
Other shared services	<b>(74)</b>	(67)
<b>Underlying operating profit before provisions</b>	<b>1,658</b>	1,664
Impairment losses on loans and advances	<b>(722)</b>	(678)
<b>Underlying operating profit</b>	<b>936</b>	986
Non-operating income	<b>56</b>	57
<b>Underlying profit before tax</b>	<b>992</b>	1,043
Net interest margin	<b>1.62%</b>	1.73%
Impairment losses as an annualised % of average advances	<b>0.57%</b>	0.57%
Cost: income ratio	<b>38.9%</b>	38.8%

*Underlying Operating Income and Margins.* Total underlying net operating income remained relatively stable in the first half of 2008 at £2,714 million (as compared to £2,717 million in the first half of 2007), with underlying net interest income 1% lower at £2,064 million (as compared to £2,087 million in the first half of 2007) and non-interest income 3% higher at £650 million (as compared to £630 million in the first half of 2007). Non-interest income includes commissions received from the HBOS Group's Insurance & Investment division in respect of the distribution of repayment insurance business.

Underlying fees and commissions income remained relatively stable in the first half of 2008 at £697 million (as compared to £700 million in the first half of 2007). Credit card and Banking fee income



both improved on the first half of 2007, the latter being driven by fee generation from HBOS's packaged current account product introduced in February 2007. The performance in other product areas was either unchanged or lower compared to the first half of 2007, the natural consequence of more subdued housing and consumer finance market activity.

Since 2007, ex gratia refunds to customers in respect of bank charges have been reported outside of the underlying results as they relate predominantly to fees charged in prior years.

The following table provides the net interest margins and spreads for the Retail division for the periods indicated.

<i>Movement in margin</i>	<i>Basis points</i>
Net interest margin for the six months ended 31 December 2007	159
Mortgages and Savings	1
Business Banking	(1)
Unsecured Lending	3
<b>Net interest margin for the six months ended 30 June 2008</b>	<b>162</b>

*Margins and Spreads.* The increased marginal cost of new deposit flows reduced the Savings spread but this was more than offset by an improvement in the Mortgage spread. The HBOS Group increased the pricing on both acquisition and retention business to cover the increased cost of funds and to manage asset growth within our planned range. Approximately one-third of the mortgage portfolio is expected to re-price in 2008 due to new lending and the transfer of existing customers from maturing fixed and introductory rates to new products or to the standard variable rate. The spread on unsecured products increased by 3bps reflecting improved pricing.

*Operating Expenses.* Underlying operating expenses remained stable in the first half of 2008 at £1,056 million (as compared to £1,053 million in the first half of 2007). The underlying cost:income ratio in the first half of 2008 remained broadly unchanged at 38.9% (as compared to 38.8% in the first half of 2007).

*Credit Quality and Provisions.* Total impaired loans grew in the first half of 2008 to 2.88% (as compared to 2.59% at 31 December 2007) of closing advances.

Impairment losses as an annualised percentage of average advances were unchanged at 0.57% in the first half of 2008 (as compared to the first half of 2007). Total impairment losses increased in the first half of 2008 by 6% to £722 million (as compared to £678 million in the first half of 2007), comprising £213 million (as compared to (£12) million in the first half of 2007) for secured lending and £509 million (as compared to £690 million in the first half of 2007) for unsecured lending. Provisions as a percentage of closing advances increased slightly in the first half of 2008 to 0.90% (as compared to 0.89% at 31 December 2007), and total provisions coverage of impaired loans decreased in the first half of 2008 to 31% (as compared to 34% at 31 December 2007).

*Secured Impairments.* Total impaired secured loans increased in the first half of 2008 to £5,138 million (as compared to £4,234 million at 31 December 2007), and increased to 2.16% (as compared to 1.80% at December 2007) as a percentage of closing advances. Mortgages in arrears, but not in possession, also increased to 1.95% (as compared to 1.67% at 31 December 2007) of closing advances. Both mainstream and specialist arrears increased in line with the Retail division's expectations. The Retail division takes comfort from the strength of collateral within its mortgage portfolio with the average indexed loan to value ("LTV") of the portfolio at 48% (as compared to 44% at 31 December 2007). 12% (as compared to 3.5% at 31 December 2007) of mortgages have an LTV of more than 90%, reflecting the decline in house prices. New lending during the first half of 2008 had an average LTV of 68% (as compared to 65% in 2007).

Secured provisions as a percentage of closing advances increased in the first half of 2008 to 0.21% (as compared to 0.14% at 31 December 2007). Provisions coverage of impaired loans has increased to 10% in the first half of 2008 (as compared to 8% at 31 December 2007). The average LTV of the impaired mortgage portfolio has increased to 63% (as compared to 57% at 31 December 2007). The equivalent figures for impaired mainstream and specialist mortgages were 57% (as compared to 52% at 31 December 2007) and 71% (as compared to 66% at 31 December 2007), respectively. The secured impairment charge as a percentage of average advances increased to 0.09% (as compared to (0.01)% in the first half of 2007).

*Unsecured Impairments.* Total impaired unsecured loans (personal loans, credit cards and bank accounts) decreased in the first half of 2008 to £2,222 million (as compared to £2,322 million at 31 December 2007), representing 12.28% (as compared to 13.04% at 31 December 2007) of closing advances. Provisions as a percentage of closing advances decreased to 10.06% (as compared to 10.78% at 31 December 2007), with provisions coverage as a percentage of impaired loans remaining broadly stable at 82% (as compared to 83% at 31 December 2007). Impairment losses for the period as a whole decreased by 26% to £509 million (as compared to £690 million in the first half of 2007).

*Personal Loans.* Impaired personal loans decreased to 14.4% of closing advances (as compared to 16.1% at 31 December 2007). Provisions as a percentage of closing advances decreased in the first half of 2008 to 10.7% (as compared to 12.9% at 31 December 2007).

*Credit Cards.* In the first half of 2008, credit card impairments increased to 15.6% of closing advances (as compared to 15.0% at 31 December 2007). Provisions as a percentage of closing advances increased in the first half of 2008 to 13.9% (as compared to 13.1% at 31 December 2007). Stability in overdrawn limits and utilisation levels has been maintained. Roll rates reflect tightening of controls over repayment plans.

*Bank Accounts.* In the first half of 2008, impaired loans decreased to 4.5% of closing advances (as compared to 5.0% 31 December 2007). Provisions as a percentage of closing advances decreased in the first half of 2008 to 3.7% (as compared to 4.1% at 31 December 2007).

*Business Banking.* Impaired loans were unchanged in the first half of 2008 to 6.5% of closing advances (as compared to 6.5% at 31 December 2007) and provisions as a percentage of closing advances decreased in the first half of 2008 to 3.2% (as compared to 3.6% in 2007).

The following table sets out Retail balance sheet and asset quality information at the dates indicated.

	<b>As at 30 June 2008</b>	<i>As at 31 December 2007</i>
<b>Loans and advances to customers</b>	<b>£255.8bn</b>	£253.4bn
Impairment provisions on advances	<b>£2.3bn</b>	£2.3bn
Loans and advances to customers before impairment provisions	<b>£258.1bn</b>	£255.7bn
	(%)	
<b>Classification of advances<sup>(1)</sup>:</b>		
Residential mortgages	<b>92.6</b>	92.6
Other personal lending:		
Secured Personal Loans	<b>0.3</b>	0.4
Unsecured Personal Loans	<b>3.6</b>	3.7
Credit cards	<b>2.8</b>	2.7
Banking	<b>0.7</b>	0.6
<b>Total</b>	<b>100.0</b>	100.0
<b>Analysis of residential mortgages:</b>		
Mainstream balances	<b>72.1</b>	73.2
Specialist balances <sup>(2)</sup>	<b>27.9</b>	26.8
<b>Total</b>	<b>100.0</b>	100.0
	(%)	
<b>Loan to value analysis of residential mortgage book<sup>(3)</sup>:</b>		
Less than 60% (averaging 24%; 30 June 2007 28%)	<b>37.8</b>	46.7
60% to 70%	<b>14.5</b>	18.2
70% to 80%	<b>17.8</b>	18.3
80% to 90%	<b>17.9</b>	13.3
Greater than 90%	<b>12.0</b>	3.5
<b>Total</b>	<b>100.0</b>	100.0
	(%)	
<b>Average loan to value<sup>(3)</sup>:</b>		
Stock of residential mortgages	<b>48</b>	44
New residential lending	<b>68</b>	65
Impaired mortgages	<b>63</b>	57

	<b>As at 30 June 2008</b>	<i>As at 31 December 2007</i>
	(£m)	
<b>Impairment provisions on advances</b>		
Secured	490	330
Unsecured	1,820	1,919
<b>Total</b>	<b>2,310</b>	2,249
	(%)	
<b>Impairment provisions as a % of closing advances</b>		
Secured	0.21	0.14
Unsecured	10.06	10.78
<b>Total</b>	<b>0.90</b>	0.89
	(%)	
<b>Impairment provisions as a % of impaired loans</b>		
Secured	10	8
Unsecured	82	83
<b>Total</b>	<b>31</b>	34
	(£m)	
<b>Impaired loans<sup>(1)</sup></b>		
Secured	5,138	4,234
Unsecured	2,222	2,322
<b>Total</b>	<b>7,360</b>	6,556
	(%)	
<b>Impaired loans as a % of closing advances</b>		
Secured	2.16	1.80
Unsecured	12.28	13.04
<b>Total</b>	<b>2.88</b>	2.59
<b>Risk weighted assets (Basel II)</b>	<b>£71.5bn</b>	£67.9bn
<b>Customer deposits</b>	<b>£160.0bn</b>	£158.3bn

(1) Before impairment provisions.

(2) Comprising predominantly buy to let and self certified mortgages.

(3) LTV analysis is based on indexed valuation for stock and valuation at inception for new loans

#### *Operational Performance (Retail)*

**Mortgages.** The UK mortgage market gross lending in the first half of 2008 is estimated at £151 billion (as compared to £178 billion in the first half of 2007), 15% lower than the same period last year.

The HBOS Group's estimated gross share of the UK mortgage market in the first half of the year was 19% (as compared to 19% in the first half of 2007). The HBOS Group's stock of mortgage assets in the UK as at 30 June 2008 was £237 billion (as compared to £235 billion at 31 December 2007). The quality of the portfolio remained strong, as evidenced by stability in the LTV of new business at 68% (as compared to 65% at 31 December 2007) and the overall book at 48% (as compared to 44% at 31 December 2007).

**Unsecured Personal Loans.** Gross lending in the unsecured personal loan market has shown an 8% contraction year-on-year. In this environment the HBOS Group has continued the cautious approach adopted in recent years and have selectively tightened risk criteria, focusing on existing

customers with known behaviour, credit history and other product relationships. Balances in the first half of 2008 have reduced by 3% to £6.4 billion (as compared to £6.6 billion at 31 December 2007), with the HBOS Group's market share of stock remaining at 10%.

*Credit Cards.* In the first half of 2008, the Retail division continued to focus on the acquisition of higher quality credit card business and acquired 324,000 new credit card accounts (396,000 including those acquired through the HBOS Group's JV partners), resulting in an estimated market share of 12% of new accounts in the UK. Total cardholder balances outstanding reduced by 1% in the first half of 2008 to £6.7 billion (as compared to £6.8 billion at 31 December 2007).

*Customer Deposits.* The first half of 2008 saw growth in deposits reflecting the strength of the HBOS Group's savings franchise. Deposits increased by 6% to £160.0 billion (as compared to £151.3 billion in the first half of 2007).

*Retail Savings.* Despite the strong competition throughout the first half of 2008, the HBOS Group's market leading position with an estimated share of Household Sector Liquid Assets of 15.4% (as compared to 15.6% at 31 December 2007).

*Bank Accounts.* The Ultimate Reward Current Account, launched in 2007 offering a package of benefits in return for a monthly fee, now accounts for 4% of the HBOS Group's full facilities current account stock. In the first half of 2008, the HBOS Group acquired 478,000 new accounts (as compared to 516,000 in the first half of 2007), of which 77% were full facilities (consistent with the first half of 2007). In the first half of 2008, the HBOS Group had an estimated market share of new current accounts in the UK of 21% (as compared to 24% in the first half of 2007).

*Business Banking.* The HBOS Group seeks to attract better quality business banking customers from the competition. During the first half of 2008, some 7,350 SME businesses (as compared to 7,300 in the first half of 2007) switched to the HBOS Group's services. This quality business has contributed in the first half of 2008 to a 6% increase in income.

### **Corporate**

Underlying profit before tax in the Corporate division decreased in the first half of 2008 by 39% to £753 million (as compared to £1,243 million in the first half of 2007). This was primarily driven by a decrease in non-interest income, partially offset by higher net interest income, and increased impairment losses on loans and advances. Underlying non-interest income having decreased in the first half of 2008 by 47% to £486 million (as compared to £922 million in the first half of 2007). Underlying operating expenses decreased in 2008 by 7%, resulting in a weakened underlying cost:income ratio of 24.8% (as compared to 22.8% in the first half of 2007).

*Underlying Financial Performance (Corporate)*

The following table sets out the Corporate income statement for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m, except %)</i>	
Underlying net interest income	<b>1,140</b>	992
Underlying non-interest income	<b>486</b>	922
Commitment fees	<b>46</b>	29
Guarantee fees	<b>16</b>	12
International fees	<b>8</b>	8
Transaction fees	<b>30</b>	30
Underwriting fees	<b>24</b>	87
Other	<b>87</b>	77
Fees and commission income	<b>211</b>	243
Fees and commission expense	<b>(13)</b>	(17)
Profit on sale of investment securities	<b>88</b>	253
Operating lease rental income	<b>659</b>	646
Other operating income	<b>225</b>	187
Share of (losses)/profits of associates and jointly controlled entities	<b>(34)</b>	108
Operating lease depreciation	<b>(505)</b>	(493)
Impairment on investment securities	<b>(145)</b>	(5)
<b>Underlying net operating income</b>	<b>1,626</b>	1,914
<b>Underlying operating expenses</b>	<b>(404)</b>	(436)
Staff	<b>(209)</b>	(259)
Accommodation, repairs and maintenance	<b>(2)</b>	(3)
Technology	<b>(9)</b>	(8)
Marketing and communication	<b>(16)</b>	(16)
Depreciation:		
Property and equipment and intangible assets	<b>(23)</b>	(23)
Other	<b>(67)</b>	(52)
Sub total	<b>(326)</b>	(361)
Recharges:		
Technology	<b>(25)</b>	(26)
Accommodation	<b>(30)</b>	(27)
Other shared services	<b>(23)</b>	(22)
<b>Underlying operating profit before provisions</b>	<b>1,222</b>	1,478
Impairment losses on loans and advances	<b>(469)</b>	(235)
<b>Underlying profit before tax</b>	<b>753</b>	1,243
Net interest margin	<b>1.96%</b>	2.12%
Impairment losses as an annualised % of average advances	<b>0.83%</b>	0.51%
Cost: income ratio	<b>24.8%</b>	22.8%

*Underlying operating income and margins*

Underlying net operating income decreased in the first half of 2008 by 15% to £1,626 million (as compared to £1,914 million in the first half of 2007). Underlying net interest income increased in the first half of 2008 by 15% to £1,140 million (as compared to £992 million in the first half of 2007) and underlying non-interest income decreased in the first half of 2008 by 47% to £486 million (as compared to £922 million in the first half of 2007). The net underlying interest margin narrowed in the first half of 2008 primarily due to slower churn of the back book, impacting the timing of fee recognition and higher funding costs.

Net fees and commission income decreased in the first half of 2008 by 12% to £198 million (as compared to £226 million in the first half of 2007) mainly arising from lower underwriting fees.

Revenues from the Corporate investment portfolio (*i.e.*, profit on the sale of investment securities, other operating income, share of profits of associates and jointly controlled entities, less impairment on investment securities) decreased in the first half of 2008 to £134 million (as compared to £543 million in the first half of 2007). As at 30 June 2008, the book value of the investment portfolio had increased by 17% to £4.9 billion (as compared to £4.2 billion at 30 June 2007) and unrealised gains in the investment portfolio, taken through equity in the Available For Sale reserve, remain broadly unchanged from the end of the year.

*Operating Expenses.* Underlying operating expenses decreased in the first half of 2008 by 7% to £404 million (as compared to £436 million in the first half of 2007), reflecting lower levels of performance based remuneration. The Corporate division's underlying cost:income ratio has weakened to 24.8% (as compared to 22.8% in the first half of 2007).

*Credit Quality and Provisions.* Impaired loans with loss as a percentage of closing advances increased in the first half of 2008 to 1.82% (as compared to 1.39% in the second half of 2007) reflecting the current economic slowdown. Impairment losses increased in the first half of 2008 to £469 million (as compared to £235 million in the first half of 2007) and as an annualised percentage of average advances moved to 0.83% (as compared to 0.51% in the first half of 2007, 0.71% in the second half of 2007). Impairment provisions as a percentage of impaired loans reduced to 44% (as compared to 53% as at 31 December 2007).

Credit conditions are deteriorating as the economic environment weakens. In terms of commercial property investment, lending to this sector is based primarily on the quality and diversity of tenant covenants and cashflows and the HBOS Group has limited evidence to date of rising tenant defaults. However, in respect of its traditional commercial lending, the HBOS Group is now seeing some signs of the slowdown impacting its customers, which has led to increased impairment losses.

The following table sets out Corporate balance sheet and asset quality information as at the dates indicated.

	<b>As at 30 June 2008</b>	<i>As at 31 December 2007</i>
Loans and advances to customers	<b>£116.9bn</b>	£109.3bn
Impairment provisions on advances	<b>£0.9bn</b>	£0.8bn
Loans and advances to customers before impairment provisions	<b>£117.8bn</b>	£110.1bn
	(%)	
<b>Classification of advances<sup>(1)</sup>:</b>		
Agriculture, forestry and fishing	<b>1</b>	1
Energy	<b>2</b>	2
Manufacturing industry	<b>4</b>	4
Construction and property:		
Property investment	<b>20</b>	19
Property development	<b>7</b>	6
Housing associations	<b>3</b>	3
Housebuilders	<b>3</b>	3
Other property	<b>7</b>	6
Hotels, restaurants and wholesale and retail trade	<b>11</b>	11
Transport, storage and communication	<b>6</b>	6
Financial	<b>5</b>	5
Other services	<b>11</b>	13
Individuals	<b>2</b>	2
Non-UK residents	<b>18</b>	19
	<b>100</b>	100

	<b>As at 30 June 2008</b>	<i>As at 31 December 2007</i>
<b>Impaired loans<sup>(1)</sup></b>		
Impaired loans no loss <sup>(2)</sup>	£1,905m	£1,648m
Impaired loans with loss	£2,131m	£1,517m
	<b>£4,036m</b>	<b>£3,165m</b>
<b>Impaired loans with loss as a % of closing advances</b>	<b>1.82%</b>	1.39%
<b>Impairment provisions</b>	<b>£941m</b>	£802m
<b>Impairment provisions as a % of closing advances</b>	<b>0.80%</b>	0.73%
<b>Impairment provisions as a % of impaired loans with loss</b>	<b>44%</b>	53%
<b>Risk weighted assets (Basel II)</b>	<b>£172.4bn</b>	£163.4bn
<b>Customer deposits</b>	<b>£44.7bn</b>	£44.1bn

(1) Before impairment provisions.

(2) Loans categorised as impaired no loss represent loans that have been individually assessed as having impairment characteristics but where HBOS expects, after taking into consideration collateral and other credit enhancements, full recovery of both interest and capital. As HBOS has progressed its Basel II project, it has refined the categorisation of assets reflected in the year on year increase.

### *Operational Performance (Corporate)*

*Real Estate.* In the first half of 2008, Real Estate continued to account for 29% (as compared to the second half of 2007) of the Corporate division's advances to customers and operates mainly in the property investment, property development and house building sectors. As a consequence of weakening UK property values as an asset class in 2008, Real Estate has been very selective when considering new business, focusing primarily on long standing proven relationships. The Corporate division's commercial real estate exposure is underwritten primarily against the quality of the tenant covenant, which includes strong underlying cash flows of the businesses to which the Corporate division have lent, and in addition are secured on the value of good collateral. Business was well spread across the UK and lending margins continued to improve.

*Commercial.* Commercial is the Corporate division's traditional lending business, which accounted in the first half of 2008 for 23% (as compared to 24% as at 31 December 2007) of the Corporate division's advances to customers. It is principally focused on relationship banking for UK businesses with annual turnover greater than £1 million. During the first half of 2008, Commercial continued to focus on building full banking relationships, supported by the launch of a series of innovative and competitive banking products which serve as a key differentiator in the market place.

*Specialised Industry Finance.* In the first half of 2008, Specialised Industry Finance ("SIF") (formerly Infrastructure, Housing and Oil & Gas) continued to account for 16% (as compared to the second half of 2007) of advances to customers. SIF consists of the following five discrete asset classes: Housing Finance, Infrastructure Finance, Energy, Telecoms & Media and Transport. Despite a difficult market environment, these asset classes performed well throughout the first half of 2008. Critical to this success was the Corporate division's ability to deliver bespoke products from a dedicated team of professionals who have experience in the industry.

*Joint Ventures.* In the first half of 2008, Joint Ventures accounted for 14% (as compared to 13% in the second half of 2007) of the Corporate division's advances to customers. Some 70% of this portfolio related to transactions with UK based associate and joint venture companies and with the remaining 30% relating to European companies. The underlying industry sectors are predominately property based and include housebuilders and hotels. For the first half of 2008, the trading and credit performance were impacted by underlying economic conditions. Property exposures continue to see no notable deterioration in occupancy rates either in the UK or Continental Europe.

*Integrated, Structured & Acquisition Finance.* Integrated, Structured & Acquisition Finance ("ISAF"), which provides debt for buy-outs across the UK and continental Europe, in the first half of 2008 accounted for 13% (as compared to 12% for the second half of 2007) of the Corporate division's advances to customers. In the first half of 2008 has been characterised by much reduced deal volumes across the private equity community and in this environment the Corporate division



adopted a cautious approach and continued to support key private equity house customers with strong track records, in selected transactions. As a result, the Corporate division's ISAF business remained strong in the first half of 2008 with drawn leveraged buy-out portfolio of £7.1 billion (as compared to £6.0 billion as at 31 December 2007).

*Asset Solutions.* Asset Solutions (formerly Asset & Motor Finance) accounted in the first half of 2008 for 5% (as compared to 6% in the second half of 2007) of the Corporate division's advances to customers. Asset Solutions focuses on a number of defined market sectors, including consumer point of sale, contract hire, public sector and specialist leasing.

The dislocation in world wide financial markets is expected to continue to shape UK and European markets and reduce the supply of credit. Corporate have adopted a cautious approach to lending and as a result, asset growth is now being slowed. In the current climate the recent focus has been on increasing margins to generate an improved return on capital.

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

Underlying profit before tax in the Insurance & Investment division increased in the first half of 2008 by 27% to £402 million (as compared to £316 million in the first half of 2007). General Insurance underlying profit before tax increased in the first half of 2008 by 64% to £176 million (as compared to £107 million in the first half of 2007), in part, reflecting the flood claims in the first half of 2007. Investment underlying profit before tax increased in the first half of 2008 by 8% to £226 million (as compared to £209 million in the first half of 2007).

On a full Embedded Value ("**EV**") basis, underlying profit before tax in Insurance & Investment increased by 15% to £518 million in the first half of 2008 (as compared to £452 million in the first half of 2007), £116 million (as compared to £136 million in the first half of 2007) higher than reported under IFRS. Full EV balance sheet embedded value, net of tax for the UK Investment Business, was £6,845 million as at 30 June 2008 (as compared to £6,794 million as at 31 December 2007) and was £2,641 million (as compared to £2,724 million as at 31 December 2007) higher than reported under IFRS. In the first half of 2008, Insurance & Investment contributed £365 million to the capital position of the HBOS Group through dividend payments.

As measured on a PVNBP basis, investment sales fell in the first half of 2008 by 5% to £7,201 million (as compared to £7,574 million in the first half of 2007). However, net fund inflows increased in the first half of 2008 by 33% to £1.2 billion, as a result of reductions in the level of lapses. General Insurance sales in the first half of 2008 increased 3% to £892 million as measured by gross written premiums ("**GWP**") (as compared to £868 million in the first half of 2007).

### Underlying Financial Performance (Insurance & Investment)

The following table sets out the Insurance & Investment income statement for the periods indicated.

	Six months ended 30 June	
	2008	2007
	(£m)	
Net interest income	(52)	(50)
Underlying non-interest income	910	775
Fees and commission income	(12)	30
Fees and commission expense	(390)	(412)
Change in value of in-force long term assurance business	201	124
Net income from long term business	555	549
Investment earnings on surplus assets attributable to shareholders using long term assumptions	68	54
Net earned premiums on General Insurance ("GI") contracts	578	631
Net GI claims incurred and net change in GI contract liabilities	(147)	(246)
Investment and other operating income in GI	41	42
Share of profits of associates and jointly controlled entities	16	3
<b>Underlying net operating income</b>	<b>858</b>	<b>725</b>
<b>Underlying operating expenses</b>	<b>(456)</b>	<b>(409)</b>
Staff	(199)	(179)
Accommodation, repairs and maintenance	(10)	(10)
Technology	(17)	(19)
Marketing and communication	(73)	(23)
Depreciation: Property and equipment and intangible assets	(24)	(29)
Other	(85)	(95)
Sub total	(408)	(355)
Recharges:		
Technology	(20)	(23)
Accommodation	(18)	(18)
Other shared services	(10)	(13)
<b>Underlying profit before tax (IFRS basis)</b>	<b>402</b>	<b>316</b>
Additional contribution from new business	218	255
Lower contribution from existing business	(102)	(123)
Additional investment earnings on net assets		4
Increase in underlying profit before tax	116	136
<b>Underlying profit before tax (Full EV basis)</b>	<b>518</b>	<b>452</b>

### General Insurance Business

General Insurance profit increased in the first half of 2008 by 64% to £176 million (as compared to £107 million in the first half of 2007), which was largely due to strong growth in Household Insurance profit driven by higher sales, robust claims management and lower weather related claims, offset in part by additional marketing spend in the HBOS Group's Motor business to drive sales momentum.

Underlying non-interest income, net of claims costs, increased 69% in the first half of 2008 to £283 million (as compared to £167 million in the first half of 2007) with income in the first half of 2007 reduced by the cost of the June floods. Underlying operating expenses increased in the first half of 2008 by 65% to £117 million (as compared to £71 million in the first half of 2007), largely reflecting additional investments made in marketing and sales resources related to the HBOS Group's Motor business.

General Insurance sales, as measured by GWP, increased in the first half of 2008 by 3% to £892 million (as compared to £868 million in the first half of 2007). Despite strong performances in the first half of 2008 by Motor (up 43% as compared to the first half of 2007) and Household (up 7% as compared to the first half of 2007), these gains were partially offset by lower sales in Repayment Insurance (down 13% as compared to the first half of 2007).

The following table sets out the General Insurance Business income statement for the periods indicated.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	(£m)	
Net interest income	<b>10</b>	11
Underlying non-interest income	<b>283</b>	167
Fees and commission income	<b>19</b>	21
Fees and commission expense	<b>(224)</b>	(288)
Net earned premiums on General Insurance contracts	<b>578</b>	631
Change in value of in-force long term assurance business		4
Investment and other operating income	<b>41</b>	42
Net claims incurred	<b>(190)</b>	(277)
Net change in insurance contract liabilities	<b>43</b>	31
Share of profits of associates and jointly controlled entities	<b>16</b>	3
<b>Underlying net operating income</b>	<b>293</b>	178
<b>Underlying operating expenses</b>	<b>(117)</b>	(71)
<b>Underlying profit before tax</b>	<b>176</b>	107

The following table sets out the General Insurance Sales – gross written premiums for the periods indicated.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	(£m)	
Household	<b>277</b>	260
Repayment: 1st Party	<b>233</b>	254
Repayment: 3rd Party	<b>149</b>	186
Motor	<b>218</b>	152
Other	<b>15</b>	16
<b>Total</b>	<b>892</b>	868

*Household Insurance.* The Insurance & Investment division places a strategic priority on growing its share of the household insurance market. Accordingly, the Insurance & Investment division increased its investment in sales and marketing activity to raise product and brand awareness. Growth in sales and a focus on retention at renewal has seen the Insurance & Investment division's stock of policies increase to 3.0 million (as compared to 2.7 million in the first half of 2007).

Despite pricing pressures resulting from competitive market conditions, GWP grew in the first half of 2008 by 7% to £277 million (as compared to £260 million in the first half of 2007), reflecting strong premium growth from the HBOS Group's retail network, with GWP up 17% to £92 million and GWP sold through the telephone and internet up 12% to £80 million.

The Household Insurance loss ratio fell in the first half of 2008 to 46% (as compared to 52% in the first half of 2007), reflecting favourable claims experience and the HBOS Group's efficient claims management approach.

*Repayment Insurance.* Sales of Repayment Insurance fell in the first half of 2008 by 13% to £382 million GWP (as compared to £440 million in the first half of 2007), with sales to HBOS Group customers falling by 8% to £233 million (as compared to £254 million in the first half of 2007).

In February 2007, the OFT announced its decision to refer Payment Protection Insurance (“PPI”) to the Competition Commission (“CC”). The statutory deadline for the CC’s investigation is 6 February 2009, but the CC has stated that it intends to publish its final report in December 2008. On 5 June 2008, the CC published its “Provisional Findings”. The CC has provisionally found a number of features of the PPI market that give rise to an “adverse effect on competition” and has published a list of remedies to address this.

The Competition Commission has therefore also considered what remedies should be adopted to regulate the future supply of PPI and, on 13 November 2008, published for consultation its provisional decision on remedies. The Competition Commission’s proposed package of remedies includes (i) a prohibition on the sale of PPI by a distributor to a customer within 14 days of the distributor selling credit to that customer (although the customer would be able proactively to contact the distributor and purchase a PPI policy 24 hours after the credit sale); (ii) a requirement on credit providers to provide a ‘personal PPI quote’ to customers; (iii) a requirement on PPI providers to provide certain information and messages in PPI marketing materials, and a requirement on distributors to advertise PPI on personal loans and second-charge mortgages in close proximity to their personal loan advertisements; (iv) a requirement on PPI providers to provide certain information on PPI policies to the FSA and a recommendation to the FSA that it uses this information for its PPI price comparison tables; (v) a requirement that distributors of PPI should provide an annual statement to customers; and (vi) a prohibition on the sale of single premium PPI policies.

The Competition Commission has invited comments on the proposed remedies. The Competition Commission expects to issue its final report in mid-January 2009. Its final report will include its decision on the remedy measures to be introduced.

On 30 September 2008, the FSA published a statement arising from its ongoing thematic review of PPI sales. In the statement, which was directed at the industry generally, the FSA highlighted certain concerns and indicated that it was escalating its regulatory intervention and considering appropriate action to deal with on-going non-compliant sales practices and to remedy non-compliant past sales. The FSA plans to publish an update on the third phase of the thematic work in the first quarter of 2009. The ultimate impact on the HBOS Group and, after the Effective Date, the Enlarged Group can only be known at the conclusion of the Competition Commission’s investigations and the FSA’s review, respectively.

The HBOS Group considers that many of the remedies will improve customer searching and facilitate customer switching, but that some, if ultimately adopted, could result in lower levels of protection for UK consumers. The findings are provisional and the ultimate remedies and impacts are unknown and may change.

The HBOS Group will continue to work constructively with the CC to demonstrate the value of PPI products; specifically, to highlight the importance of being able to offer customers appropriate insurance products at a time when they are taking on increasing financial commitments and the unintended consequences on the market and customers arising from some of the potential remedies.

*Motor.* Sales of Motor Insurance, predominantly under the HBOS Group’s joint venture esure brand, increased in the first half of 2008 by 43% to £218 million GWP (as compared to £152 million in the first half of 2007). This performance reflects the strength of the brand portfolio, supported by the additional spend which will fund incremental marketing and new business activity in 2008 and 2009. An increasing proportion of sales across the industry are through the internet, which provides significant opportunities given the Insurances and Investments Divisions strength in this channel.

#### *Investment Business*

Underlying profit before tax in the Investment Business increased in the first half of 2008 by 8% to £226 million (as compared to £209 million in the first half of 2007), largely due to an increasing contribution from the growing in-force book. On a Full EV basis, underlying profit fell slightly in the first half of 2008 to £342 million (as compared to £345 million in the first half of 2007).

Underlying net operating income increased in the first half of 2008 by 3% to £565 million (as compared to £547 million in the first half of 2007), while underlying operating expenses remained stable in the first half of 2008 at £339 million (as compared to £338 million in the first half of 2007).

New business margins decreased in the first half of 2008 to 3.0% (as compared to 3.5% in the first half of 2007) of PVNBP (calculated as new single premiums plus the expected present value of new annual premiums).

The following table sets out the Investment Business income statement for the periods indicated.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	( <i>£m</i> )	
Net interest expense	<b>(62)</b>	(61)
Debt financing costs	<b>(66)</b>	(64)
Other net interest income	<b>4</b>	3
Underlying non-interest income	<b>627</b>	608
Fees and commission income	<b>(31)</b>	9
Fees and commission expense	<b>(166)</b>	(124)
Change in value of in-force long term assurance business	<b>201</b>	120
Net income from long term business	<b>555</b>	549
Investment earnings on surplus assets attributable to shareholders using long term assumptions	<b>68</b>	54
<b>Underlying net operating income</b>	<b>565</b>	547
<b>Underlying operating expenses</b>	<b>(339)</b>	(338)
Core operating expenses	<b>(289)</b>	(276)
Development expenditure	<b>(30)</b>	(38)
Overheads associated with development activity	<b>(20)</b>	(24)
<b>Underlying profit before tax (IFRS basis)</b>	<b>226</b>	209
Additional contribution from new business	<b>218</b>	255
Lower contribution from existing business	<b>(102)</b>	(123)
Additional investment earnings on net assets	<b>116</b>	4
Increase in underlying profit before tax	<b>116</b>	136
<b>Underlying profit before tax (Full EV basis)</b>	<b>342</b>	345

Under IFRS, insurance contracts (*i.e.*, investment business which carries significant insurance risk as well as 'with-profit' contracts) are accounted for on an EV basis, whereas investment contracts (*i.e.*, investment business which does not carry significant insurance risk) are accounted for under IAS 39. Consequently, on an IFRS basis, the income statement incorporates two very different profit recognition patterns depending on the nature of the contract.

The table below sets out the profit contribution from each type of contract.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	( <i>£m</i> )	
Contribution from insurance contracts	<b>322</b>	306
Contribution from investment contracts	<b>20</b>	29
Development expenditure	<b>(30)</b>	(38)
Overheads associated with development activity	<b>(20)</b>	(24)
Debt financing cost	<b>(66)</b>	(64)
<b>Underlying profit before tax</b>	<b>226</b>	209

*Insurance Contracts (accounted for on an EV basis).* The contribution from insurance contracts increased in the first half of 2008 by 5% to £322 million (as compared to £306 million in 2007). The contribution from new business decreased in the first half of 2008 by 28% to £103 million (as compared to £142 million in the first half of 2007), reflecting lower sales of bonds through the Bancassurance channel. The contribution from existing business increased in the first half of 2008 by 37% to £151 million (as compared to £110 million in the first half of 2007). Actual vs. expected experience in the first half of 2008 was £72 million (as compared to £34 million in the first half of 2007), including an element of accelerated profit benefit arising from enhancements to the HBOS Group's intermediary bond proposition, which has resulted in these contracts being transferred from investment contracts to insurance contracts.

The following table sets out the contribution from insurance contracts for the periods indicated.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	2007
	(£m)	
Contribution from existing business:		
Expected contribution	<b>79</b>	76
Actual vs. expected experience	<b>72</b>	34
	<b>151</b>	110
Contribution from new business	<b>103</b>	142
Investment earnings on surplus assets attributable to shareholders using long term assumptions	<b>68</b>	54
<b>Contribution from insurance contracts</b>	<b>322</b>	306

*Investment Contracts (accounted for on an IAS 39 basis).* Under IAS 39, profit recognition on investment contracts is deferred to later years, whereas a loss is typically recorded in the year of sale. The emergence of profit from the HBOS Group's in-force book exceeded new business strain in the first half of 2008, resulting in a net positive contribution from investment contracts of £20 million (as compared to £29 million in 2007). The contribution from existing business fell in the first half of 2008 by 5% to £146 million (as compared to £153 million in 2007), reflecting lower investment market levels which result in lower annual management charges, and the impact of transferring certain bond business to insurance contracts.

The following table sets out the contribution from investment contracts for the periods indicated.

	<i>Six months ended</i> <i>30 June</i>	
	<b>2008</b>	2007
	(£m)	
Contribution from existing business	<b>146</b>	153
Contribution from new business	<b>(126)</b>	(124)
<b>Contribution from investment contracts</b>	<b>20</b>	29

*Operational Performance.* Most Life Assurers have moved their primary reporting basis for sales away from the historic APE measure and are using the PVNBP measure, which is thought to better illustrate the volume of new business.

Investment sales measured by PVNBP decreased in the first half of 2008 by 5% to £7,201 million (as compared to £7,574 million in the first half of 2007), reflecting a fall in Bancassurance sales, down 18% to £3,070 million (as compared to £3,735 million in the first half of 2007), which was partially offset by a 13% increase in Intermediary (£2,283 million compared to £2,012 million in the first half of 2007) and an increase in Wealth Management of 1% to £1,848 million (as compared to £1,827 million in the first half of 2007).

The following table sets out investment sales for the periods indicated.

	<i>Six months ended 30 June</i>					
	<i>Single</i>	<i>2008 Annual</i>	<i>PVNB<sup>(1)</sup></i>	<i>Single (£m)</i>	<i>2007 Annual</i>	<i>PVNB<sup>(1)</sup></i>
Investment Bonds	2,654	5	2,696	3,394	4	3,437
Individual Pensions	1,401	122	1,945	1,393	115	1,882
HBOS Group Pensions	21	55	289	49	52	304
Annuities	185		185	167		167
Protection	2	26	106	2	23	88
Mutual Funds	1,284	167	1,980	945	144	1,696
<b>Total (excluding GGB)</b>	<b>5,547</b>	<b>375</b>	<b>7,201</b>	<b>5,950</b>	<b>338</b>	<b>7,574</b>
Guaranteed Growth Bonds ("GGB")				707		707
<b>Total (including GGB)</b>	<b>5,547</b>	<b>375</b>	<b>7,201</b>	<b>6,657</b>	<b>338</b>	<b>8,281</b>
Bancassurance	2,083	220	3,070	2,753	193	3,735
Intermediary	1,803	100	2,283	1,528	99	2,012
Wealth Management	1,661	55	1,848	1,669	46	1,827
<b>Total (excluding GGB)</b>	<b>5,547</b>	<b>375</b>	<b>7,201</b>	<b>5,950</b>	<b>338</b>	<b>7,574</b>
Insurance Contracts	2,145	32	2,280	2,238	31	2,385
Investment Contracts	3,402	343	4,921	3,712	307	5,189
<b>Total (excluding GGB)</b>	<b>5,547</b>	<b>375</b>	<b>7,201</b>	<b>5,950</b>	<b>338</b>	<b>7,574</b>

(1) PVNB<sup>(1)</sup> is the present value of new business premiums. It equals new single premiums plus the expected present value of new annual premiums.

*Movement in Assets Under Management.* Assets under management fell in the first half of 2008 by 6% to £77.0 billion with net fund flows up 33% to £1.2 billion (as compared to £0.9 billion in the first half of 2007). Premiums decreased by 6% to £6.1 billion (as compared to £6.5 billion in the first half of 2007). Lapse rates improved to 10% as the absolute level of lapses reduced. In addition, market uncertainty has continued to create upward pressure in terms of surrender activity and the overall reduction in lapse levels reflects the success of the HBOS Group's retention initiatives.

The table below sets out the movement in assets under management for the periods indicated.

	<i>Six months ended 30 June</i>	
	<i>2008</i>	<i>2007</i>
	<i>(£bn, except %)</i>	
<b>Opening assets under management<sup>(1)</sup></b>	<b>82.2</b>	77.4
Premiums (new and existing business)	6.1	6.5
Maturities and claims	(0.8)	(0.9)
Lapses (i.e. surrenders and repurchases)	(4.1)	(4.7)
Net inflow of business	1.2	0.9
Investment return (net of charges)	(6.4)	2.1
(Decrease)/increase in assets under management	(5.2)	3.0
<b>Closing assets under management</b>	<b>77.0</b>	80.4
Lapse rate (i.e. lapses as % of average assets)	<b>10%</b>	12%

(1) Opening assets under management have been adjusted to exclude the impacts of GGB business.

*Bancassurance.* Sales through the Bancassurance channel fell in the first half of 2008 by 18% to £3,070 million PVNBP (as compared to £3,735 million in the first half of 2007), due to lower lapses in 2008. New business margins have remained strong in the first half of 2008 at 3.9% of PVNBP (as compared to 4.1% in the first half of 2007), reflecting the efficiency of the division's distribution model.

Recently the Insurance & Investment division has observed increased competition for quality advisers in the market. The strength of the Insurance & Investment division's customer proposition, however, as well as the support it provides to advisers, has allowed the Insurance & Investment division to increase both adviser numbers and maintain market-leading levels of productivity. Branch-based Personal Financial Advisers increased in the first half of 2008 by 3% to 1,041 (as compared to 1,007 at 31 December 2007) whilst the number of BoSIS Client Managers grew to 318 (up 13% as compared to the first half of 2007).

The FSA announced a review of Retail Distribution in June 2006 and, following discussions with stakeholders, published a Discussion Paper in June 2007, followed by an Interim Report in April 2008. The FSA is continuing to develop its thinking in this area in consultation with all relevant stakeholders. Publication of the final report is expected by the end of November 2008 and this will be followed by a period of consultation before any changes to regulation are proposed. No assessment of the ultimate potential outcome for the HBOS Group is possible at this time.

*Intermediary.* The intermediary channel has performed strongly in the first half of 2008 and new business sales grew by 13% to £2,283 million PVNBP (as compared to £2,012 million in the first half of 2007). The HBOS Group has a number of initiatives underway which will improve margins and returns on capital in this channel although these initiatives have yet to affect new business margins which fell to 0.9% PVNBP (as compared to 1.3% in the first half of 2007). The fall in new business margins reflects changes in business mix and case size in respect of pensions business.

*Wealth Management.* Sales at St. James's Place ("SJP") have continued to grow, increasing in the first half of 2008 by 1% to £1,848 million PVNBP (as compared to £1,827 million in the first half of 2007). This follows two years of strong growth.

The HBOS Group has seen encouraging growth in the size of the SJP partnership, and partner numbers increased in the first half of 2008 by 3% to 1,291 (as compared to 1,251 at 31 December 2007). Assets under management in the first half of 2008 fell 6% to £17.2 billion (as compared to £18.2 billion in 2007) reflecting falling market values, however SJP continues to generate positive net inflows of business and retention performance remains strong.

### ***International***

Underlying profit before tax in International in the first half of 2008 was broadly in line with same period in 2007 at £323 million (as compared to £327 million in the first half of 2007).



### Underlying Financial Performance (International)

The following table sets out the International income statement for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<i>2007</i>
	<i>(£m, except %)</i>	
Net interest income	<b>670</b>	504
Underlying non-interest income	<b>215</b>	207
Fees and commission income	<b>106</b>	92
Fees and commission expense	<b>(90)</b>	(79)
Change in value of in-force long term assurance business	<b>(15)</b>	35
Net income from long term business	<b>197</b>	134
Investment earnings on surplus assets attributable to shareholders using long term assumptions	<b>2</b>	3
Operating lease rental income	<b>5</b>	8
Other operating income	<b>15</b>	19
Share of (losses)/profits and jointly controlled entities	<b>(2)</b>	2
Operating lease depreciation	<b>(3)</b>	(7)
<b>Underlying net operating income</b>	<b>885</b>	711
<b>Underlying operating expenses</b>	<b>(443)</b>	(334)
Staff	<b>(255)</b>	(183)
Accommodation, repairs and maintenance	<b>(35)</b>	(23)
Technology	<b>(27)</b>	(25)
Marketing and communication	<b>(37)</b>	(24)
Depreciation: Property and equipment and intangible assets	<b>(29)</b>	(20)
Other	<b>(58)</b>	(58)
Sub total	<b>(441)</b>	(333)
Recharges:		
Technology	<b>(2)</b>	(1)
<b>Underlying operating profit before provisions</b>	<b>442</b>	377
Impairment losses on loans and advances	<b>(119)</b>	(50)
<b>Underlying profit before tax</b>	<b>323</b>	327
Net interest margin	<b>1.84%</b>	1.95%
Impairment losses as an annualised % of average advances	<b>0.33%</b>	0.19%
Cost: income ratio	<b>50.1%</b>	47.0%

### *Australia*

Underlying profit before tax in Australia decreased in the first half of 2008 by 6% to £135 million (as compared to £144 million in the first half of 2007). Lending increased in the first half of 2008 by an annualised 39% to £39.6 billion (as compared to £33.2 billion at 31 December 2007) (annualised local currency growth of 17%) with deposits in the first half of 2008 up by an annualised 19% to £17.7 billion (as compared to £16.2 billion at 31 December 2007) (broadly in line with 2007 in local currency terms), mainly reflecting the early success of the HBOS Group's national expansion programme, which focuses on retail and commercial business.

The following table sets out the International – Australia income statement for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m, except %)</i>	
Net interest income	<b>385</b>	290
Underlying non-interest income	<b>89</b>	78
Fees and commission income	<b>83</b>	71
Fees and commission expense	<b>(11)</b>	(7)
Net income from long term business	<b>8</b>	7
Other operating income	<b>6</b>	3
Operating lease rental income	<b>3</b>	6
Operating lease depreciation	<b>(2)</b>	(3)
Share of profits of associates and jointly controlled entities	<b>2</b>	1
<b>Underlying net operating income</b>	<b>474</b>	368
<b>Underlying operating expenses</b>	<b>(264)</b>	(188)
Staff	<b>(158)</b>	(111)
Accommodation, repairs and maintenance	<b>(19)</b>	(13)
Technology	<b>(20)</b>	(18)
Marketing and communication	<b>(23)</b>	(12)
Depreciation: Property and equipment and intangible assets	<b>(14)</b>	(10)
Other	<b>(30)</b>	(24)
<b>Underlying operating profit before provisions</b>	<b>210</b>	180
Impairment losses on loans and advances	<b>(75)</b>	(36)
<b>Underlying profit before tax</b>	<b>135</b>	144
Net interest margin	<b>2.09%</b>	2.20%
Impairment losses as an annualised % of average advances	<b>0.41%</b>	0.27%
Cost: income ratio	<b>55.7%</b>	51.1%

*Operating Income and Margins.* Underlying net operating income increased in the first half of 2008 by 29% to £474 million (as compared to £368 million in the first half of 2007), reflecting growth in net interest income.

Underlying net interest income increased in the first half of 2008 by 33% to £385 million (as compared to £290 million in the first half of 2007), driven by increased asset growth with relatively stable margins, which largely reflected careful management of funding costs by the HBOS Group.

Underlying non-interest income rose in the first half of 2008 by 14% to £89 million (as compared to £78 million in the first half of 2007).

*Operating Expenses.* Underlying operating expenses increased in the first half of 2008 by 40% to £264 million (as compared to £188 million in the first half of 2007), largely as a result of the significant investment in physical distribution (particularly the initial phase of the national retail branch expansion and the roll out of business banking centres), new products, brand recognition, customer facing staff and back office infrastructure, all of which underpin the HBOS Group's future growth. In line with this investment for growth, the underlying cost:income ratio increased in the first half of 2008 to 55.7% (as compared to 51.1% in the first half of 2007).

*Credit Quality and Provisions.* Impaired loans as a percentage of closing advances have increased in the first half of 2008 to 1.40% (as compared to 1.00% at 31 December 2007), reflecting an increase in a small number of high value impaired corporate loans. Impairment provisions as a percentage of impaired loans were 34% in the first half of 2008 (as compared to 44% at 31 December 2007). Impairment losses as an annualised percentage of average advances were 0.41% in the first half of 2008 (as compared to 0.27% in the first half of 2007).

The following table sets out International – Australia balance sheet and asset quality information at the dates indicated.

	<b>As at 30 June 2008</b>	<b>As at 31 December 2007</b>
<b>Loans and advances to customers</b>	<b>£39.6bn</b>	£33.2bn
Impairment provisions on advances	<b>£0.2bn</b>	£0.1bn
Loans and advances to customers before impairment provisions	<b>£39.8bn</b>	£33.3bn
<b>Classification of advances<sup>(1)</sup>:</b>	(%)	
Agriculture, forestry and fishing	<b>3</b>	3
Energy	<b>1</b>	2
Manufacturing industry	<b>3</b>	3
Construction and property	<b>27</b>	26
Hotels, restaurants and wholesale and retail trade	<b>8</b>	8
Transport, storage and communication	<b>3</b>	3
Financial	<b>3</b>	2
Other services	<b>7</b>	8
Individuals:		
Home mortgages	<b>39</b>	39
Other personal lending	<b>4</b>	4
Non-Australian residents	<b>2</b>	2
	<b>100</b>	100
<b>Impaired loans<sup>(1)</sup></b>	<b>£554m</b>	£333m
<b>Impaired loans as a % of closing advances</b>	<b>1.40%</b>	1.00%
<b>Impairment provisions</b>	<b>£190m</b>	£147m
<b>Impairment provisions as a % of closing advances</b>	<b>0.48%</b>	0.44%
<b>Impairment provisions as a % of impaired loans</b>	<b>34%</b>	44%
<b>Risk weighted assets (Basel II)</b>	<b>£37.0bn</b>	£31.0bn
<b>Customer deposits</b>	<b>£17.7bn</b>	£16.2bn

(1) Before impairment provisions

*Operational Performance.* Significant investment in the national expansion of the HBOS Group's Australian operations continued in 2008, with a major part of this relating to Retail expansion programme launched in October 2007.

*Lending and Deposit Growth.* Lending grew in the first half of 2008 by an annualised 39% to £39.6 billion (as compared to £33.2 billion as at 31 December 2007). Growth has been driven by early success in the national expansion programme, which focuses on retail and commercial businesses. Customer deposits, which benefited from initiatives implemented two years ago, slowed as a result of stronger market competition driven by the financial market dislocation. In the first half of 2008 deposits grew by an annualised 19% to £17.7 billion, mainly reflecting the strength of the Australian dollar. In local currency terms, deposits remain broadly unchanged from 31 December 2007, but have increased by 16% since 30 June 2007.

*Retail Business.* The Australian Retail business, operating under the BankWest brand, saw sustained growth in credit cards, mortgages and deposits. Lending increased in the first half of 2008 by an annualised 42% to £13.3 billion (as compared to £11.0 billion as at 31 December 2007) and deposits increased by an annualised 29% to £7.1 billion (as compared to £6.2 billion as at 31 December 2007). Retail Business continued to grow having now opened 24 stores since the national expansion was announced in July 2007, principally in New South Wales and Victoria. In the first half of 2008 Australia's first genuine tracking mortgage product, Rate Tracker, and HBOS Australia's national banking platform, Happy Banking, were both launched with encouraging initial early results.

*Commercial Business.* The Australian commercial business Business Bank, operating under the BankWest brand, performed strongly in the first half of 2008. Lending increased in the first half of 2008 by an annualised 43% to £13.1 billion (as compared to £10.8 billion as at 31 December 2007) and deposits increased in the first half of 2008 by an annualised 12% to £10.6 billion (as compared to £10.0 billion as at 31 December 2007). Throughout the first half of 2008, the BankWest Business continued to spread its offering to more Australian businesses through its value for money products, fast and simple processes, support of highly trained staff and opening of business centres across metropolitan and regional Australia. The Australian commercial business has opened 43 business centres on the east coast of Australia, 15 of which have opened in the last 12 months.

*Corporate Business.* The Australian Corporate business, operating under the BOS International brand, had another strong year, increasing lending in the first half of 2008 by an annualised 31% to £7.5 billion (as compared to £6.5 billion as at 31 December 2007).

*Asset Finance Business.* The Australian Asset Finance business, operating under the Capital Finance brand, in the first half of 2008 increased lending by an annualised 33% to £5.7 billion (as compared to £4.9 billion as at 31 December 2007), with strong performance in core property, motor and equipment markets. Given the expected customer impact from a slowing economy, this growth was achieved while maintaining credit quality and securing higher margins from new business.

*Insurance & Investment Business.* Sales of life insurance products, as measured by GWP, continued to experience good growth, increasing in the first half of 2008 by 33%. The term life product, which continues to diversify the insurance income stream away from reliance on credit protection products, was a major contributor to this growth.

#### *Ireland*

Underlying profit before tax in Ireland increased in the first half of 2008 by 6% to £85 million (as compared to £80 million in the first half of 2007), reflecting strong growth in net interest income partially offset by high funding costs, increased operating expenses as the HBOS Group continues to grow the franchise, and an increase in impairment charges from a low base.

Lending in the first half of 2008 increased by an annualised 34% to £25.6 billion (as compared to £21.9 billion in 2007) (local currency growth of 17%) and customer deposits were in the first half of 2008 broadly flat at £7.0 billion (as compared to £7.1 billion in 2007). In local currency, deposits fell by €0.8 billion from 2007, reflecting the competitive market in Ireland.

The following table sets out International – Ireland income statement for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m, except %)</i>	
Net interest income	<b>196</b>	151
Underlying non-interest income		12
Fees and commission income	<b>8</b>	6
Operating lease rental income	<b>2</b>	5
Other operating income	<b>(5)</b>	5
Share of losses of associates and jointly controlled entities	<b>(4)</b>	
Operating lease depreciation	<b>(1)</b>	(4)
<b>Underlying net operating income</b>	<b>196</b>	163
<b>Underlying operating expenses</b>	<b>(92)</b>	(73)
Staff	<b>(50)</b>	(37)
Accommodation, repairs and maintenance	<b>(9)</b>	(7)
Technology	<b>(3)</b>	(3)
Marketing and communication	<b>(9)</b>	(8)
Depreciation: Property and equipment and intangible assets	<b>(7)</b>	(4)
Other	<b>(14)</b>	(14)
<b>Underlying operating profit before provisions</b>	<b>104</b>	90
Impairment losses on loans and advances	<b>(19)</b>	(10)
<b>Underlying profit before tax</b>	<b>85</b>	80
Net Interest Margin	<b>1.64%</b>	1.80%
Impairment losses as an annualised % of average advances	<b>0.16%</b>	0.12%
Cost:Income Ratio	<b>46.9%</b>	44.8%

*Operating Income and Margins.* Underlying net operating income grew in the first half of 2008 by 20% to £196 million (as compared to £163 million in the first half of 2007). Net interest income increased in the first half of 2008 by 30% to £196 million (as compared to £151 million in the first half of 2007), reflecting strong growth in advances, moderated by a decline in margin due to higher funding costs, slower churn in the back book impacting the timing of fee recognition and a changing asset mix as HBOS Ireland continue to grow their Retail business.

The following table sets out the movement in margin in Ireland in the first half of 2008.

	<i>Basis Points</i>
Net interest margin for the six months ended 31 December 2007	181
Increased funding costs	(10)
Fee recognition	(3)
Retail and Intermediary	(4)
<b>Net interest margin for the six months ended 30 June 2008</b>	<b>164</b>

*Operating Expenses.* Underlying operating expenses increased in the first half of 2008 by 26% to £92 million (as compared to £73 million in the first half of 2007). The HBOS Group continues to build infrastructure in Ireland, with a further two Retail branches opened in the first half of 2008 bringing the total to 42 (compared with 32 at 30 June 2007). While the HBOS Group's underlying cost:income ratio in Ireland increased in the first half of 2008 to 46.9% (as compared to 44.8% in the first half of 2007), it remains the lowest cost full service bank in the Irish market.

*Credit Quality and Provisions.* Impairment losses as an annualised percentage of average advances increased to 0.16% (as compared to 0.12% in the first half of 2007), reflecting deteriorating economic conditions and a reduction in the level of recovery in the impaired portfolio. Impaired loans as a percentage of closing advances increased in the first half of 2008 to 1.46% (as compared to 1.08% as at 31 December 2007).

The following table sets out International – Ireland balance sheet and asset quality information at the dates indicated.

	<b>As at 30 June 2008</b>	<b>As at 31 December 2007</b>
<b>Loans and advances to customers</b>	<b>£25.6bn</b>	£21.9bn
Impairment provisions on advances	<b>£0.1bn</b>	£0.1bn
Loans and advances to customers before impairment provisions	<b>£25.7bn</b>	£22.0bn
<b>Classification of advances:<sup>(1)</sup></b>	(%)	
Agriculture, forestry and fishing		1
Energy	<b>1</b>	1
Manufacturing industry	<b>3</b>	3
Construction and property	<b>28</b>	28
Hotels, restaurants and wholesale and retail trade	<b>13</b>	12
Transport, storage and communication	<b>2</b>	2
Financial	<b>2</b>	2
Other services	<b>6</b>	6
Individuals:		
Home mortgages	<b>28</b>	28
Other personal lending	<b>6</b>	6
Non-Ireland residents	<b>11</b>	11
	<b>100</b>	100
<b>Impaired loans<sup>(1)</sup></b>	<b>£375m</b>	£237m
<b>Impaired loans as a % of closing advances</b>	<b>1.46%</b>	1.08%
<b>Impairment provisions on advances</b>	<b>£161m</b>	£141m
<b>Impairment provisions as a % of closing advances</b>	<b>0.63%</b>	0.64%
<b>Impairment provisions as a % of impaired loans</b>	<b>43%</b>	59%
<b>Risk weighted assets (Basel II)</b>	<b>£21.8bn</b>	£18.5bn
<b>Customer deposits</b>	<b>£7.0bn</b>	£7.1bn

(1) Before impairment provisions

*Lending Growth.* Overall, lending grew in the first half of 2008 by an annualised 34% to £25.6 billion (as compared to £21.9 billion in 2007) (local currency growth of 17%). This was predominantly driven by increases within Business Banking lending, up 31% on an annualised basis to £17.8 billion (as compared to £15.4 billion as at 31 December 2007), supported by the regional distribution capability. Irish residential property prices continue to fall. Arrears levels have increased from historic lows but the HBOS Group remains satisfied with the quality of its residential portfolio in Ireland. The indexed LTV of the HBOS Group's mortgage book in Ireland at 30 June 2008 was 53% (as compared to 49% at 31 December 2007).

*Deposit Growth.* Deposits in the first half of 2008 were broadly flat at £7.0 billion (as compared to £7.1 billion in 2007), reflecting the strength of the Euro. In local currency, deposits fell by €0.8 billion from 2007, reflecting the competitive market in Ireland.

*Business Banking.* In the first half of 2008 the core divisions within Business Banking of Business, Property and Regional Banking all contributed a strong performance. Advances grew in the first half of 2008 by an annualised 31% to £17.8 billion (as compared to £15.4 billion as at 31 December 2007). The regional distribution capability was key to this success and Business Banking Ireland now has 11 banking centres. The declining economic environment has reduced lending opportunities, particularly in property, and also lowered the churn on the back book. Despite this Business Banking Ireland continues to write new business at higher margins and has also modified its credit appetite to ensure the strong quality of the portfolio is maintained.

*Retail.* The HBOS Group's Retail businesses (Retail branch network, Intermediary Home loans and Asset Finance) in Ireland have generated a strong performance. Retail network expansion is on

track, with 42 branches now open and a further four branches due to be opened by the end of 2008. The Retail network is expected to support growth of the Retail deposit base in the Irish market. The Halifax Current Account, which has been in operation for just over a year, has generated significant levels of new customers, demonstrating the propensity of the customer to switch to the HBOS Group when there are more competitive offerings.

#### *Europe and North America*

Underlying profit before tax in Europe and North America in the first half of 2008 remained unchanged at £103 million (as compared to £103 million in the first half of 2007).

The following table sets out International – Europe and North America income statement for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m, except %)</i>	
Net interest income	<b>89</b>	63
Underlying non-interest income	<b>126</b>	117
Fees and commission income	<b>15</b>	15
Fees and commission expense	<b>(79)</b>	(72)
Change in value of in-force long term assurance business	<b>(15)</b>	35
Net income from long term business	<b>189</b>	127
Investment earnings on surplus assets attributable to shareholders using long term assumptions	<b>2</b>	3
Other operating income	<b>14</b>	8
Share of profits of associates and jointly controlled entities		1
<b>Underlying net operating income</b>	<b>215</b>	180
<b>Underlying operating expenses</b>	<b>(87)</b>	(73)
Staff	<b>(47)</b>	(35)
Accommodation, repairs and maintenance	<b>(7)</b>	(3)
Technology	<b>(4)</b>	(4)
Marketing and communication	<b>(5)</b>	(4)
Depreciation: Property and equipment and intangible assets	<b>(8)</b>	(6)
Other	<b>(14)</b>	(20)
Sub total	<b>(85)</b>	(72)
Recharges:		
Technology	<b>(2)</b>	(1)
Accommodation		
<b>Underlying operating profit before provisions</b>	<b>128</b>	107
Impairment losses on loans and advances	<b>(25)</b>	(4)
<b>Underlying profit before tax</b>	<b>103</b>	103
Net interest margin	<b>1.46%</b>	1.47%
Impairment losses as an annualised % of average advances	<b>0.40%</b>	0.09%
Cost:income ratio	<b>40.5%</b>	40.6%

*Operating Income and Margins.* Underlying net interest income increased in the first half of 2008 by 41% to £89 million (as compared to £63 million in the first half of 2007), reflecting growth in advances to customers across the HBOS Group's corporate and retail banking businesses. The underlying net interest margin remained broadly stable at 1.46% (as compared to 1.47% in the second half of 2007).

Underlying non-interest income increased in the first half of 2008 by 8% to £126 million (as compared to £117 million in the first half of 2007), primarily driven by activity in the US, with increased fee and commission income and realisations.

*Operating Expenses.* Underlying operating expenses increased in the first half of 2008 by 19% to £87 million (as compared to £73 million in the first half of 2007). This increase reflects continued targeted investment to expand the product range and distribution channels and adapting to legislative changes in key markets such as Germany. The underlying cost:income ratio remained stable in the first half of 2008 at 40.5% (as compared to 40.6% in the first half of 2007).

*Credit Quality and Provisions.* Impaired loans as a percentage of closing advances increased from historically low levels in the first half of 2008 to 2.36% (as compared to 0.59% at 31 December 2007) due to a small number of impaired corporate credit exposures. Impairment losses as a percentage of average advances also increased from a low base to 0.40% in the first half of 2008 (as compared to 0.09% in the first half of 2007), while impairment provisions as a percentage of impaired loans were lower in the first half of 2008 at 18% (as compared to 48% at 31 December 2007).

The following table sets out International – Europe and North America balance sheet and asset quality information for the periods indicated.

	<b>As at 30 June 2008</b>	<b>As at 31 December 2007</b>
<b>Loans and advances to customers</b>	<b>£13.3bn</b>	£12.0bn
Impairment provisions on advances	<b>£0.1bn</b>	
Loans and advances to customers before impairment provisions	<b>£13.4bn</b>	£12.0bn
<b>Classification of advances<sup>(1)</sup>:</b>	<b>(%)</b>	
Energy	<b>7</b>	7
Manufacturing industry	<b>2</b>	2
Construction and property	<b>7</b>	7
Hotels, restaurants and wholesale and retail trade	<b>2</b>	2
Transport, storage and communication	<b>1</b>	1
Financial	<b>6</b>	7
Other services etc.	<b>12</b>	10
Individuals:		
Home mortgages	<b>62</b>	64
Other personal lending	<b>1</b>	
	<b>100</b>	100
<b>Impaired loans</b>	<b>£314m</b>	£71m
<b>Impaired loans as a % of closing advances</b>	<b>2.36%</b>	0.59%
<b>Impairment provisions</b>	<b>£56m</b>	£34m
<b>Impairment provisions as a % of closing advances</b>	<b>0.42%</b>	0.28%
<b>Impairment provisions as a % of impaired loans</b>	<b>18%</b>	48%
<b>Risk weighted assets (Basel II)</b>	<b>£10.6bn</b>	£10.2bn
<b>Customer deposits</b>	<b>£0.3bn</b>	£0.3bn

(1) Before impairment provisions.

*Lending Growth.* Loans and advances, which are predominantly European residential mortgages, grew in the first half of 2008 by an annualised 22%, with an increase in the portfolio to £13.3 billion (as compared to £12.0 billion at 31 December 2007).

The particularly strong growth in the European and North American corporate business in the first half of 2008 enhanced the spread of the portfolio both geographically and by business, with 38% of lending in corporate and 62% in retail. The European and North American corporate business continues to benefit from a diverse portfolio spread across a range of specialist sectors such as oil and gas, gaming and real estate.

*United States.* The International division's corporate US business, now based in nine major economic centres across the US grew lending in the first half of 2008 by an annualised 28% to



£4.9 billion (as compared to £4.3 billion in 2007). The US business has continued to focus on its chosen specialist sectors, while expanding the regional banking partnership initiative.

*Canada.* The HBOS Group's first office in Canada targets specialist corporate sectors such as corporate finance, real estate, infrastructure and natural resources, with the aim of creating a diverse portfolio and a platform for sustainable, profitable growth. Since establishing the HBOS Group's presence, the business has focused on building an expansive network of relationships across the local financial community, while completing a small number of loans in partnership with local banks.

*Retail Europe.* BoSNL, the International division's market leading online residential mortgage sales business, experienced lending growth in the first half of 2008 of an annualised 16% to £6.8 billion (as compared to £6.3 billion at 31 December 2007). In Spain, in a more difficult and slowing residential property market, targeted BHH lending grew by an annualised 14% to £1.5 billion (as compared to £1.4 billion at 31 December 2007).

*European Financial Services.* Underlying profit decreased in the first half of 2008 by 25% to £42 million (as compared to £56 million in the first half of 2007). The vast majority of investment business in EFS is accounted for on an EV basis under IFRS. The table below analyses the EV profit contribution of EFS.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m)</i>	
Contribution from existing business:		
Expected contribution	<b>33</b>	25
Actual vs. expected experience	<b>(7)</b>	12
	<hr/> <b>26</b>	<hr/> 37
Contribution from new business	<b>14</b>	16
Investment earnings on net assets using long term assumptions	<b>2</b>	3
	<hr/> <b>42</b>	<hr/> 56
<b>Underlying profit before tax</b>	<hr/> <b>42</b>	<hr/> 56

The HBOS Group's European investment business were impacted by difficult market conditions and substantial changes in German regulation, with total new business sales in the first half of 2008 decreasing by 12% to £300 million (as compared to £342 million in the first half of 2007) on a PVNBP basis. To ensure compliance with the German VVG legislation, which became effective on 1 January 2008, EFS made a significant investment in products and systems. Funds under management decreased in the first half of 2008 by an annualised 11% to £5.4 billion (as compared to £5.7 billion in 2007).

### ***Treasury & Asset Management***

An update to the HBOS Group's treasury portfolio and negative fair value adjustments for the period from 1 July 2008 to 3 November 2008 is set out in Part IX ("HBOS Trading Update") of this Prospectus.

Underlying loss before tax in the Treasury & Asset Management division for the first half of 2008 was £871 million, reflecting a NFVA relating to certain debt securities of £1,095 million. Underlying profit before tax excluding NFVA increased in the first half of 2008 by 15% to £224 million (as compared to £194 million in the first half of 2007). Treasury's performance reflects the turmoil in global financial markets and the related difficult market conditions in the first half of 2008. Excluding these effects, there was strong growth in both underlying income and operating profit. During the first half of 2008, the Treasury division continued to have a strong credit portfolio. Asset Management's profit growth also remained strong with growth in assets under management to £120.0 billion in the first half of 2008 (as compared to £117.8 billion as at 31 December 2007).

*Underlying Financial Performance (Treasury & Asset Management)*

The following table sets out the Treasury & Asset Management income statement for the periods indicated.

	<i>Six months ended</i>	
	<i>30 June</i>	
	<b>2008</b>	<b>2007</b>
	<i>(£m, except %)</i>	
Net interest income	<b>39</b>	93
Underlying non-interest income (excluding NFVA) <sup>(1)</sup>	<b>345</b>	267
Net trading income	<b>200</b>	105
Fees and commission income	<b>133</b>	128
Fees and commission expense	<b>(30)</b>	(21)
Other operating income	<b>46</b>	55
Share of losses of associates and jointly controlled entities	<b>(4)</b>	
<b>Underlying net operating income</b>	<b>384</b>	360
<b>Underlying operating expenses</b>	<b>(160)</b>	(170)
Staff	<b>(91)</b>	(99)
Accommodation, repairs and maintenance	<b>(1)</b>	(1)
Technology	<b>(5)</b>	(5)
Marketing and communication	<b>(3)</b>	(2)
Depreciation: Property and equipment and intangible assets	<b>(3)</b>	(2)
Other	<b>(34)</b>	(40)
Subtotal	<b>(137)</b>	(149)
Recharges:		
Technology	<b>(4)</b>	(3)
Accommodation	<b>(7)</b>	(7)
Other shared services	<b>(12)</b>	(11)
<b>Underlying operating profit</b>	<b>224</b>	190
Non-operating income		4
<b>Underlying profit before tax (excluding NFVA)<sup>(1)</sup></b>	<b>224</b>	194
Negative fair value adjustments	<b>(1,095)</b>	
<b>Underlying profit before tax (including NFVA)<sup>(1)</sup></b>	<b>(871)</b>	194
<b>Underlying cost:income ratio (excluding NFVA)<sup>(1)</sup></b>	<b>41.7%</b>	47.2%
<b>Risk weighted assets (Basel II)</b>	<b>£17.6bn</b>	

(1) Relating to certain debt securities in the Trading Book.

Underlying net operating income (excluding NFVA) increased by 7% to £384 million (as compared to £360 million in the first half of 2007). Net interest income decreased by 58% to £39 million (as compared to £93 million in the first half of 2007), primarily as a result of the impact of higher funding costs.

Underlying non-interest income (excluding NFVA) increased in the first half of 2008 by 29% to £345 million (as compared to £267 million in the first half of 2007). This growth was driven by sales and trading operations.

*Operating Expenses.* Underlying operating expenses decreased in the first half of 2008 by 6% to £160 million (as compared to £170 million in the first half of 2007). This decrease is as a result of a reduction in performance related staff costs and a number of cost savings initiatives implemented in the HBOS Group's Asset Management business.

*Treasury Debt Securities.* As at 30 June 2008, Treasury held a portfolio of debt securities, which is analysed below. The investment credit business has two functions; firstly it manages part of the Group's prudential liquidity portfolio and secondly it takes investment positions principally through the Grampian conduit. As at 30 June 2008, in line with the fall in values generally the profit outcome for the first half of 2008 is impacted by a £1,095 million NFVA (compared to a £227

million NFVA for the full year 2007) relating primarily to the Treasury's holdings of Asset Backed Securities and Floating Rate Notes in the Treasury's Trading Book.

As at 30 June 2008, Treasury has made a NFVA of £1,916 million post-tax (compared to £509 million for the full year 2007) to the HBOS Group's Available For Sale reserves, primarily in respect of its holding of Asset Backed Securities and Floating Rate Notes on its banking book. This adjustment has no impact on reported profits or regulatory capital strength.

The HBOS Group believes that it has adopted a prudent basis for the valuation of its Treasury assets, including significant adjustments for certain parts of the portfolio reflecting the current illiquidity of the relevant markets.

Treasury's total debt securities portfolio as at 30 June 2008, is summarised in the following table:

<i>Asset Class</i>	<i>Banking Book Grampian</i>	<i>Banking Book Other</i>	<i>Trading Book</i>	<i>Total</i>
	<i>(£bn)</i>			
<b>Asset Backed Securities</b>				
Direct		9.2	12.0	<b>21.2</b>
Grampian conduit	16.2			<b>16.2</b>
	16.2	9.2	12.0	<b>37.4</b>
<b>Covered Bonds</b>		3.2		<b>3.2</b>
<b>Bank/Financial Institution Floating Rate Notes (FRNs)</b>		11.8	5.5	<b>17.3</b>
<b>Bank Certificates of Deposit</b>		1.7	12.1	<b>13.8</b>
<b>Other<sup>(1)</sup></b>		2.5	1.4	<b>3.9</b>
	16.2	28.4	31.0	<b>75.6</b>
<b>Total</b>	<b>16.2</b>	<b>28.4</b>	<b>31.0</b>	<b>75.6</b>

(1) Principally governments and supra-nationals.

An update to the HBOS Group's Treasury portfolio for the period from 1 July 2008 to 3 November 2008 can be found in Part IX ("HBOS Trading Update") of this Prospectus.

*Exposure to Asset Backed Securities.* Asset Backed Securities (“ABS”) include the HBOS Group’s Grampian conduit, which is, and always has been, consolidated into the HBOS Group’s balance sheet. For a further analysis of ABS’s by asset class and credit rating as at 30 June 2008, see the table below.

<i>Asset class</i>	<i>Banking Book Grampian</i>	<i>Banking Book Other</i>	<i>Trading Book</i>	<i>Total</i>
	<i>(£bn)</i>			
<b>Mortgage Backed Securities</b>				
US RMBS <sup>(1)</sup>	4.5	1.2	3.0	<b>8.7</b>
Non-US RMBS	1.3	2.0	4.5	<b>7.8</b>
CMBS <sup>(1)</sup>	3.1		0.2	<b>3.3</b>
	<u>8.9</u>	<u>3.2</u>	<u>7.7</u>	<u><b>19.8</b></u>
<b>Collateralised Debt Obligations</b>				
CBO <sup>(1)</sup>	3.2	0.2		<b>3.4</b>
CLO <sup>(1)</sup>	2.7		0.5	<b>3.2</b>
	<u>5.9</u>	<u>0.2</u>	<u>0.5</u>	<u><b>6.6</b></u>
<b>Personal Sector</b>				
Auto Loans	0.5		0.9	<b>1.4</b>
Credit Cards	1.6	0.3	1.0	<b>2.9</b>
Personal Loans	0.7		0.2	<b>0.9</b>
	<u>2.8</u>	<u>0.3</u>	<u>2.1</u>	<u><b>5.2</b></u>
<b>FFELP Student Loans<sup>(1)</sup></b>		5.5	0.1	<b>5.6</b>
<b>Other ABS</b>	0.6		0.1	<b>0.7</b>
	<u>18.2</u>	<u>9.2</u>	<u>10.5</u>	<u><b>37.9</b></u>
<b>Negative Basis<sup>(2)</sup></b>		0.5	2.8	<b>3.3</b>
	<u>18.2</u>	<u>9.7</u>	<u>13.3</u>	<u><b>41.2</b></u>
<b>Fair Value Adjustments<sup>(3)</sup></b>	(2.0)	(0.5)	(1.3)	<b>(3.8)</b>
	<u>18.2</u>	<u>9.7</u>	<u>13.3</u>	<u><b>41.2</b></u>
<b>Total<sup>(4)(5)</sup></b>	<u><b>16.2</b></u>	<u><b>9.2</b></u>	<u><b>12.0</b></u>	<u><b>37.4</b></u>

(1) RMBS means Residential Mortgage Backed Securities; CMBS means Commercial Mortgage Backed Securities; CBO means Collateralised Bond Obligations; CLO means Collateralised Loan Obligations; FFELP means Federal Family Education Loan Programme.

(2) Negative basis means bonds held with separate matching credit default swap (“CDS”) protection.

(3) This comprises Mortgage Backed Securities £2.0 billion, Collateralised Debt Obligations £0.8 billion, Personal Sector £0.1 billion, FFELP Student Loans £0.2 billion, Other ABS £0.1 billion and Negative Basis £0.6 billion before CDS protection.

(4) The total comprises US securities of £22.1 billion, and Non-US securities of £15.3 billion.

(5) The reduction in ABS balances since December 2007 includes paydowns of £2.2 billion and negative fair value adjustments of £3.3 billion offset by FX translation of £1.0 billion.

*Exposure to US RMBS.* The table below details the HBOS Group’s direct exposure to US RMBS by asset class as at 30 June 2008.

<i>Asset class</i>	<i>Banking Book Grampian</i>	<i>Banking Book Other</i>	<i>Trading Book</i>	<i>Total</i>
	<i>(£m)</i>			
<b>Prime<sup>(1)</sup></b>	1,029	218	697	<b>1,944</b>
<b>Alt-A</b>	3,427	975	2,226	<b>6,628</b>
<b>Sub-prime</b>	62	9	19	<b>90</b>
	<u>4,518</u>	<u>1,202</u>	<u>2,942</u>	<u><b>8,662</b></u>

(1) Includes £568 million of second lien loans to prime borrowers, all of which are monoline wrapped.

As at 30 June 2008, the HBOS Group considers their Alt-A portfolio to be of high quality, noting that the current weighted average credit enhancement level is 30%. The HBOS Group has little direct exposure to the US sub-prime residential real estate sector, as shown above. After taking into account ABS CDOs with exposure to that market Treasury's total exposure to US sub-prime investments is less than 0.1% of the HBOS Group balance sheet, at £381 million (as compared to £434 million as at 31 December 2007), as shown in the table below.

The table below sets out the HBOS Group's US sub-prime exposures as at 30 June 2008.

Asset class	Banking Book Grampian	Banking Book Other	Trading Book	Total
	(£m)			
ABS CDO with Sub-prime Collateral <sup>(1)</sup>	163	128		291
Sub-prime RMBS <sup>(2)</sup>	62	9	19	90
<b>Total US Sub-prime</b>	<b>225</b>	<b>137</b>	<b>19</b>	<b>381</b>

(1) Includes £97 million of bonds that are monoline wrapped.

(2) 1997-2005 vintages.

*Exposure to Collateralised Debt Obligations.* The HBOS Group's Collateralised Debt Obligation ("CDO") exposure as at 30 June 2008 is quantified in the table below. As at 30 June 2008, this was a highly rated portfolio, the majority of which is based on corporate credits. ABS CDOs includes bonds based on residential mortgage backed bonds, as noted above.

Asset class	Banking Book Grampian	Banking Book Other	Trading Book	Total
	(£m)			
<b>ABS CDO<sup>(1)</sup></b>	195	128		<b>323</b>
<b>High Yield Corporate CBO</b>	101			<b>101</b>
<b>Investment Grade Corporate CBO</b>	2,235			<b>2,235</b>
<b>Commercial Real Estate CBO</b>	708	63		<b>771</b>
<b>Total CBO</b>	<b>3,239</b>	<b>191</b>		<b>3,430</b>
<b>CLO</b>	2,701	43	442	<b>3,186</b>
<b>Total</b>	<b>5,940</b>	<b>234</b>	<b>442</b>	<b>6,616</b>

(1) ABS CDO includes £291 million of US Sub-prime related as shown in the previous table.

#### *Exposures to Monolines.*

As at 30 June 2008, the HBOS Group's exposure to monolines arose from two sources, bonds that were wrapped, with a nominal exposure of £2.2 billion (as compared to £2.3 billion at 31 December 2007), and "negative basis" trades, with a continued nominal exposure of £2.8 billion (as compared to £2.8 billion at 31 December 2007), where the HBOS Group had purchased a bond and then bought CDS protection from a monoline separately. In respect of the former, the HBOS Group calculates an exposure to the monoline based on its internal rating of the underlying exposure and the uplift in rating provided by the monoline wrap. For CDS, all underlying bonds are triple-A rated externally, and the exposure calculation to the monoline is a combination of mark to market exposure based on the bond price and a Potential Future Exposure calculation. Using the HBOS Group's methodology described above, as at 30 June 2008 the HBOS Group had £0.7 billion (as compared to £0.4 billion at 31 December 2007) of credit exposure to monolines.

At 30 June 2008, 77% of the underlying bonds of the HBOS Group's "negative basis" trades were triple-A rated, 10% were rated AA+ and 13% were rated B+ (with investment grade monoline protection). At 30 June 2008, 87% of the HBOS Group's total wrapped bonds were rated A- or better, 9% are rated between BBB- and A- and 4% were rated BB.

*Fair Values of Debt Securities.* The fair value of debt securities in active markets is based on market prices or broker/dealer valuations. Where quoted prices on instruments are not readily and regularly available from a recognised broker, or dealer or pricing service or available prices do not represent regular transactions in the market, the fair value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics or similar valuation models.

ABS not traded in an active market are valued using valuation models that include non-market observable inputs. These models use observed issuance prices, benchmarking methodology and modelled market correlations. Additional assessments are also made on possible deterioration in credit risk for each individual security.

At 30 June 2008, the value of ABS measured using models with non-market observable inputs comprised £2.4 billion (as compared to £5.3 billion at 31 December 2007) within financial assets held for trading and £15.4 billion (as compared to £12.2 billion at 31 December 2007) within assets classified as available for sale.

During the first half of 2008, a £461 million pre-tax NFVA was recognised in the income statement on ABS that were valued using models with non-market observable inputs (as compared to £nil in the first half of 2007). In addition to this, a post-tax negative fair value adjustment of £1,485 million (as compared to £158 million at 31 December 2007) on ABS classified as available for sale was recognised in equity reserves.

As at 30 June 2008 for ABS asset valuations using non-market observable inputs, the effect of a one basis point move in credit spreads would result in a pre-tax movement of £1.1 million for ABS assets classified as held for trading and a post-tax movement of £5.1 million (recognised in equity reserves) on assets classified as available for sale.

The use of non-market observable inputs in the valuation models will diminish as and when activity returns to these markets.

#### *Impairment Review*

Treasury's Banking Book debt securities portfolio is held at fair value and reviewed regularly for impairment at the specific investment level, in accordance with IFRS. The Banking Book portfolio is reviewed on an ongoing basis for impairment and as at 30 June 2008 no objective evidence of impairment has been found. Objective evidence of impairment might include non-receipt of due interest or principal repayment or a measurable decrease in the estimated future cashflows from a group of financial assets since the initial recognition of those assets. The disappearance of active markets, declines in fair values and rating downgrades associated with this asset portfolio do not in themselves constitute objective evidence of impairment and unless a default has occurred, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement. Although the fair value of the Banking Book portfolio is significantly below its purchase cost, the HBOS Group believes that currently this is due to market dislocations rather than impairments of its assets.

### Credit Ratings

An analysis of external credit ratings of the HBOS Group's ABS portfolio by asset class is provided below. These ratings are based on the lowest of Moody's, Standard and Poor's and Fitch.

Asset class	Nominal (£bn)	As at 30 June 2008						Total
		AAA	AA	A	BBB (%)	BB	B	
<b>Mortgage Backed Securities</b>								
US RMBS								
Prime	2.0	80.1	9.3	5.0	3.4	2.2		100
Alt-A	6.6	97.4	2.3		0.1	0.2		100
Sub Prime	0.1	87.9	10.2	0.1	1.8			100
	<b>8.7</b>	<b>93.5</b>	<b>3.9</b>	<b>1.1</b>	<b>0.9</b>	<b>0.6</b>		<b>100</b>
Non-US RMBS	7.8	98.6	0.7	0.7				100
CMBS	3.3	96.9	1.9	1.2				100
	<b>19.8</b>							
<b>Collateralised Debt Obligations</b>								
CBO								
ABS CDO	0.3	26.0	23.9	13.4	5.6		31.1	100
High Yield Corporate CBO	0.1	84.8	15.2					100
Investment Grade								
Corporate CBO	2.2	100.0						100
Commercial Real Estate								
CBO	0.8	78.5	15.0	6.5				100
	<b>3.4</b>	<b>87.8</b>	<b>6.1</b>	<b>2.7</b>	<b>0.5</b>		<b>2.9</b>	<b>100</b>
CLO	3.2	98.7	0.9	0.4				100
	<b>6.6</b>							
<b>Personal Sector</b>								
Auto Loans	1.4	68.5	15.5	13.1		2.9		100
Credit Cards	2.9	100.0						100
Personal Loans	0.9	92.2	5.8	2.0				100
	<b>5.2</b>							
FFELP Student Loans	5.6	100.0						100
Other ABS	0.7	26.5	53.2	3.6	16.7			100
<b>Negative Basis<sup>(1)</sup></b>								
Monolines <sup>(2)</sup>	2.8	77.1	9.8				13.1	100
Banks	0.5	97.7	2.3					100
	<b>3.3</b>	<b>80.3</b>	<b>8.6</b>				<b>11.1</b>	<b>100</b>
<b>Total as at 30 June 2008</b>	<b>41.2</b>	<b>93.0</b>	<b>3.9</b>	<b>1.3</b>	<b>0.5</b>	<b>0.2</b>	<b>1.1</b>	<b>100</b>
Total as at 31 December 2007	42.4	99.6	0.2	0.2				100

(1) The external credit rating is based on the bond ignoring the benefit of the CDS.

(2) The non AAA bonds in the negative basis book are ABS CDOs with investment grade monoline protection. These are the only ABS CDOs within the negative basis book.

### Operational Performance (Treasury & Asset Management)

*Funding and Liquidity during the first half of 2008.* Treasury continued to support the HBOS Group's capital and funding plans.

In respect of funding, the HBOS Group has raised some £8.7 billion in the (over one year) term capital markets, including £5.7 billion senior debt issuance, a £0.6 billion issuance of covered bonds, a £0.5 billion securitisation, £750 million innovative Tier 1 securities and a £1.1 billion lower Tier 2 subordinated debt issuance.

*Conduits.* The HBOS Group sponsors special purpose entities ("SPEs") that are used in its securitisation and funding programmes. In addition, the HBOS Group sponsors two conduit

programmes, Grampian and Landale, which invest in asset-backed securities funded by commercial paper or through banking facilities.

At 30 June 2008, debt securities include asset backed securities of £16,208 million (as compared to £18,563 million at 31 December 2007) which are held in the HBOS Group's Grampian conduit. This is a series of bankruptcy remote SPEs that are funded by the issue of commercial paper and banking facilities. As some of the rewards and risks of the portfolio are retained by the HBOS Group, including the provision of liquidity facilities by Bank of Scotland plc, to the conduit, the assets and liabilities of the conduit are consolidated as part of the HBOS Group.

The HBOS Group also has a smaller conduit, Landale, which is partially consolidated. At 30 June 2008, debt securities of £552 million (as compared to £604 million at 31 December 2007) are included in available for sale investments.

Two of the Landale SPEs are not consolidated by the HBOS Group. One is the central funding company for the conduit that obtains external funding and lends it to the purchasing companies. The second is a purchasing company that has acquired floating rate notes issued under the HBOS Group's mortgage securitisation programmes and which is supported by liquidity lines that are provided by third party banks. These entities are not consolidated as there are insufficient indicators of control, in particular as the credit risk relating to the assets held by the entities and the liquidity risks are not borne by the HBOS Group. If these entities were consolidated the financial impact would be minimal.

*Sales and Trading.* Net sales and trading income (excluding NFVA) increased in the first half of 2008 by 43% to £249 million (as compared to £174 million in the first half of 2007), reflecting a strong performance from Treasury's UK sales and trading operations, although this is down from an exceptionally strong second half of 2007.

In the first half of 2008 the UK Sales business area has performed well, with net revenues increasing by 23% to £103 million (as compared to £84 million in the first half of 2007), with the majority of the growth in sales to corporate customers.

UK Trading business revenues increased by 62% in the first half of 2008 to £146 million (as compared to £90 million in the first half of 2007), due to strong performances by Treasury's rate desks, in particular interest rate derivatives and collateral trading.

#### *Asset Management*

*Insight.* In the first half of 2008, Insight saw net inflows of £8.7 billion (as compared to £6.0 billion in the first half of 2007) as its market leading Liability Driven Investment capability continued to attract strong levels of new business. Overall, assets under management increased in the first half of 2008 to £112.0 billion (as compared to £109.1 billion as at 31 December 2007), despite the fall in equity markets and a transfer of £1.5 billion as part of the agreed sale of Equitable Life funds. Insight's pipeline of new business is strong and their business model is proving resilient in these challenging conditions.

*Invista.* The first half of 2008 has been a period of continued development for Invista, despite significant challenges from the economy and difficult real estate market conditions. The Opportunity Fund, launched last year, has made a good entrance to the market and a number of investments have been made. Invista now also manages a new International Fund initially targeting Singapore, Hong Kong and Japan and recent investment performance relative to benchmarks has been good.

#### **Liquidity Risk and Funding**

Part XVI ("Risk Management") of this document contains details of the HBOS Group liquidity risk and funding position.

#### **Selected Statistical and Other Information**

Further historical information on HBOS for 2007, 2006 and 2005 relating to the Group's loan portfolio, lending concentrations, county exposure, securities portfolio, assets and liabilities, deposits, capital resources, capital adequacy, contingent liabilities, geographical regions and income taxes is contained in Part XV ("Selected Statistical and Other Information") from pages 117-121 of the HBOS Rights Issue Prospectus.

See Part XXIV of this document for further details about information that has been incorporated by reference into this document.



## **PART XIV**

### **OPERATING AND FINANCIAL REVIEW RELATING TO LLOYDS TSB**

The Operating and Financial Review of Lloyds TSB Group for the period 1 January 2005 to 31 December 2007 can be found on pages 3, 15 to 74 of the Annual Report on Form 20-F for the year ended 31 December 2007 which is incorporated by reference into this document.

The Operating and Financial Review of Lloyds TSB Group for the period 1 January 2008 to 30 June 2008 can be found on pages 116 to 133 of the Lloyds TSB Prospectus which is incorporated by reference into this document.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## PART XV

### CAPITAL RESOURCES

#### 1 Overview

It is the HBOS Group's policy to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

The HBOS Group recognises the impact on shareholder returns of the level of equity capital employed and seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position and the higher returns on equity possible with greater leverage.

The HBOS Group's capital is managed via the Board through the Group Business Plan, with the objective of maintaining both the optimal amount of capital and the most appropriate mix between the different components of capital. The day-to-day management of the HBOS Group's capital is delegated to the HBOS Group Capital Committee.

Liquidity risk is the risk that the HBOS Group does not have sufficient financial resources to meet its obligations when they are due or will have to do so at excessive cost. Paragraph 1.6 ("Funding and liquidity risks are inherent in the HBOS Group's Operations") of Part II ("Risk Factors") of this document sets out details of the funding and liquidity risks applicable to the HBOS Group.

Liquidity risk is governed by the HBOS Group Liquidity Policy Statement, which is approved by the HBOS Board and defines the core principles for identifying, measuring, managing and monitoring liquidity risk across the HBOS Group. Detailed liquidity risk framework documents and limit structures are in place for the HBOS Group's operations, where liquidity is managed on a Group basis, and for overseas banking units subject to specific regulatory requirements. The responsibility for oversight and management of liquidity risk is delegated to the HBOS Group Capital Committee ("**GCC**"). Details of the HBOS Group's approach to liquidity risk management are set out in paragraph 7 of Part XVI ("Risk Management") of this document.

## 2 Capitalisation and Indebtedness

The capitalisation and indebtedness of HBOS Group as at 30 June 2008 is shown in the table below and the HBOS Group's total indebtedness as at 30 September 2008 is disclosed in note 6 to the table.

The figures show the external net financial indebtedness of the HBOS Group and exclude balances between entities that comprise the HBOS Group.

	<i>As at 30 June 2008 (£ millions)</i>
<b>Share capital – authorised</b>	
Ordinary Shares of 25p each	1,910
Preference Shares	9,867
	<hr/> 11,777 <hr/>
<b>Share capital – allotted, called up and fully paid</b>	
Ordinary Shares of 25p each	938
Preference shares	198
	<hr/> 1,136 <hr/>
<b>Reserves</b>	18,964
	<hr/>
<b>Total owners' equity</b>	20,100
	<hr/>
<b>Group indebtedness</b>	
Dated subordinated liabilities	12,494
Undated subordinated liabilities	6,954
Preference shares	1,567
Preferred securities	5,069
	<hr/>
<b>Total other borrowed funds</b>	26,084
<b>Debt securities in issue</b>	193,475
	<hr/>
<b>Total indebtedness</b>	219,559
	<hr/>
<b>Total capitalisation and indebtedness</b>	239,659
	<hr/>

Notes:

- (1) The authorised preference share capital of the group as at 30 June 2008 was £9,867 million, consisting of 3,000 million preference shares of €1 each, 4,998 million preference shares of US\$1 each, 2.3 million non-cumulative callable preference shares of US\$1 each, 1,000 million preference shares of AUS\$1 each, 1,000 million preference shares of CAN \$1 each, 400 million preference share of YEN250, 199 million non-cumulative preference shares of £1 each, 200 million non-cumulative redeemable preference shares of £1 each, 0.4 million non-cumulative perpetual preferences shares of £10 each, 500 million non-cumulative irredeemable preference shares of £1 each, and 2,597 million cumulative preference shares of £1 each.
- (2) The allotted, called up and fully paid equity preference share capital of the HBOS Group as at 30 June 2008 consisted of 198 million preference shares of £1 each.
- (3) The allotted, called up and fully paid non-equity preference share capital of the HBOS Group as at 30 June 2008 consisted of 400 million non-cumulative irredeemable preference shares of £1 each and 2,250 million non-cumulative callable preference shares of US\$1 each.
- (4) As at 30 June 2008, the HBOS Group had total liabilities and equity of £681.4 billion, including deposits by banks of £47.0bn and customer accounts of £258.1 billion.
- (5) As at 30 June 2008, the HBOS Group had contingent liabilities and guarantees arising in the normal course of business totalling £4,896 million, consisting of guarantees and irrevocable letters of credit of £4,890 million and acceptances and endorsements of £6m.
- (6) At 30 September 2008, the HBOS Group's total indebtedness was £205,302 million (debt securities in issue: £178,719 million; other borrowed funds £26,583 million).
- (7) On 29 April 2008 an increase to HBOS authorised share capital was approved at the AGM in relation to 400 million preference shares of YEN250.
- (8) On 21 July 2008, HBOS issued 1,500 million ordinary shares of 25p each in respect of the Rights Issue.
- (9) On 6 October 2008, HBOS issued 137 million ordinary shares of 25p each in lieu of the 2008 interim dividend.
- (10) The HBOS Group has not issued any new subordinated liabilities in the three months to 30 September 2008; during this period, the HBOS Group redeemed its YEN60 billion 0.55 per cent. Subordinated Callable Notes 2013, which had a balance sheet value at 30 June 2008 of £284 million.
- (11) The HBOS Group issues debt securities that are secured against loans and advances, debt securities and certain other assets of the HBOS Group, principally from special purpose entities. Save for £5,640 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 £44,681 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 30 September 2008, are secured or guaranteed.
- (12) Save as disclosed above or in the HBOS Trading Update (which is set out in Part IX of this document), there has been no material change in the total capitalisation and indebtedness of the HBOS Group since 30 June 2008.

The capitalisation and indebtedness of Lloyds TSB Group as at 30 June 2008 and the Lloyds TSB Group's total indebtedness as at 30 September 2008 is disclosed in section 4 of Part A of Part XIV of the Lloyds TSB Prospectus which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

### **3 Funding Arrangements**

The ability of the HBOS Group to access wholesale funding sources and raise retail deposits on favourable economic terms is dependent on a variety of factors, including a number of factors outside of its control, such as general market conditions, including the state of UK and global finance markets, an increase in competitive behaviour, and confidence in the UK banking system in general or the HBOS Group in particular. Following speculation on HBOS's future in mid-September, the HBOS Group suffered deposit outflows. In the retail and corporate markets, any further loss in confidence in the UK banking system or the HBOS Group could lead to significantly increased retail or commercial deposit withdrawals and could prevent the HBOS Group from meeting minimum liquidity requirements. In wholesale markets, the HBOS Group has previously looked 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.

As a result of the increasingly turbulent conditions in the global financial markets in the second half of 2008, there has been a significant deterioration in the inter-bank and term funding markets and a consequent material reduction in the availability of longer-term funding. As a result, HBOS has had to source more shorter-term and overnight funding, with a consequent increase of refinancing risk.

In recent months, the strain in the financial systems has increased substantially, leading to a significant tightening in market liquidity and the threat of a more marked deterioration in the global economic outlook, with a consequent increase in recourse to liquidity schemes provided by central banks. While various governments including the UK government have taken substantial measures to ease the current crisis in liquidity, such as the measures announced in the UK on 8 October 2008 and 13 October 2008, there can be no assurance that these global measures will succeed in improving the funding and liquidity of the markets in which the major banks, including the HBOS Group, operate. In addition, the availability and the terms on which central bank liquidity facilities (such as those offered by the Bank of England) as well as HM Treasury's guarantee scheme will be made available to the HBOS Group and how and when such measures will be implemented are uncertain. There can be no assurance that these measures will not lead to an increase in the overall cost of funding of the HBOS Group. The HBOS Group expects it will substantially rely for the foreseeable future on the continued availability of central bank liquidity facilities (particularly those with the Bank of England) as well as HM Treasury's guarantee scheme for short- and medium-term debt issuance. If the Bank of England liquidity facilities, HM Treasury's guarantee scheme or other sources of short-term funding do not continue to be made available at current levels or at all, or if the current systemic market liquidity stress worsens, the HBOS Group could face serious liquidity constraints, which could have a material adverse impact on its solvency and, in the absence of the UK Government taking appropriate action to support the HBOS Group's liquidity consistent with the policy objectives set out in HM Treasury's announcement on 8 October 2008 could cause the value of HBOS Shares to decline substantially, with negative implications for HBOS Shareholders and, *in extremis*, could result in HBOS being unable to meet its ongoing funding requirements.

#### 4 Cash Flow Analysis

The following table shows the cash flow analysis of HBOS Group for the years ended 31 December 2007, 2006 and 2005 and the six months to 30 June 2008. The figures for the years ended 31 December 2007, 2006 and 2005 have been extracted from the HBOS audited consolidated financial statements for the years ended 31 December 2007 and 31 December 2005 without material adjustment.

	<b>30 June 2008</b>	2007 (£ million)	2006	2005
Cash generated by operations	3,209	(2,631)	(1,033)	21,246
Tax paid	(631)	(895)	(991)	(1,317)
<b>Net cash provided by operating activities</b>	<b>2,578</b>	<b>(3,526)</b>	<b>(2,024)</b>	<b>19,929</b>
<b>Net cash used in investing activities</b>	<b>(442)</b>	<b>(289)</b>	<b>(1,643)</b>	<b>(3,999)</b>
Issue of shares	93	146	548	1,078
Issue of equity preference shares	750			
Ordinary share buyback including costs		(500)	(982)	(994)
Purchase of own shares	(62)	(212)	(99)	(174)
Disposal of own shares	167	35	52	
Issue of other borrowed funds	1,144	4,742	1,571	1,889
Repayment of other borrowed funds		(928)	(777)	(273)
Interest on other borrowed funds relating to the servicing of finance	(673)	(1,199)	(1,153)	(1,078)
Minority interest acquired			287	
Minority interest disposed			(30)	
Repayment of capital to minority interest	(110)			
Equity dividends paid	(1,256)	(1,747)	(1,501)	(1,363)
Dividends paid to minority shareholders in subsidiaries	(11)	(39)	(22)	(8)
<b>Net cash from/(used in) financing activities</b>	<b>42</b>	<b>298</b>	<b>(2,106)</b>	<b>(923)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>2,178</b>	<b>(3,517)</b>	<b>(5,773)</b>	<b>15,007</b>
				<b>30 June 2008 (£ million)</b>
Profit before taxation				848
Adjusted for:				
Impairment losses on loans and advances				1,310
Impairment losses on investment securities				145
Depreciation and amortisation				716
Goodwill impairment				2
Interest on other borrowed funds				702
Pension charge for defined benefit schemes				74
Cash contribution to defined benefit schemes				(105)
Exchange differences				867
Movement in derivatives held for trading				56
Other non-cash items				344
Net change in operating assets				(13,764)
Net change in operating liabilities				12,014
<b>Cash generated by operations</b>				<b>3,209</b>

## **5. Enlarged Group Capital Resources**

Information relating to the capital resources of the Enlarged Group is set out in Part XIV (“Capital Resources – Part B: Enlarged Group”) of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## PART XVI

### RISK MANAGEMENT

#### 1. Introduction

Identification, measurement and management of risk are a strategic priority for the HBOS Group. The Board has established a comprehensive framework covering accountability, oversight, measurement and reporting to maintain high standards of risk management throughout the HBOS Group.

#### 2. Key risks and uncertainties facing the HBOS Group

The key risks and uncertainties faced by the HBOS Group are set out in Part II (“Risk Factors”).

#### 3. Management and Controls

##### 3.1 Governance

The HBOS Group’s governance model comprises a robust committee structure that allows an efficient and mutually supportive control environment across the HBOS Group. The governance framework description set out in this Part XVI is not intended to cover the business and control environments of St James’s Place plc and Invista Real Estate Investment Holdings plc.

The Board is responsible for setting the HBOS Group’s risk appetite and does so through an iterative process that aims to ensure that the HBOS Group’s approved business plan is consistent with the Board’s appetite for risk.

The strategy for managing risk is formulated by the Executive Committee (the “**Executive Committee**”) and is informed through divisional and HBOS Group planning and key performance indicators, including monthly financial and business performance reporting of variances against plan.

The Board has overall responsibility for the HBOS Group’s system of control and approval of principal risk policies and standards. The Board is also responsible for reviewing the effectiveness of the systems and controls. The system of controls described in this section accords with the Turnbull guidance on internal control and has also been reviewed by the Board. Within the HBOS Group, risk is managed in accordance with the following principles.

##### 3.2 Risk Appetite

The HBOS Group uses risk appetite to describe:

- the level of acceptable risk given the HBOS Group’s appetite for earnings volatility, external stakeholder expectations and any other defined objectives such as paying dividends; and
- the types of risk the HBOS Group is prepared to accept in line with its control environment and the market conditions in which it operates.

Key risks are identified and managed to achieve a balance between risk and reward which is acceptable to the HBOS Board. The HBOS Board carries out an annual strategic review of risk management, its appetite for risk and the HBOS Group’s annual business plan. This focus on aligning the taking of risk with the achievement of business objectives means that the control system is designed to manage, rather than eliminate, risk. The HBOS Board also reviews the effectiveness of risk management through regular management information reporting.

Responsibility for risk is a key element of managers’ competencies at all levels. Specialist Group and divisional risk teams have been established where appropriate to assist managers across the HBOS Group. Specialist risk managers research industry best practice and ensure that standards and policies within the HBOS Group evolve in line with recognised risk management practice.

Staff and systems resources are dedicated to ensuring that risk management information is accurate, timely and relevant to the business.

**3.3 The Risk Management Framework**

The HBOS Group allocates specific roles in the management of risk to executives and senior managers and to the Board and Executive Committees. This is undertaken within an overall framework and strategy established by the HBOS Board. The model is based on the concept of “three lines of defence”, as shown in the table below.

1st Line of Defence	<b>RISK MANAGEMENT</b>	<ul style="list-style-type: none"> <li>● Divisional CEOs</li> <li>● Divisional Risk Specialists</li> <li>● Divisional Risk Committees</li> </ul>	<ul style="list-style-type: none"> <li>● Strategy</li> <li>● Performance</li> <li>● Risk control</li> </ul>
2nd Line of Defence	<b>RISK OVERSIGHT</b>	<ul style="list-style-type: none"> <li>● Group Chief Executive</li> <li>● Executive Committee</li> <li>● Group Functions (incl. Group Risk and Group Finance)</li> <li>● Executive Risk Committees</li> </ul>	<ul style="list-style-type: none"> <li>● Centralised policy management</li> <li>● Independent oversight of risk</li> </ul>
3rd Line of Defence	<b>RISK ASSURANCE</b>	<ul style="list-style-type: none"> <li>● Audit Committee</li> <li>● Divisional Risk Control Committees</li> <li>● Group Internal Audit</li> </ul>	<ul style="list-style-type: none"> <li>● Independent assurance</li> </ul>

Divisional management has primary responsibility for identifying and evaluating significant risks to the business and for designing and operating suitable controls. Internal and external risks are assessed, including economic factors, control breakdowns, disruption of information systems, competition and regulatory requirements.

The four Group Executive Risk Committees – the Group Credit Risk Committee, the Group Market Risk Committee, the Group Insurance Risk Committee and the Group Operational Risk Committee develop the policies and parameters within which Divisions are required to manage risk. These Committees provide central oversight by reviewing and challenging the work of the Divisions and considering the application of appropriate risk management techniques.

The specialist Group Risk function, reporting to the Group Risk Director, supports these Group Executive Risk Committees. Its responsibilities are:

- to recommend HBOS Group policies, standards and limits;
- to monitor compliance with those policies, standards and limits;
- to provide leadership in the development and implementation of risk management techniques; and
- to aggregate risks arising in the Divisions and to monitor the overall HBOS Group position independently from the Divisions’ own analysis.

Consideration of capital, liquidity and balance sheet management is undertaken on an integrated basis. All capital and funding related activities are the responsibility of the Group Capital Committee, supported by three sub-committees, which focus on the core aspects of overall HBOS Group requirements. The Group Capital Committee is chaired by the Group Finance Director and operates under delegated authority from the HBOS Board to oversee and manage the HBOS Group’s balance sheet and capital in accordance with the HBOS Board approved HBOS Group business plan and within regulatory ratios.



In judging the effectiveness of the HBOS Group's controls, the HBOS Board reviews the reports of the Audit Committee and management. Certain responsibilities are delegated to the Audit Committee, including ensuring that there is an ongoing review of the adequacy and effectiveness of the internal control environment procedures. This role provides oversight on the financial internal control environment throughout the HBOS Group.

The Audit Committee, supported by Divisional Risk Control Committees, obtains assurance about the internal control and risk management environment through regular reports from Group Functions (including Group Risk and Group Finance) and Group Internal Audit. It also considers external auditors' reports.

#### **4. Management of Key Risks**

The HBOS Group is committed to developing its risk management techniques and methodologies, both to maintain high standards of risk management practice and to fulfil the requirements of UK and international regulators.

#### **5. Credit Risk**

Credit Risk is the risk of financial loss resulting from a counterparty's failure to settle financial obligations as they fall due.

The Group Credit Risk Committee, one of the Group Executive Risk Committees, is chaired by the Group Risk Director and comprises senior executives from across the business Divisions and the Group Risk function. It meets monthly and reviews the HBOS Group's lending portfolio, approves material credit models and HBOS Group credit standards, limits and divisional credit risk policies. The Group Credit Risk Policy Statement is approved by the HBOS Board on an annual basis. The Group Credit Risk Committee also assists the HBOS Board in formulating the HBOS Group's credit risk appetite in respect of key products and sectors.

Group Credit, a specialist support function within Group Risk, provides centralised expertise in the area of credit risk measurement and management techniques. In addition to reporting on the performance of each divisional portfolio to the Group Credit Risk Committee, Group Credit exercises independent oversight over the effectiveness of credit risk management arrangements and adherence to approved policies, standards and limits.

Day to day management of credit risk is undertaken by specialist credit teams working within each Division in compliance with policies approved by the HBOS Board. Typically functions undertaken by these teams include credit sanctioning, portfolio management and management of high risk and defaulted accounts and credit risk model build and governance.

To mitigate credit risk, a wide range of policies and techniques are used across the HBOS Group:

- For retail portfolios use is made of credit scoring software for new applications. In addition, behavioural scoring is used to provide an assessment of the conduct of a customer's account in granting extensions to, and setting limits for, existing facilities. Affordability is a vitally important measure and is reviewed in combination with either application and/or behavioural scores. Small business customers may be rated using scorecards in a similar manner to retail customers.
- For corporate portfolios a full independent credit assessment of the financial strength of each potential transaction and/or customer is undertaken awarding an internal risk rating which is reviewed regularly. The same approach is also used for larger small to medium enterprise ("SME") customers.
- Within Treasury, which handles the HBOS Group's banking and sovereign related exposures, as well as the HBOS Group's structured credit bond portfolio held for liquidity and proprietary purposes, focused credit risk policies are established and reviewed by Group Wholesale Credit Committee ("GWCC"), a sub-committee of the Group Credit Risk Committee. Basel II Advanced IRB compliant models are used to rate banking and sovereign counterparties. Structured credit bonds are reviewed individually by an independent credit function prior to purchase and an internal rating is applied to all exposures. The rating assessment is commensurate with, and often more stringent than, those of the external credit rating agencies. Additional thresholds and limits are applied by rating and asset class and, as part of an ongoing portfolio review process, thorough surveillance is performed covering each bond holding, supplemented by stress analyses conducted on a periodic basis.

An additional measure within the credit risk framework is the establishment of product, industrial sector and country limits to avoid excessive concentrations of risk. Material portfolios, such as mortgages, have approved sub-sector limits to ensure that they remain within plan and tolerance for risk. All such limits are set and monitored by the Group Credit Risk Committee. Standards have been established across the HBOS Group for the management of credit risk. All Divisions are committed to continuously improving credit risk management. There continues to be investment in the development of credit risk rating tools, including enhancements to the portfolio risk measurement systems and in governance arrangements to support operations within the terms of the Basel II Accord. These include principles for development, validation and performance monitoring of credit risk models. The approval process for credit models is dependent upon materiality, with all models impacting the regulatory capital calculation requiring approval by the Group Credit Risk Committee and those deemed material to the HBOS Group being approved by the Group Capital Committee.

Internal reporting has developed further in response to the introduction of improved rating tools. Senior Management across the HBOS Group are now capable of assessing the risk profile in terms of Probability of Default and Expected Loss and will do so under the Basel II environment going forward.

### 5.1 *Financial Instruments Subject to Credit Risk*

The table below sets out the HBOS Group's exposure to credit risk relating to financial instruments before taking account of collateral and other security. Policyholder assets are excluded from the analysis in this table as the underlying credit risks are for the account of the policyholders and have no direct impact on the HBOS Group's results.

	<i>As at 31 December 2007</i>	<i>As at 31 December 2006</i>
	<i>(£m)</i>	
Loans and advances to customers	430,007	376,808
Financial assets held for trading	54,681	49,139
Debt securities	56,839	49,901
Other financial assets	24,215	22,290
	<hr/>	<hr/>
Contingent liabilities and commitments	565,742	498,138
	<hr/>	<hr/>
<b>Total</b>	<b>672,460</b>	<b>589,082</b>
	<hr/> <hr/>	<hr/> <hr/>

#### *Loans and Advances to Customers*

Loans and advances to customers are managed on a divisional basis.

#### *Financial Assets Held for Trading*

Management of credit risk within Treasury portfolios relies on obtaining detailed knowledge and understanding of the assets and issuers it deals with. As described above, full credit analysis is undertaken and, based upon that, an internal rating is derived which helps to establish a credit appetite for the issuer or asset intended to be acquired.

As Treasury manages the liquidity of the HBOS Group, its mandate is to maintain a high quality credit portfolio and, in addition to the credit process mentioned above, it also actively uses portfolio techniques to manage and monitor the quality of its portfolios, and to avoid concentration risk.

This includes the use of rating based thresholds, established portfolio level thresholds, asset class limits and sub-limits. There are also rules governing the types of assets that can be held within Treasury's Liquidity portfolios, Trading and Banking books and for individual Asset Backed Security ("ABS") tranche sizes. There are also limits controlling the maximum weighted average life of assets.

As at 31 December 2007, financial assets held for trading were almost exclusively investment grade investments with 99.6% (2006 99.5%) of inter-bank and structured investment portfolios rated A or above based on an internal credit ratings scale that is, in general, aligned with the ratings scales of the major credit ratings agencies (Moody's, S&P and Fitch).

	<i>As at 31 December 2007</i>	<i>As at 31 December 2006</i>
	%	
AAA	51.5	51.9
AA	34.4	30.6
A	13.7	17.0
Below A	0.4	0.5

#### *Debt Securities*

Debt securities are primarily held within the Treasury or Insurance & Investment Divisions and as at 31 December were almost exclusively invested in investment grade counterparties with 96.5% (2006 94.0%) of debt securities rated 'A' or above, again based on the HBOS Group's internal rating scale.

	<i>As at 31 December 2007</i>	<i>As at 31 December 2006</i>
	%	
AAA	57.8	67.6
AA	25.8	18.2
A	12.9	8.2
Below A	3.5	6.0

The AAA proportion of the portfolio fell during 2007 due to two factors: (i) a reduction in sovereign assets and (ii) an increase in the size of the portfolio comprising mainly AA and A assets, thereby reducing the AAA proportion.

#### *Other Financial Assets*

Other financial assets include cash and balances at central banks, items in the course of collection, derivative assets, loans and advances to banks and sundry financial assets.

## **6. Market Risk**

Market risk is defined as the potential loss in value or earnings of the organisation arising from:

- changes in external market factors such as interest rates (interest rate risk), foreign exchange rates (foreign exchange risk), credit spreads, commodities and equities; and
- the potential for customers to act in a manner which is inconsistent with business, pricing and hedging assumptions.

The objectives of the HBOS Group's market risk framework are to ensure that:

- market risk is taken only in accordance with the HBOS Board's appetite for such risk;
- such risk is within the HBOS Group's financial capability, management understanding and staff competence;
- the HBOS Group complies with all regulatory requirements relating to the taking of market risk; and
- the quality of the HBOS Group's profits is appropriately managed and its reputation safeguarded.

Risk appetite is set by the HBOS Board which allocates responsibility for oversight and management of market risk to the Group Market Risk Committee, an Executive Risk Committee chaired by the Group Risk Director.

The HBOS Group devotes resources to ensuring that market risk is comprehensively captured, accurately modelled and reported, and effectively managed. Trading and non-trading portfolios are managed at various organisational levels, from the HBOS Group overall, down to specific business areas. Market risk measurement and management methods are designed to meet or exceed industry standards, and the tools used facilitate internal market risk management and reporting.

Market risk is controlled across the HBOS Group by setting limits using a range of measurement methodologies. The principal methodologies are Net Interest Income ("NII") sensitivity and Market

Value (“**MV**”) sensitivity for banking books and Value-at-Risk (“**VaR**”) for trading books. All are supplemented by scenario analysis which is performed in order to estimate the potential economic loss that could arise from extreme, but plausible stress events.

Detailed market risk framework documents and limit structures have been developed for each division. These are tailored to the specific market risk characteristics and business objectives of each division. Each divisional policy requires appropriate divisional sanction, and is then forwarded to the Group Market Risk Committee for approval on at least an annual basis.

Market risk within the insurance and investment businesses arises in a number of ways and, depending upon the product; some risks are borne directly by the customer and some by the insurance and investment companies. Risk to customers is controlled by adherence to and regular monitoring of investment mandates and, if appropriate, unit pricing systems and controls. In the case of the risk to the companies, individual Boards approve overall risk appetites and policies against which exposure is monitored.

Market risk – principally interest rate, inflation and equity – also arises from the HBOS Group’s defined benefit pensions obligations. These sensitivities are regularly measured and are reported to the Group Market Risk Committee every month.

### **6.1 Interest Rate Risk (Non-Trading)**

A key market risk faced by the HBOS Group in its non-trading book is interest rate risk. This arises where the HBOS Group’s financial assets and liabilities have interest rates set under different bases or reset at different times.

The principal Board limit for structural interest rate risk is expressed in terms of potential volatility of net interest income in adverse market conditions. Risk exposure is monitored using the following measures:

- Net Interest Income (“**NII**”) sensitivity – This methodology comprises an analysis of the HBOS Group’s current interest rate risk position overlaid with behavioural assessment and re-pricing assumptions of planned future activity. The change to forecast NII is calculated with reference to a set of defined parallel interest rate shocks which measure how much current projections would alter over a 12 month period.
- Market Value sensitivity – This methodology considers all re-pricing mismatches in the current balance sheet including those beyond the time horizon of the NII measure. It is also calculated with reference to a set of defined parallel interest rate shocks.

The HBOS Board has delegated authority to the Group Market Risk Committee to allocate limits to divisions as appropriate within the overall risk appetite approved by the HBOS Board each year. In turn, the Group Market Risk Committee has granted limits which constitute the risk tolerance for each division.

Banking divisions are required to hedge all significant open interest rate mismatch positions with Treasury and are not permitted to take positions of a speculative nature. A limit structure exists to ensure that risks stemming from residual and temporary positions or from changes in assumptions about customer behaviour remain within the HBOS Group’s risk appetite.

### Net Interest Income Sensitivity

The following table shows, split by major currencies, the HBOS Group's sensitivities as at 31 December 2007 to an immediate up and down 25 basis points change to all interest rates.

<b>Impact of interest rate shift</b>	<i>As at</i>	
	<i>31 December 2007</i>	<i>31 December 2006</i>
	<i>+ 25 bps</i>	<i>- 25 bps</i>
	<i>(£m)</i>	
<b>Currency</b>		
Sterling	(21.2)	21.6
US Dollar	(0.6)	0.5
Euro	(4.3)	4.3
AU Dollar	0.1	(0.1)
Other	0.1	(0.1)
<b>Total</b>	<u>(25.9)</u>	<u>26.2</u>

<b>Impact of interest rate shift</b>	<i>As at</i>	
	<i>31 December 2006</i>	<i>31 December 2005</i>
	<i>+ 25 bps</i>	<i>- 25 bps</i>
	<i>(£m)</i>	
<b>Currency</b>		
Sterling	(14.1)	16.0
US Dollar	(1.2)	1.2
Euro	(4.4)	4.4
AU Dollar	1.0	(1.2)
Other	(0.2)	0.2
<b>Total</b>	<u>(18.9)</u>	<u>20.6</u>

Base case projected NII is calculated on the basis of the HBOS Group's current balance sheet, forward rate paths implied by current market rates, and contractual re-pricing dates (adjusted according to behavioural assumptions for some products); it also incorporates business planning assumptions about future balance sheet volumes and the level of early redemption fees. The above sensitivities show how this projected NII would change in response to an immediate parallel shift to all relevant interest rates – market and administered.

The principal driver of the risk is re-pricing mismatch but the methodology also recognises that behavioural re-pricing assumptions – for example, prepayment rates – are themselves a function of the level of interest rates.

The measure, however, is simplified in that it assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount. Also, it does not incorporate the impact of management actions that, in the event of an adverse rate movement, could reduce the impact on NII.

### Reserve Sensitivity

The following table shows the market value sensitivity, for a 25 basis point shift, of those items in respect of which a change in market value must be reflected in the equity of the HBOS Group – principally “available for sale” assets and cash flow hedges.

Impact of interest rate shift	As at 31 December 2007		As at 31 December 2006	
	+ 25 bps	- 25 bps	+ 25 bps	- 25 bps
	(£m)			
Available for sale reserve	(15.7)	15.7	(21.9)	21.9
Cash flow hedge reserve	101.5	(101.5)	76.4	(76.4)
<b>Total</b>	<b>85.8</b>	<b>(85.8)</b>	<b>54.5</b>	<b>(54.5)</b>

### 6.2 Foreign Exchange Risk (Non-Trading)

The Group Funding & Liquidity Committee (“**GFLC**”) is responsible for the framework within which structural foreign currency risk is managed. The GFLC manages foreign currency exposures based on forecast currency information provided by the Divisions, and mandates Treasury to execute transactions and undertake currency programmes to manage structural currency risk. The actual risk position is monitored monthly by the Group Market Risk Committee.

Transaction exposures arise primarily from profits generated in the overseas operations, which will be remitted back to the UK and then converted into sterling.

Translation exposures arise due to earnings that are retained within the overseas operations and reinvested within their own balance sheet.

Structural currency exposures arise from the HBOS Group’s investments in overseas subsidiaries, branches and other investments and are noted in the table below.

Functional currency of the operation	Net investments in overseas operations	Borrowing taken out to hedge net investments	As at
			31 December 2007
			Remaining structural currency exposure
			(£m)
AU Dollar	2,023	2,023	
Euro	1,888	1,613	275
US Dollar	97	97	
Other	4		4
<b>Total</b>	<b>4,012</b>	<b>3,733</b>	<b>279</b>

Functional currency of the operation	Net investments in overseas operations	Borrowing taken out to hedge net investments	As at
			31 December 2006
			Remaining structural currency exposure
			(£m)
AU Dollar	1,560	1,560	
Euro	1,464	1,224	240
US Dollar	106	99	7
Other	13		13
<b>Total</b>	<b>3,143</b>	<b>2,883</b>	<b>260</b>

As at 31 December 2007 and 31 December 2006, there were no material net currency exposures in the HBOS Group's non-trading book relating to transactional (or non-structural) positions that would give rise to net currency gains or losses.

### **6.3 Trading**

The HBOS Group's market risk trading activities are conducted by Treasury. This HBOS Group activity is subject to a Trading Book Policy Statement, which is approved by the HBOS Board, and limits set by the Group Market Risk Committee.

Treasury trading primarily centres around two activities: proprietary trading and trading on the back of business flows. Both activities incur market risk, the majority being interest rate and foreign exchange rate exposure. In addition, a number of marketable assets held as part of the HBOS Group's liquidity risk management framework are also held in trading books. Such activity gives rise to market risk as a result of movements in credit spread.

The framework for managing the market risk in these activities requires detailed and tailored modelling techniques, which are the responsibility of the Treasury Market Risk team.

The HBOS Group employs several complementary techniques to measure and control trading activities including: Value at Risk ("**VaR**"), sensitivity analysis, stress testing and position limits.

The VaR model, used as part of the HBOS Group's management for trading activity, expresses market risk to 99% confidence using a one day holding period. The number provides an indication of the maximum mark to market loss which, to this level of confidence, might be incurred on a single day given the size of current trading positions. It is computed using a historical simulation approach and a one year history of price data. The underlying assumption is that future price volatility and correlation will not differ significantly from that previously observed. It also implicitly assumes that all positions are sufficiently liquid to be realisable within the chosen one day holding period. Also, VaR gives no indication of the size of any loss that could occur from extreme adverse price changes (i.e. outside the chosen confidence level). For these reasons, stress testing is employed to simulate the effect of selected adverse market movements. Such measures are particularly relevant when market conditions are abnormal and daily price movements are difficult to source. This has been the case in a number of financial markets since August 2007.

Following the dislocation of the credit trading markets, the HBOS Board agreed in early 2008 to suspend the use of VaR as a control measure for the credit portfolios held in trading books (principally FRNs and Asset Backed Securities) and to replace it by regular valuation reports to senior Treasury management and Group Risk. This decision was based on the judgement that VaR only constitutes a meaningful control over a portfolio that is actively traded and for which reliable two way prices are available. In October 2008, a further decision was made to transfer with effect from 1 July, the majority of these portfolios to the Available for Sale portfolio for which VaR is not used as a control by HBOS.

As at 31 December 2007, the regulatory capital charge for market risk trading exposures represented only 1.87% (2006 1.93%) of the HBOS Group's capital base.

All significant exposures subject to VaR are calculated on a daily basis. On a more detailed desk and trader level, to increase transparency, interest rate risk relating to the trading book is principally managed using risk sensitivities to measure exposure and set limits. This methodology calculates the present value impact of a one basis point movement in interest rates on the outstanding positions. Foreign exchange risk is principally managed by the use of position limits. Equity risk is managed through Equity Index VaR and position limits.

The HBOS Group's trading market risk exposure for the year ended 31 December 2007 is analysed below.

Exposure	As at	As at	Average		Highest		Lowest	
	31 Dec. 2007	31 Dec. 2006	2007	2006	2007	2006	2007	2006
Total Value at Risk	13.2	4.5	7.6	4.2	13.9	6.4	4.0	2.9
Included in the above is the Value at Risk relating to:								
Interest rates	4.7	2.2	3.0	2.4	5.9	3.9	1.7	1.4
Credit spread	8.3	2.0	4.3	1.4	8.4	3.9	1.8	0.9
Foreign exchange	1.9	0.2	0.6	0.3	2.0	0.7	0.1	0.1
Equity risk factor	0.2	0.1	0.2	0.1	0.4	0.4		

#### 6.4 Derivatives

In the normal course of business, the HBOS Group uses a limited range of derivative instruments for both trading and non-trading purposes. The principal derivative instruments used are interest rate swaps, interest rate options, cross currency swaps, forward rate agreements, credit derivatives, forward foreign exchange contracts and futures. The HBOS Group uses derivatives as a risk management tool for hedging interest rate and foreign exchange rate risk.

The HBOS Group's activity in derivatives is controlled within risk management limits set by the HBOS Board and overseen by the relevant Group Risk Committees.

#### 7. Liquidity Risk

Liquidity risk is the risk that the HBOS Group does not have sufficient financial resources to meet its obligations when they are due or will have to do so at excessive cost.

Liquidity risk is governed by the Group Liquidity Policy Statement ("**GLPS**"), which is approved by the HBOS Board and defines the core principles for identifying, measuring, managing and monitoring liquidity risk across the HBOS Group. Detailed liquidity risk framework documents and limit structures are in place for the HBOS Group's operations, where liquidity is managed on a group basis, and for overseas banking units subject to specific regulatory requirements. The responsibility for oversight and management of Liquidity Risk is delegated to the Group Capital Committee ("**GCC**").

Policy is reviewed at least annually to ensure its continued relevance to the HBOS Group's current and planned operations. Operational liquidity management is delegated to Treasury. The authority to set specific limits and guidelines and responsibility for monitoring and controlling liquidity is delegated by the GCC to the GFLC (a sub-committee of the GCC).

The HBOS Group's internal approach to liquidity management looks at the HBOS Group's forecast cash flows across all currencies and at longer timeframes than the regulatory rules require. The liquidity portfolio is recorded in Treasury and predominantly comprises Treasury debt securities, excluding Grampian and Landale. The assets in the liquidity portfolio are treated in two forms. Firstly, assets which the HBOS Group knows to be eligible under normal arrangements with the Bank of England, the European Central Bank and the US Federal Reserve. Secondly, high quality assets to assist the HBOS Group to manage through periods of stress taking into account the likely behaviours of depositors and wholesale markets. These approaches are supported by a framework that includes:

- funding diversity criteria focusing on retail, other customer and wholesale sources;
- sight to one week and sight to one month mismatch limits as a percentage of total wholesale funding for all major currencies and for all currencies in aggregate;
- targets on the appropriate balance of short to medium term wholesale funding; and
- criteria and limits on marketable assets, by asset class for Sterling, US Dollars, Euros, other currencies, and for all currencies in aggregate.

Daily monitoring and control processes are in place to address both statutory and prudential liquidity requirements.

In addition to day-to-day prudential limits, the liquidity framework has two other important components.



Firstly, the HBOS Group stress tests its potential cash flow mismatch position under various scenarios on an ongoing basis. The cash flow mismatch position considers on balance sheet cash flows, commitments received and granted, and material derivative cash flows. Specifically, commitments granted include the pipeline of new business awaiting completion as well as other standby or revolving credit facilities. Behavioural adjustments are developed evaluating how the cash flow position might change under each stress scenario to derive a stressed cash flow position.

Scenarios are based on varying degrees of stress and cover both the HBOS Group name specific and systemic difficulties. The scenarios and the assumptions are reviewed at least annually to gain assurance they continue to be relevant to the nature of the business.

Secondly, the HBOS Group has a Liquidity Contingency Plan embedded within the Group Liquidity Policy Statement which has been designed to identify emerging liquidity concerns at an early stage, so that action can be taken to avoid a more serious crisis developing. This is achieved through the use of Early Warning Indicators (“EWIs”).

Clear guidelines are set out for the management escalation process in the event of EWIs triggering and the actions to be taken (short and medium term) should such an event take place. Responsibilities for communication with various external parties and contact details of key personnel are also clearly stated.

In response to the market dislocation that started in the second half of 2007 and intensified in September 2008, the HBOS Group has been operating under its contingency arrangements including weekly meetings of the Group Capital committee. Further, in response to severe constraints on term funding to HBOS and the UK banking sector, the HBOS Group has had to source more short term funding, including increasing its recourse to repo schemes operated by central banks.

#### *Funding*

The wholesale funding capacity of the HBOS Group is dependent upon factors such as the strength of the balance sheet, earnings, asset quality, ratings and market position. GFLC assesses the HBOS Group funding mix to ensure that adequate diversity is maintained. It is HBOS Group policy to manage its balance sheet profile to ensure customer deposits sourced outside Treasury represent a significant component of overall funding, and GFLC directs and coordinates the activities of the Divisions in raising liabilities from a range of sources.

In order to strengthen the HBOS Group’s funding position, the HBOS Group has over the last few years diversified its funding sources and lengthened its maturity profile of market sensitive funding. This has been achieved through:

- widening the wholesale investor base and product set;
- building and maintaining a large securitisation programme;
- accessing the covered bond market;
- utilising the geographic diversity of New York and Sydney as funding hubs for the HBOS Group; and
- extending the HBOS Group’s Medium Term Note programmes.

Prior to the market dislocations that began in August 2007, the HBOS Group’s wholesale funding sources were well diversified by instrument, currency and by maturity as shown in the tables below. Tables are prepared on the basis that “retail” is defined using the current statutory definition, *i.e.* administered rate products. Wholesale funding, when issued in a foreign currency but swapped into sterling, is included at the swap exchanged amount. Wholesale funding is shown excluding any repo activity and the funding raised in the names of the conduits.

<b>Retail and Wholesale Funding Sources</b>	<i>As at</i>		<i>As at</i>	
	<i>31 December 2007</i>		<i>31 December 2006</i>	
<b>Instrument</b>	<i>£bn</i>	<i>%</i>	<i>£bn</i>	<i>%</i>
Bank Deposits	32.9	6.7	27.9	6.6
Deposits from Customers	27.8	5.6	17.1	4.0
Certificates of Deposit	63.1	12.8	42.5	10.0
MTNs issued	42.8	8.7	41.5	9.7
Covered Bonds	23.7	4.8	17.2	4.0

<b>Retail and Wholesale Funding Sources</b>	<i>As at</i>		<i>As at</i>	
	<i>31 December 2007</i>		<i>31 December 2006</i>	
<b>Instrument</b>	<i>£bn</i>	<i>%</i>	<i>£bn</i>	<i>%</i>
Commercial Paper	16.9	3.4	17.3	4.1
Securitisation	45.9	9.3	47.2	11.1
Subordinated Debt	20.0	4.1	15.4	3.6
Other	4.9	0.9	4.9	1.1
Total Wholesale	278.0	56.3	231.0	54.2
Retail	215.4	43.7	194.8	45.8
Total HBOS Group Funding	493.4	100.0	425.8	100.0

<b>Wholesale Funding – Currency</b>	<i>As at</i>		<i>As at</i>	
	<i>31 December 2007</i>		<i>31 December 2006</i>	
	<i>£bn</i>	<i>%</i>	<i>£bn</i>	<i>%</i>
US dollar	104.5	37.6	87.2	37.7
Euro	79.0	28.4	65.3	28.3
Sterling	69.7	25.1	60.7	26.3
Other	24.8	8.9	17.8	7.7
Total Wholesale Funding	278.0	100.0	231.0	100.0

<b>Wholesale Funding – Residual Maturity</b>	<i>As at</i>		<i>As at</i>	
	<i>31 December 2007</i>		<i>31 December 2006</i>	
	<i>£bn</i>	<i>%</i>	<i>£bn</i>	<i>%</i>
Less than one year	164.1	59.0	121.2	52.5
One to two years	21.6	7.8	19.3	8.4
Two to five years	46.3	16.7	46.5	20.1
More than five years	46.0	16.5	44.0	19.0
Total Wholesale Funding	278.0	100.0	231.0	100.0

Since the market dislocations began and particularly since they further intensified in September 2008, the global appetite for medium and long term investments, including securitisations has been severely constrained leading to increased reliance on short term funding, and central bank liquidity schemes and support from HM Treasury's guarantee scheme.

#### *Conduits*

HBOS sponsors two conduits, Grampian and Landale, which are special purpose vehicles that have invested in highly rated assets and fund via the Asset Backed Commercial Paper (“**ABCP**”) market. At 31 December 2007, investments held by Grampian totalled £18.6 billion. Grampian is, and always has been, fully consolidated into the HBOS Group's balance sheet. The HBOS Group also consolidated £0.6 billion of assets held by Landale. Grampian has a liquidity line in place with HBOS which covers all of the assets and programme wide credit enhancement is also provided by HBOS. Landale holds both assets originated from the HBOS Group's own balance sheet and third party transactions. Landale has liquidity lines from HBOS and from third-party banks, and therefore the former, but not the latter, are consolidated into the HBOS Group's balance sheet.

Since August 2007, the HBOS Group has provided funding to these conduits when required.

## **8. General Insurance & Long Term Assurance Business Risks**

The general insurance and long term assurance business contracts underwritten by the HBOS Group expose HBOS to both investment and insurance risk.

Insurance risk is the potential for loss, arising out of adverse claims from both life and general insurance contracts.

Investment risk is the potential for financial loss arising from the risks associated with the investment management activities of the HBOS Group. Investment risk includes market, credit and liquidity risks. The loss can be as a result of:

- direct risks relating to changes in the value of HBOS Group assets in support of the general insurance and long term insurance contracts;
- indirect risks arising from policyholder funds where the assets and policyholder liabilities are matched; and
- indirect risks associated with the management of assets held on behalf of third parties.

The Group Insurance Risk Committee, one of the Executive Risk Committees considers regular reports on specified aggregate insurance risks across all of the HBOS Group's insurance and investment businesses. It oversees the development, implementation and maintenance of the overall insurance risk management framework, covering insurance risk in each business individually, as well as in aggregate.

As part of the overall HBOS Group risk management framework, the Group Insurance & Investment Risk Team provides regular support to the Group Market Risk Committee and to the Group Credit Risk Committee on the inter-relationship between insurance risk and investment risks (market, credit and liquidity risks respectively) arising within these businesses, and the development of appropriate policies and standards for the management of those risks.

The majority of the HBOS Group's long term insurance and investment contract liabilities are managed within the HBOS Insurance and Investment Division and Insight Investment with approximately 3% (2006: 3%) operated by the life businesses outside the UK. Day-to-day management of insurance and investment risk is undertaken by management supported by specialist risk functions. Use is made of the statutory actuarial roles, both to help ensure regulatory compliance in respect of the authorised insurance companies in the HBOS Group and to help meet HBOS Group risk management standards.

### **8.1 Long Term Assurance**

The insurance and investment business that is transacted by the life insurance companies within the HBOS Group comprises unit linked business, fixed benefit business (also known as non-profit business) and with-profits business (described as insurance contracts and investment contracts with discretionary participating features (“**DPF**”) written within the with-profits fund).

Several companies within the insurance and investment business transact either unit linked and/or other non profit business, but all with-profits business is underwritten by Clerical Medical Investment Group Limited (“**Clerical Medical**”), a subsidiary of HBOS Financial Services Limited.

The key characteristics of long term assurance that give rise to insurance and investment risk are its long term nature, the guarantees provided to policyholders, the dependency on the performance of investment markets and the extent to which assets backing the contractual liabilities are matched.

The quality, mix and volume of business have a significant influence on the extent of insurance and investment risk assumed by the HBOS Group and resulting profits. The quality of business written is influenced by variations in product terms as well as the average premium size, age and term profile within the particular products. Accordingly, the mix in products written may impact on profits, depending on the nature, extent and profitability of new business in addition to existing business. This risk is managed through the application of clear pricing policies that require full financial assessment for each new product, incorporating consideration of expected hurdle rates of return.

Additionally, variations in administration and development costs may impact the available profit margin within the product charges. To manage this risk, there is a regular process of expense budgeting and reporting with appropriate targets set for new insurance and investment products that are developed.

The risks associated with particular sections of the long term assurance business are set out below.

## **8.2 Unit Linked Funds**

For unit linked funds, including consolidated collective investment schemes, which comprise 77% (2006 74%) of the HBOS Group's long term insurance and investment contract liabilities, investors bear the investment risk, with changes in the underlying investments being matched by changes in the underlying contract liabilities. Similarly, the HBOS Group manages a number of collective investment schemes where the investors bear the investment risks. The investor selects from a range of investment opportunities available from the HBOS Group in accordance with their personal risk appetite and circumstances.

On a day-to-day basis, cash outflows which are necessitated by investors withdrawing their funds are generally met by cash inflows from new investors. In circumstances where funds are contracting, or to meet unusually high levels of withdrawals, the HBOS Group sells assets in the fund in order to meet the cash demands with any dealing costs charged to the underlying unit linked fund and consequently the policyholders. The underlying assets in the unit linked funds are subject to credit and market risks in the form of interest rate, equity prices, foreign exchange and other market risks depending on the fund, including movement in property values. These changes are matched by changes in the unit linked liabilities. Accordingly, the HBOS Group is not directly exposed to significant liquidity, credit or market risks, although the investors' benefits will vary as a consequence. Decreases in the capital value of unit linked funds (as a result of falls in market values of equities, property or fixed interest assets) will however reduce the future annual investment management charges that will be earned from unit linked business. The HBOS Group estimates that if the capital value of the unit linked funds, excluding consolidated collective investment schemes, classified as investment contracts had been reduced, on average by 10% for the year, the profit before tax for the year would have decreased by £22 million (2006 £25 million).

Unit linked products provide some discretion for variation in annual administration charges, and therefore management of variations in expenses may be achieved through variation in charges.

An additional risk the HBOS Group faces in respect of unit linked business is the risk that increases to surrender rates for both insurance and investment contracts reduce the value of future investment management charges. Actions to control and monitor this risk include charges applicable on some products where the investor surrenders early, regular experience monitoring, consideration of the sensitivity of product profitability to levels of lapse rates at the product development stage; and initiatives within the relevant businesses to encourage customer retention.

## **8.3 Non-Profit Business**

The HBOS Group has a diversified portfolio of life insurance and annuity policies within its portfolio of non-profit insurance contracts, which includes the insurance risk component of unit linked policies classified as insurance contracts. The principal investment risk in respect of the non-profit business is interest rate risk which arises because assets and liabilities may exhibit differing changes in value as a result of changes in interest rates. This may potentially impact on the results and the capital position. The investment risk also includes the risk of increases in corporate bond yield spreads over government risk free yields or the ratings downgrade of certain securities, both of which reduce the capital value of the bonds. These risks are controlled by processes carried out to help ensure an appropriate level of matching is maintained in the funds so that changes in fixed interest assets backing the non-profit business are substantially mitigated by offsetting changes in liabilities (as the discount rate used in valuing the liabilities is linked to that of the matching assets). These processes include the use of and monitoring against fund mandates.

The ultimate amounts payable under these policies are sensitive to general trends in mortality rates. For annuitants comprising 3% (2006 3%) of the HBOS Group's long term insurance and investment contract liabilities, there is a risk that increases to life expectancy through medical advances will prove greater than that anticipated. For protection business, the risk is that an unforeseen event such as a natural disaster will cause a material increase in death rates.

#### **8.4 With-Profits Fund**

The insurance and investment business includes the Clerical Medical With-Profits Fund, which comprises 16% (2006 20%) of the HBOS Group's long term insurance and investment contract liabilities (the "**With-Profits Fund**"). The With-Profits Fund takes some investment risks with the aim of enhancing policyholder returns, but aims to limit payouts to policyholders to that supportable by the With-Profits Fund's assets.

For "unitised" with-profits contracts the HBOS Group receives an annual management charge. For "traditional" with-profits contracts, which form the minority of the with-profits fund business, the HBOS Group receives one ninth of bonuses declared to policyholders as long as there is a distributable surplus within the fund.

Ordinarily, variations in the capital value of the fund's assets would result in variations in the level of benefits available to the with-profits contract holders and accordingly, a variation in the insurance and investment contracts with DPF liabilities. Included in the With-Profits Fund are certain contracts with minimum payment guarantees at certain policy durations and on death. Of these with-profits contracts issued between 1997 and 2001, a significant proportion have guaranteed benefits which are in the money at the balance sheet date. The costs of meeting these guarantees, up to a certain level, are met by charges to the benefits for all with-profits contract policyholders. The amount of these guaranteed benefits, net of charges to be levied on policyholder funds, was less than 1% (2006 1%) of the HBOS Group's long term insurance and investment contract liabilities at the balance sheet date. Above this level the costs are met by the free assets of the fund (the assets maintained in the fund which are not held to meet contractual liabilities). There remains a risk that Clerical Medical may suffer an additional charge in exceptional circumstances where even after management action, the fund is unable to meet the costs of guarantees within the fund.

As well as pooling of risks, the other important measures in controlling the investment risk within the With-Profits Fund include having agreed management actions to adjust the nature and extent of investment exposure in response to certain investment conditions; by recognising and holding appropriate levels of risk capital; by restricting holdings to assets which meet admissibility criteria; and by using derivative strategies to reduce downside risk.

Accordingly, other than the secondary impact of the HBOS Group's annual management charges and bonuses declared, the insurance and other investment risks (credit, liquidity and market risks) within the With-Profits Fund are generally expected to be borne by the with-profits insurance and investment contracts with DPF policyholders except in the extreme scenarios.

#### **8.5 General Insurance**

For general insurance household contracts the most significant risks to claims experience arise from weather events. For repayment insurance contracts the most significant risks arise from changes in economic conditions.

The HBOS Group manages its exposure to insurance risk through a strategy which includes limitation of the nature of the risks underwritten and allowance within the price charged for the underlying risks. This allowance for risks is based on both external information and the HBOS Group's own experience data. For all classes of insurance there are pricing models that are regularly adjusted for actual claims experience. For household insurance the HBOS Group limits its exposure to large weather events through the use of reinsurance.

The majority of claims are reported and settled within 12 months and generally there is limited reserving uncertainty for events before the balance sheet date.

For some renewable contracts (household, travel and some repayment insurance), the longer term exposure to risk is managed in conjunction with the ability to re-price contracts to take account of changes in the level of risk within those contracts.

### **9. Operational Risk**

Operational risk exists in the normal conduct of business. Examples of potential sources of operational risk include fraud, system reliability, human error, failure of key suppliers, IT security, business continuity, change management, operational outsourcing and failure to comply with legislation or regulation.

The HBOS Board has approved an Operational Risk Policy that establishes the framework for managing operational risk (the “**Operational Risk Policy**”). The main components of the Operational Risk Framework include risk and control assessment, internal loss reporting, capture of risk event information, key risk indicator monitoring and evaluation of external events.

The Group Operational Risk Committee is one of the four Executive Risk Committees chaired by the Group Risk Director. It is attended by senior executives from the divisions and group specialist areas. The Group Operational Risk Committee considers the management of issues and exposures, recommends the appropriate capital requirement, approves policies and standards and provides oversight of the operational risk communities.

A key enhancement to the HBOS Group’s infrastructure has been to focus on the explicit risk management of specialist areas that underpin the Operational Risk Policy. All specialist functions have clear roles defined to help lead the identification, management and measurement of risks relevant to their areas across the HBOS Group. The Group Business Risk Function co-ordinates the specialist areas, designs and maintains HBOS Group-wide risk systems, a specialist portfolio management team and undertakes the detailed modelling required to assess risk exposure.

## **10. Regulatory Risk**

The FSA is the main regulator for HBOS, although the HBOS Group’s international businesses in the USA, Australia and Ireland are subject to direct scrutiny from the Federal Reserve Board, the Australian Prudential Regulation Authority and The Financial Regulator, respectively.

The HBOS Group understands that consumers have a choice of suppliers and products and are more demanding of financial services providers. The HBOS Group supports the FSA’s Treating Customers Fairly initiative and has set clear principles for doing business. This is supported by ongoing maintenance of procedures across the HBOS Group, with associated enhancement and development where necessary. The objective is to meet the requirements of the HBOS shareholders through meeting the needs of the HBOS Group’s customers.

The HBOS Group is alert to the wider, cumulative picture of regulatory change and utilises centralised expertise in the area of regulatory and legal compliance, specifically to:

- identify and assess the impact of, respond to and where possible influence the direction of regulatory developments on behalf of the HBOS Group;
- lead the development and monitoring of the application of specific HBOS Group-wide policies and standards; and
- oversee the management, support and co-ordination of the liaison and interaction with HBOS Group regulatory stakeholders across all its international businesses.

The impact of regulatory change is reported across all Executive Risk Committees, with specific reference to the discipline affected; and at HBOS Group level to the Audit Committee and the Board.

## **11. Capital Management**

It is the HBOS Group’s policy to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times.

The HBOS Group recognises the impact on shareholder returns of the level of equity capital employed but seeks to maintain a prudent balance between the advantages and flexibility afforded by a strong capital position, particularly at times of stress in the financial system or the broader economy and the higher return on equity possible with greater leverage.

The HBOS Group’s capital is managed via the HBOS Board through the Group Business Plan, with the objective of maintaining both the optimal amount of capital and the most appropriate mix between the different components of capital. The day-to-day management of the HBOS Group’s capital is delegated to the Group Capital Committee.

The HBOS Group’s policy is to issue capital in a range of different forms and also from diverse sources to spread the investor base. HBOS raises the non-equity Tier 1 capital and subordinated debt for all the HBOS Group’s businesses, with the exception of Clerical Medical which is permitted to raise capital separately as part of the overall HBOS Group capital plan to spread the investor base for subordinated debt.

### 11.1 *Regulatory Capital Requirements*

The FSA supervises the HBOS Group on a consolidated basis and, as such, receives information on the capital adequacy of, and sets minimum capital requirements for, the HBOS Group as a whole. Individual banking, investment and insurance subsidiaries are directly regulated by either the FSA or their local supervisors, who set their capital adequacy requirements.

Up to 31 December 2007 the HBOS Group was regulated under the EU's Banking Consolidation Directive ("**Basel 1**").

From 1 January 2008 regulatory capital requirements were determined by the FSA general prudential sourcebook ("**GENPRU**") and the FSA prudential sourcebook for banks, building societies and investment firms ("**BIPRU**"). This legislation converted the European Capital Requirements Directive and, therefore, the Basel II Capital Accord ("**Basel II**") into UK regulation that applies to the HBOS Group. Comparable regulation was introduced in Ireland and Australia by local supervisors.

The HBOS Group is required at all times to monitor and demonstrate compliance with the relevant regulatory capital requirements of the FSA. The HBOS Group had in place processes and controls to monitor the HBOS Group's capital adequacy and no breaches were reported to the FSA during the year to 31 December 2007 or in 2008.

### 11.2 *Basel I Capital Requirements*

Under Basel I the FSA required each bank and banking group to maintain an individually prescribed ratio of total capital to risk-weighted assets, taking into account both balance sheet assets and off-balance sheet transactions.

The rules specified eligible capital resources and divided these into two tiers:

- Tier 1 capital comprised shareholders' funds, innovative Tier 1 securities and minority interests, after adjusting for items reflected in shareholders' funds which were treated differently for the purposes of capital adequacy. The book values of goodwill and intangible assets were deducted in arriving at Tier 1 capital.
- Tier 2 capital comprised qualifying subordinated loan capital, and unrealised gains arising on the fair valuation of equities held as available for sale. Under Basel 1, collective impairment allowances could be included within capital.

Various limits were applied to elements of the capital base. The amount of innovative Tier 1 securities could not exceed 15% of overall Tier 1 capital, qualifying Tier 2 capital could not exceed Tier 1 Capital, and qualifying dated subordinated loan capital could not exceed 50% of Tier 1 capital. There were also limitations on the amount of collective impairment allowances which could be included as part of Tier 2 capital. From the total of Tier 1 and Tier 2 capital the carrying amounts of unconsolidated investments (e.g. insurance company investments), investments in the capital of banks, and certain regulatory items were deducted.

Risk weighted assets were categorised as either trading book or banking book and risk weighted assets determined accordingly. Banking book risk weighted assets were measured by means of hierarchy of risk weightings classified according to the nature of each asset and counterparty, taking into account any eligible collateral or guarantees. Banking book off balance sheet items giving rise to credit, foreign exchange or interest rate risk were assigned weights appropriate to the category of the counterparty, taking into account any eligible collateral or guarantees. Trading book risk weighted assets were determined by taking into account market-related risks such as foreign exchange, interest rate and equity position risks and counterparty risk.

### 11.3 *Basel II Capital Requirements*

On 1 January 2008 HBOS adopted Basel II rules.

Basel II is structured around three “pillars”: minimum capital requirements, supervisory review process and market disclosure.

Pillar One determines the minimum capital requirements and is divided into two approaches to determine credit risk regulatory capital requirements, with increasing complexity and sophistication.

- *Standardised approach.* This is an extension of Basel I and requires banks to use external credit ratings to determine risk weightings for rated counterparties. Like Basel I it groups other counterparties into broad categories and applies standardised risk weightings to these categories.
- *Advanced Internal Ratings Based Approach.* Banks use their own internal assessment of the probability of default, exposure at default and loss given default for risk weight asset calculations.

Basel II also introduces capital requirements for operational risk comprising three levels of increasing sophistication. One level calculates a capital charge based on gross revenues, a second uses three defined percentages based on gross revenues in eight business lines and finally the third is the Advanced Measurement Approach based on the bank’s own analysis of potential loss based on operational risk data.

The FSA approved HBOS to adopt the Advanced Internal Ratings Based Approach (“**AIRB**”) and Advanced Measurement Approach (“**AMA**”) for capital determination purposes with effect from 1 January 2008. From 1st January 2008 HBOS has used AIRB and AMA calculations.

Pillar Two is the supervisory review of a bank’s internal assessment of the appropriate level of regulatory capital to hold, consistent with its risk profile and strategy. Internal Capital Adequacy Assessment Process (“**ICAAP**”) is the mechanism to determine the internal assessment. The first HBOS ICAAP was completed and submitted to the FSA during 2007. The FSA conducted its supervisory review and evaluation process and issued under Pillar Two rules Individual Capital Guidance (“**ICG**”) to HBOS. HBOS had operated with a capital buffer in excess of the ICG throughout 2008. HBOS will submit an updated ICAAP before 31 December 2008.

Under Basel II the composition of eligible capital resources is largely unaltered from Basel I although a small number of changes apply to AIRB firms:-

- removal of collective impairment allowances from capital resources for AIRB portfolios;
- deduction of expected losses that are in excess of accounting provisions from capital resources. This is a 50/50 deduction from Tier 1 and Tier 2 capital;
- securitisation deductions are also 50/50 deductions from Tier 1 and Tier 2 rather than a full deduction from total capital.

Pillar Three requires disclosure of risk exposures and risk assessment processes of each firm. It is the HBOS Group’s intention to publish full disclosures under Pillar Three as required by BIPRU rules as at 31 December 2008.

The HBOS Group continues to promote a prudent and responsible approach to the management of capital. Management and the HBOS Board’s view of future capital requirements will continue to be the main determinant of total capital holdings.



## **PART XVII**

### **HISTORICAL FINANCIAL INFORMATION RELATING TO HBOS**

#### **Part A – Audited Financial Information**

The financial statements of HBOS included in the Annual Report and Accounts of HBOS for each of the years ended 31 December 2007, 2006 and 2005 together with the audit reports thereon are incorporated by reference into this document. The audit reports for each of the financial years ended 31 December 2007, 31 December 2006 and 31 December 2005 were unqualified.

The financial statements for the years ended 2007, 2006 and 2005 were prepared in accordance with IFRS.

See Part XXIV of this document for further details about information that has been incorporated by reference into this document.

## **PART XVII**

### **HISTORICAL FINANCIAL INFORMATION RELATING TO HBOS**

#### **Part B – Unaudited Interim Information**

The financial statements of HBOS included in the unaudited interim financial information for the six months ended 30 June 2008 and 30 June 2007 are incorporated by reference into this document. In accordance with applicable requirements, such information is prepared on a consolidated basis. These financial statements were prepared in accordance with IFRS.

See Part XXIV of this document for further details about information that has been incorporated by reference into this document.

## **PART XVIII**

### **HISTORICAL FINANCIAL INFORMATION RELATING TO LLOYDS TSB**

#### **Part A – Audited Financial Information**

The financial statements and related notes of Lloyds TSB included in the consolidated audited Annual Report and Accounts of Lloyds TSB for each of the years ended 31 December 2007 (and also included in the Annual Report, on Form 20-F for the year ended 31 December 2007), 2006 and 2005 together with the audit reports thereon and the Segmental Analysis Restatement section in the Lloyds TSB Report on Form 6-K dated 19 September 2008 are incorporated by reference into this document. The audit reports for each of the financial years ended 31 December 2007, 31 December 2006 and 31 December 2005 were unqualified. The financial statements for the years ended 2007, 2006 and 2005 were prepared in accordance with IFRS.

See Part XXIV of this document for further details about information that has been incorporated by reference into this document.

## **PART XVIII**

### **HISTORICAL FINANCIAL INFORMATION RELATING TO LLOYDS TSB**

#### **Part B – Unaudited Interim Information**

The unaudited interim financial statements and related notes of Lloyds TSB for the six months ended 30 June 2008, submitted to the US Securities and Exchange Commission under cover of Form 6-K are incorporated by reference into this document. These interim financial statements were prepared in accordance with IFRS.

## **PART XIX**

### **RECONCILIATION OF ACCOUNTING POLICIES**

Reconciliation of the HBOS Group's financial information to IFRS as applied by the Lloyds TSB Group, together with the report thereon from PricewaterhouseCoopers LLP dated 3 November 2008 are contained in Part X ("Reconciliation of Accounting Policies") of the Lloyds TSB Circular, which is incorporated by reference into this document.

See Part XXIV of this document for further details about information that has been incorporated by reference into this document.

## **PART XX**

### **UNAUDITED PRO FORMA NET ASSETS STATEMENT OF THE ENLARGED GROUP AS AT 30 JUNE 2008**

#### **Unaudited *pro forma* net assets statement of the Enlarged Group as at 30 June 2008**

The unaudited proforma net assets statement of the Enlarged Group as at 30 June 2008 and the notes thereto are set out in Part XVIII (“Unaudited Pro Forma Net Assets Statement of the Enlarged Group as at 30 June 2008”) of the Lloyds TSB Prospectus, which is incorporated by reference into this document.

See Part XXIV of this document for further details about information that has been incorporated into this document.

## PART XXI

### TAXATION CONSIDERATIONS

#### PART A – UNITED KINGDOM TAXATION CONSIDERATIONS

The following sections, which are intended as a general guide only and not a substitute for detailed tax advice, are based on current legislation and on what is understood to be current HMRC practice as at the date of this document. They summarise certain limited aspects of the United Kingdom taxation treatment of Qualifying Shareholders and they are intended to apply only to Qualifying Shareholders who are resident or, if individuals, ordinarily resident in the United Kingdom and domiciled in the United Kingdom for taxation purposes (unless specified otherwise), who hold HBOS Shares as an investment (other than under an Individual Savings Account) and who are the absolute beneficial owners thereof. Certain categories of shareholders, such as traders, broker-dealers, insurance companies and collective investment schemes, and shareholders who have (or are deemed to have) acquired their shares by virtue of or in connection with their or another's office or employment, may be subject to special rules and the comments below do not apply to such shareholders.

Qualifying Shareholders who are in any doubt about their tax position (including, without limitation, the application of any tax regime in a jurisdiction outside the United Kingdom to their shares), or who are resident or otherwise subject to taxation in a jurisdiction outside the United Kingdom, should consult their own professional advisers immediately.

#### 1 Taxation of Dividends

Neither HBOS nor Lloyds TSB is required to withhold at source any amount in respect of United Kingdom tax when paying a dividend.

A shareholder who is an individual will be entitled to a tax credit equal to one-ninth of the dividend paid by HBOS or Lloyds TSB. The individual will be taxable on the total of the dividend and the related tax credit (the "**gross dividend**"), which will be regarded as the top slice of the individual's income. The tax credit will, however, be treated as discharging the individual's liability to income tax in respect of the gross dividend, unless and except to the extent that the gross dividend falls above the threshold for the higher rate of income tax, in which case the individual will, to that extent, pay tax on the gross dividend calculated at 32.5 per cent. of the gross dividend less the related tax credit. Therefore, for example, a dividend of £90 will carry a tax credit of £10 and the income tax payable on the dividend by an individual liable to income tax at the higher rate would be 32.5 per cent. of £100, namely £32.50 less the tax credit of £10, leaving a net tax charge of £22.50.

A corporate shareholder resident for tax purposes in the United Kingdom will not generally be taxable on any dividend it receives from HBOS or Lloyds TSB.

A shareholder who is not liable to tax on dividends received from HBOS or Lloyds TSB will not be entitled to claim payment of the tax credit in respect of those dividends.

The right of a shareholder who is not resident (for tax purposes) in the United Kingdom to a tax credit in respect of a dividend received from Lloyds TSB and to claim payment of any part of that tax credit will depend on the existence and terms of any double taxation convention between the United Kingdom and the country in which the holder is resident.

#### 2 Taxation of Chargeable Gains

##### 2.1 *Open Offer*

As a matter of English law, the Open Offer may not, strictly speaking, be a reorganisation of the share capital of the Company for the purposes of the UK taxation of chargeable gains. Although HMRC's published practice to date has been to treat an open offer as a reorganisation, the Company understands that HMRC may not apply this practice in circumstances where an open offer is not made to all shareholders.

Consequently, as this Open Offer is made to Qualifying Shareholders and not to all HBOS Shareholders, the capital gains tax treatment is not free from doubt.

If the Open Offer is treated as a reorganisation, to the extent that a Qualifying Shareholder takes up all or part of his entitlement under the Open Offer, he would not be treated as making a disposal of all or part of his holding of Existing HBOS Shares. Instead, his Existing HBOS Shares and his Open Offer Shares issued pursuant to the Open Offer would generally be treated as a single asset (a “**New Holding**”), acquired at the time he is deemed to have acquired his Existing HBOS Shares. In these circumstances, the issue of Open Offer Shares will not result in UK taxation of chargeable gains. For the purpose of computing any capital gain or loss on a subsequent disposal by a Qualifying Shareholder of any shares comprised in his New Holding, the amount paid for the Open Offer Shares issued pursuant to the Open Offer will be added to the base cost of his Existing HBOS Shares.

If, or to the extent that, the issue of Open Offer Shares by the Company to Qualifying Shareholders under the terms of the Open Offer is not treated as a reorganisation of the Company’s share capital for the purposes of UK taxation of chargeable gains, such Open Offer Shares will be treated as acquired as part of a separate acquisition. In these circumstances, it is not expected that the issue of Open Offer Shares will result in UK taxation of chargeable gains. Subject to specific rules for acquisitions within specified periods either side of disposal and pre-1982 holdings held by corporates, the Existing HBOS Shares and the Open Offer Shares issued pursuant to the Open Offer will be treated as the same asset, the base cost of which will be the aggregate of the amount paid for the Open Offer Shares and the base cost of the Existing HBOS Shares.

To the extent that a Qualifying Shareholder takes up Open Offer Shares in excess of their Open Offer Entitlement pursuant to the Excess Application Facility, this will not constitute a reorganisation.

## **2.2 Placing**

The issue of Open Offer Shares under the Placing will not constitute a reorganisation of share capital for the purposes of the UK taxation of chargeable gains and, accordingly, any Open Offer Shares acquired pursuant to the Placing will be treated as acquired as part of a separate acquisition.

## **2.3 Disposal of Open Offer Shares**

A disposal or deemed disposal of Open Offer Shares by a Qualifying Shareholder may give rise to a chargeable gain (or allowable loss) for the purposes of UK capital gains tax (where the Qualifying Shareholder is an individual) and UK corporation tax on chargeable gains (where the Qualifying Shareholder is within the charge to UK corporation tax), depending on their circumstances and subject to any available exemption or relief.

An individual Qualifying Shareholder who ceases to be resident or ordinarily resident in the UK for a period broadly of less than five years and who disposes of Open Offer Shares during that period of temporary non-residence may be liable to UK capital gains tax on his or her return to the UK (subject to available exemptions or reliefs).

A Qualifying Shareholder who is not resident or, in the case of an individual, ordinarily resident for tax purposes in the UK (and is not temporarily non-resident as described above) will not be liable for UK tax on chargeable gains realised on the sale or other disposal of his or her Open Offer Shares unless such Open Offer Shares are used, held or acquired for the purposes of a trade, profession or vocation carried on in the UK through a branch or agency or, in the case of a corporate shareholder, through a permanent establishment. Such Qualifying Shareholders may be subject to foreign taxation on any gain under local law subject to the terms of any applicable double tax treaty.

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

No stamp duty or SDRT will be payable on the issue of the Open Offer Shares unless Open Offer Shares are issued or transferred (i) to, or to a nominee for, a person whose business is or includes the provision of clearance services (a “**Clearance Service**”) or (ii) to, or to a nominee or agent for, a person whose business is or includes issuing depositary receipts (a “**Depositary Receipts System**”). In this event, stamp duty or SDRT will generally be payable at the higher rate of 1.5 per cent. of the consideration payable, or in certain circumstances, the value of the Open Offer Shares (rounded up to the nearest £5 in the case of stamp duty).



Any subsequent dealings by Qualifying Shareholders in the Open Offer Shares will be subject to stamp duty or SDRT in the normal way. The transfer on sale of Open Offer Shares will generally be liable to stamp duty at the rate of 0.5 per cent. (rounded to the nearest multiple of £5) of the consideration paid. An unconditional agreement to transfer such shares will generally be liable to SDRT at the rate of 0.5 per cent. of the consideration paid, but such liability will be cancelled if the agreement is completed by a duly-stamped transfer within six years of the agreement having become unconditional.

Under the CREST system for paperless share transfers, no stamp duty or SDRT will arise on the issue or transfer of shares into the system provided (i) the shares are not issued or transferred into the CREST account of, or of a nominee for, a Depository Receipts System or the CREST account of, or of a nominee for, a Clearance Service which has not made an election under section 97A of the Finance Act 1986, and (ii) in the case of SDRT, the transfer is not for money or money's worth. Transfers of Shares within CREST are liable to SDRT (at a rate of 0.5 per cent. of the amount or value of the consideration payable) rather than stamp duty, and SDRT on relevant transactions settled within the system or reported through it for regulatory purposes will be collected by CREST.

**The statements in this section are intended as a general guide to the current United Kingdom stamp duty and SDRT position and do not apply (i) to persons such as market makers, dealers, brokers, intermediaries and persons (or nominees or agents for such persons) who issue depository receipts or operate clearance services to whom special rules apply or (ii) as regards transfers of shares to any of the persons mentioned in (i).**

#### **4 Acquisition**

A general guide to certain UK taxation considerations for Scheme Shareholders in respect of the Acquisition is set out at section 19(a) of Part 2 of the Scheme Document, which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## PART B – UNITED STATES TAXATION CONSIDERATIONS

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, HBOS INFORMS YOU THAT: (A) ANY DISCUSSION OF US FEDERAL TAX ISSUES IN THIS DOCUMENT IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY TAXPAYERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON TAXPAYERS UNDER THE INTERNAL REVENUE CODE OF 1986; (B) SUCH DISCUSSION IS INCLUDED HEREIN IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) TAXPAYERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

### I. CERTAIN US FEDERAL INCOME TAX CONSIDERATIONS REGARDING THE OPEN OFFER SHARES

The following is a summary of certain material US federal income tax consequences of the purchase, ownership and disposition of Open Offer Shares to a US Holder (as defined below) that purchases Open Offer Shares as part of the Placing and Open Offer. This summary does not purport to be a comprehensive description of all tax considerations that may be relevant to particular investors in light of their particular circumstances. This summary deals only with US Holders that hold Open Offer Shares as capital assets and does not address the tax treatment of US Holders subject to special treatment under US federal income tax law such as insurance companies and other financial institutions, tax-exempt organizations, retirement plans, real estate investment trusts, regulated investment companies, US expatriates, securities broker-dealers, dealers or traders in securities, currencies or notional principal contracts, persons that own (or are deemed to own for US federal income tax purposes) 10 percent or more of the voting stock of HBOS, persons holding Open Offer Shares as part of a “straddle” or as part of a “synthetic security”, a hedging or conversion transaction or other integrated transaction, and holders whose “functional currency” is not the US dollar.

In addition to the above limitations, this discussion does not address any tax consequences applicable to holders of equity interests in a holder of Open Offer Shares. The US federal income tax treatment of a partner in a partnership that holds Open Offer Shares will depend on the status of the partner and the activities of the partnership. Holders of Open Offer Shares that are partnerships should consult their tax advisers concerning the US federal income tax consequences to their partners of the acquisition, ownership and disposition of Open Offer Shares.

The summary assumes that HBOS is not and will not become a passive foreign investment company (a “PFIC”) for US federal income tax purposes, which HBOS believes to be the case. HBOS’s possible status as a PFIC must be determined annually and therefore may be subject to change. If HBOS were to be a PFIC in any year, materially adverse consequences could result for US Holders.

For the purposes of this summary, a “US Holder” is a beneficial owner of Open Offer Shares that is, for US federal income tax purposes, (i) a citizen of or an individual resident in the United States, (ii) a corporation, or other entity treated as a corporation for US federal income tax purposes, created in or organized under the laws of the United States or any state thereof or the District of Columbia, (iii) an estate, the income of which is subject to US federal income taxation regardless of its source or (iv) a trust, if (x) a court within the United States is able to exercise primary supervision over its administration and one or more United States persons have the authority to control all of the substantial decisions of such trust, or (y) it has a valid election in place to be treated as a domestic trust for US federal income tax purposes.

This summary is for general information purposes only and is based on the tax laws of the United States, including the US Internal Revenue Code of 1986, its legislative history, existing, temporary and proposed US Treasury regulations promulgated thereunder, and judicial and administrative interpretations thereof, all as in effect on the date hereof and all of which are subject to change, possibly with retroactive effect. The discussion below does not address the effect of any US state, local, or any alternative minimum, estate or gift tax law or the tax laws of any other jurisdiction on a US Holder of Open Offer Shares.

THE SUMMARY OF US FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF

## OWNING OPEN OFFER SHARES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

### **Distributions**

The gross amount of any distributions paid by HBOS to a US Holder that are actually or constructively received by the US Holder will generally be subject to US federal income tax as foreign source dividend income to the extent paid out of current and accumulated earnings and profits of HBOS, as determined for US federal income tax purposes, and, to the extent that an amount received by a US Holder exceeds the allocable share of HBOS's current and accumulated earnings and profits, such excess will be applied first to reduce such US Holder's tax basis in its Open Offer Shares and then, to the extent such distribution exceeds such US Holder's tax basis, it will be treated as capital gain. Such dividends will not be eligible for the dividends received deduction allowed to corporations.

HBOS does not maintain calculations of its earnings and profits under US federal income tax principles. Therefore, a US Holder should expect that a distribution will generally be treated as a dividend. The amount of any distribution of property other than cash will be the fair market value of that property on the date of the distribution.

Certain dividends received by individual or other non-corporate US Holders before 1 January 2011 will be eligible for reduced rates of taxation. This reduced income tax rate is only applicable to dividends paid by a company organised or incorporated outside of the United States if it is a qualified foreign corporation (which term excludes PFICs) and only with respect to Open Offer Shares held for a minimum holding period. HBOS currently expects to be considered a qualified foreign corporation for this purpose.

The gross amount of dividends paid in non-US currency will be included in the income of such US Holder in a US dollar amount calculated by reference to the spot exchange rate in effect on the day the dividends are received by the US Holder regardless of whether the payment is in fact converted into US dollars. A US Holder will have a tax basis in any non-US currency distributed equal to its US dollar value on the date it is received by the US Holder. If any non-US currency is converted into US dollars on the date of the receipt, the US Holder should, therefore, not be required to recognise any foreign currency gain or loss in respect of the receipt of non-US currency as dividends. Any gain or loss recognised upon a subsequent disposition of non-US currency will generally be ordinary income or loss. Dividends will be treated as foreign source income for US foreign tax credit limitation purposes. The limitation on foreign taxes eligible for the US foreign tax credit is complex. US Holders should consult their tax advisors as to the application of these limitations to their particular circumstances.

### **Sale, Exchange or Other Disposition**

Gain or loss realised by a US Holder on the sale or other disposition of Open Offer Shares generally will be subject to US federal income taxation as capital gain or loss in an amount equal to the difference between the US Holder's adjusted tax basis in the Open Offer Shares and the amount realised on the sale, exchange or other disposition, as determined in US dollars. Such gain or loss generally will be treated as long-term capital gain or loss if the Open Offer Shares have been held for more than one year. Long term capital gains derived by individuals and certain other non-corporate US Holders are eligible for reduced rates of taxation. The deductibility of capital losses against ordinary income is subject to significant limitations. Any gain or loss realised will generally be treated as derived from US sources for US federal income tax purposes.

A US Holder that receives non-US currency from the sale, exchange or other disposition of Open Offer Shares generally will realise an amount equal to the US dollar value of such non-US currency on the settlement date of such sale, exchange or disposition if (i) such US Holder is a cash basis or electing accrual basis taxpayer and the Open Offer Shares are treated as being "traded on an established securities market" (which HBOS believes the London Stock Exchange to be) or (ii) such settlement date is also the date of such sale, exchange or disposition. If the non-US currency so received is converted into US dollars on the settlement date, such US Holder should not recognise foreign currency gain or loss on such conversion. If the non-US currency so received is not converted into US dollars on the settlement date, such US Holder will have a tax basis in such non-US currency equal to its US dollar value on the settlement date. Any gain or loss on a subsequent conversion or other disposition of such non-US currency generally will be

treated as ordinary income or loss to such US Holder and generally will be income or loss from sources within the United States for US foreign tax credit purposes.

### **US Information Reporting and Backup Withholding**

In general, payments of dividends with respect to, and the proceeds of a sale or other disposition of Open Offer Shares payable to a US Holder by a US paying agent or other US intermediary will be reported to the Internal Revenue Service (the “**IRS**”) and to the US Holder as may be required under applicable regulations. Backup withholding will apply to these payments if the US Holder fails to provide an accurate taxpayer identification number or certification of exempt status or otherwise fails to comply with the requirements of the backup withholding rules. Certain US Holders (including, among others, corporations) are not subject to backup withholding. US Holders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a US Holder’s federal income tax liability, and a US Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by timely filing the appropriate claim for refund with the IRS and furnishing all required information.

US Holders may be required to file IRS Form 926 reporting the payment of the Issue Price to HBOS. Substantial penalties may be imposed upon a US Holder that fails to comply.

### **II. CERTAIN US FEDERAL INCOME TAX INFORMATION REGARDING THE SCHEME**

For a summary of the US federal income tax consequences of the Scheme to US Holders of Open Offer Shares, such US Holders should refer to section 19(b) of Part 2 (“Taxation”) of the Scheme Document, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

### **III. CERTAIN US FEDERAL INCOME TAX INFORMATION REGARDING THE NEW LLOYDS TSB SHARES**

A general summary of the US federal income tax treatment of New Lloyds TSB Shares is set forth in Part B of Part XIX of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## PART XXII

### ADDITIONAL INFORMATION

#### 1. Responsibility

The HBOS Directors, whose names are set out in paragraph 7.1 of this Part XXII, and the Company accept responsibility for the information contained in this Prospectus. To the best of the knowledge of the HBOS Directors and the Company (who have taken all reasonable care to ensure that such is the case), the information contained in this Prospectus is in accordance with the facts and contains no omissions likely to affect its import.

#### 2. The Company

- 2.1** The Company was incorporated and registered in Scotland on 3 May 2001 with registered number SC218813 under the Companies Act as a public company limited by shares with the name HBOS plc.
- 2.2** The registered office of the Company is at The Mound, Edinburgh EH1 1YZ, United Kingdom.
- 2.3** The principal laws and legislation under which the Company operates, and under which the HBOS Shares have been created, are the Companies Act and regulations made thereunder.
- 2.4** The ISIN of the HBOS Shares is GB0030587504. The Open Offer Shares will be in registered form and may be held in either certificated or uncertificated form.

#### 3. Share capital

- 3.1** As at 14 November 2008, being the latest practicable date prior to the publication of this Prospectus, the authorised, issued and fully paid share capital of the Company was as follows:

<i>Class of Share</i>	<i>Authorised Number</i>	<i>Amount (£)</i>	<i>Issued Number</i>	<i>Amount (£)</i>
Ordinary shares of 25p each	7,640,000,000	1,910,000,000.00	5,406,574,275	1,351,643,568.75
Preference shares of £1 each	2,593,834,398	2,593,834,398.00	0	0.00
6 $\frac{1}{8}$ % non-cumulative redeemable preference shares of £1 each	200,000,000	200,000,000.00	0	0.00
9 $\frac{1}{4}$ % non-cumulative irredeemable preference shares of £1 each	375,000,000	375,000,000.00	300,000,000	300,000,000.00
9 $\frac{3}{4}$ % non-cumulative irredeemable preference shares of £1 each	125,000,000	125,000,000.00	100,000,000	100,000,000.00
8.117% non-cumulative perpetual preference shares class 'A' of £10 each	250,000	2,500,000.00	0	0.00
7.754% non-cumulative perpetual preference shares class 'B' of £10 each	150,000	1,500,000.00	0	0.00
6.0884% non-cumulative preference shares of £1 each	750,000	750,000.00	750,000	750,000.00
6.475% non-cumulative preference shares of £1 each	198,065,600	198,065,600.00	198,065,600	198,065,600.00
6.3673% fixed to floating non-cumulative preference shares of £1 each	350,002	350,002.00	350,000	350,000.00
Preference shares of €1 each	3,000,000,000	€3,000,000,000.00	0	€0.00
Preference shares of US\$1 each	4,997,750,000	US\$4,997,750,000.00	0	US\$0.00
6.413% non-cumulative callable fixed-to-floating rate Series 'A' preference shares of US\$1 each	750,000	US\$750,000.00	750,000	US\$750,000.00
5.92% non-cumulative callable fixed-to-floating rate series 'B' preference shares of US\$1 each	750,000	US\$750,000.00	750,000	US\$750,000.00
6.657% non-cumulative callable preference shares of US\$1 each	750,000	US\$750,000.00	750,000	US\$750,000.00
Preference shares of Aus\$1 each	1,000,000,000	AUS\$1,000,000,000.00	0	AUS\$0.00
Preference shares of Can\$1 each	1,000,000,000	CAN\$1,000,000,000.00	0	CAN\$0.00
Preference shares of 250YEN each	400,000,000	YEN100,000,000,000.00	0	YEN0.00

<i>Class of Share</i>	<i>Authorised Number</i>	<i>Amount (£)</i>	<i>Issued Number</i>	<i>Amount (£)</i>
12% fixed to floating callable non-cumulative preference shares of £1 each	3,000,000	3,000,000.00	1	1.00

**3.2** The authorised, issued and fully paid ordinary share capital of the Company immediately following the Placing and Open Offer, but prior to the Acquisition becoming Effective, is expected to be as follows:

<i>Class of Share</i>	<i>Authorised Number</i>	<i>Amount (£)</i>	<i>Issued Number</i>	<i>Amount (£)</i>
Ordinary shares of 25p each	15,140,000,000	£3,785,000,000.00	12,888,968,641	3,222,242,160.25

**3.3** As at 1 January 2005, the first day covered by the historical financial information incorporated by reference into this document, the authorised ordinary share capital of the Company was £1,185,000,000, divided into 4,740,000,000 HBOS Shares. At a General Meeting of HBOS Shareholders held on 26 June 2008, the authorised share capital of the Company was increased to £1,910,000,000 divided into 7,640,000,000 HBOS Shares, by the creation of 2,900,000,000 new HBOS Shares. Other than as described in this paragraph 3.3, since 1 January 2005 there has been no change to HBOS's authorised ordinary share capital.

#### ***Issued ordinary share capital***

**3.4** As at 1 January 2005, the first day covered by the historical financial information incorporated by reference into this document, 3,925,659,366 HBOS Shares were in issue fully paid or credited as fully paid. Since 1 January 2005, there have been the following changes in the issued ordinary share capital of the Company:

<i>Year</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>
Ordinary shares issued as a result of the Rights Issue	0	0	0	1,499,662,328
Ordinary shares issued as a result of the exercise of Options granted under the Sharesave Scheme	209,236	272,919	4,308,344	5,818,635
Ordinary shares issued as a result of the exercise of the All Employee Share Option Scheme	18,994,244	19,475,966	6,174,797	39,313
Ordinary shares issued as a result of the exercise of Executive Share Option Scheme	1,730,991	782,581	382,360	2,000
Ordinary shares issued as a result of the exercise of HBOS St James's Place Share Option Scheme	10,823	272,915	343,025	41,359
Ordinary shares issued as a result of the grant or maturity of Annual Bonus Plan	0	0	0	12,432,521
Ordinary shares issued under the Share Incentive Plan	0	6,780,219	7,606,380	18,091,377
Treasury HBOS Shares purchased under the buy-back scheme	115,571,000	97,461,000	49,557,000	0
HBOS Shares transferred out of Treasury	0	0	0	2,589,000
Treasury HBOS Shares cancelled	110,000,000	100,000,000	50,000,000	0
HBOS Shares issued as a result of the Capitalisation Issue	0	0	0	137,482,576

**3.5** As at 31 December 2007, the authorised ordinary share capital of the Company was £1,185,000,000 divided into 4,740,000,000 HBOS Shares, of which 3,730,415,166 (excluding 2,589,000 HBOS Shares held in Treasury) were issued and fully paid up.

**3.6** Between 2 March 2005 and 31 December 2007 the Company undertook a share buyback programme. Some of the HBOS Shares purchased have not been cancelled but are held in a treasury reserve. The total number of HBOS Shares held in treasury as at 31 December 2007 was 2,589,000, with a book value of £21,042,470 and a nominal value of £647,250, representing approximately 0.07% of the issued share capital of the Company.

**3.7** Under Section 80 of the Companies Act 1985, HBOS Directors are, with certain exceptions, unable to allot relevant securities without the authority of the shareholders in a general meeting. Relevant securities, as defined in the Companies Act 1985, include the HBOS Shares or securities convertible into HBOS Shares. In addition, Section 89 of the Companies Act 1985 imposes further restrictions on the issue of equity securities (as defined in the Companies Act 1985, which include the HBOS Shares and securities convertible into HBOS Shares) which are, or are to be, paid up wholly in cash and not first offered to existing shareholders, except insofar as such statutory pre-emption rights have been disapplied in accordance with Section 95 of the Companies Act 1985.

**3.8** It is proposed that resolutions will be passed at the HBOS General Meeting to be held on 12 December 2008 so that:

(1) Approval of Rule 9 waiver

Subject to and conditional on the Placing and the Open Offer becoming unconditional, the waiver granted by the Panel of any obligation which might otherwise arise for HM Treasury or their nominee to make a general cash offer to the remaining ordinary shareholders of the Company for all the issued ordinary shares in the capital of the Company held by them pursuant to Rule 9 of the City Code following completion of the Placing and Open Offer will be approved.

(2) Approval of Capital Raising

Subject to and conditional on resolution 3 being passed:

(a) the authorised share capital of the Company will be increased from £5,410,000,000, €3,000,000,000, US\$5,000,000,000, AUS\$1,000,000,000, CAN\$1,000,000,000 and YEN100,000,000,000 to £7,288,000,000, €3,000,000,000, US\$5,000,000,000, AUS\$1,000,000,000, CAN\$1,000,000,000 and YEN100,000,000,000 by the creation of:

- (i) 7,500,000,000 new ordinary shares of 25 pence each; and
- (ii) 3,000,000 new preference shares of £1 each;

(b) (i) pursuant to Section 80 of the Companies Act 1985, the HBOS Directors will be generally and unconditionally authorised to exercise all the powers of the Company to allot relevant securities (as defined in Section 80(2) of the Companies Act 1985) up to an aggregate nominal amount of:

- (A) £1,875,000,000 in respect of ordinary shares of 25 pence each in connection with the Placing and Open Offer; and
- (B) £3,000,000 in respect of preference shares of £1 each;

(ii) the authority given by section (b) shall expire on 30 June 2009, and is in addition to and without prejudice to any other authorities under section 80 of the Companies Act 1985 to allot the relevant securities of the Company previously granted and in force, or to be granted, on the date on which this resolution is passed. (For the avoidance of doubt the authority given by section (b) of resolution 2 will not invalidate, and will not be invalidated by, any authority given by any other section of resolution 2 or by resolution 3, 4 or 5 below.); and

(iii) during the period stipulated in (ii) above, the HBOS Directors can make offers and enter into agreements which would or might require relevant securities to be allotted after the expiry of such period and the HBOS Directors may allot relevant securities in pursuance of such offer or agreement as if the authority conferred hereby had not expired; and

(c) the terms of the Capital Raising will be approved and the HBOS Directors will be directed to implement the Capital Raising on the basis described in the Scheme Document and generally and unconditionally authorised to exercise all the powers of the Company to the extent the HBOS Directors determine necessary to implement the Capital Raising.

(3) Ordinary Share Scheme of Arrangement

Subject to and conditional on the passing of the resolution to be proposed at the Court Meeting and resolution 2:

(a) for the purposes of giving effect to the Scheme:

- (i) upon delivery of a certified copy of the Scheme Court Order, each of the Scheme Shares will be reclassified as an A Ordinary Share or a B Ordinary Share, on the following basis:

- (A) each Scheme Share which is held by (or by a nominee on behalf of) any of the Restricted Entities will be reclassified as a B Ordinary Share; and
- (B) each other Scheme Shares will be reclassified as an A Ordinary Share;
- (ii) with effect from the reclassification referred to in paragraph (i) above, the HBOS Articles will be amended (accordingly);
- (b) contingently upon the reclassification referred to in paragraph (a)(i) above taking effect and the requisite entries having been made in the register of members of the Company, the share capital of the Company will be reduced by cancelling and extinguishing A Ordinary Shares and B Ordinary Shares;
- (c) forthwith and contingently upon the reduction of capital referred to in paragraph (b) above taking effect, the share capital of the Company will be increased to its former amount by the creation of such number of New HBOS Shares as is equal to the aggregate number of A Ordinary Shares and B Ordinary Shares cancelled pursuant to paragraph (b) above;
- (d) forthwith and contingently upon the reduction of capital referred to in paragraph (b) above taking effect:
  - (A) the reserve arising in the books of account of the Company as a result of the said reduction of capital will be capitalised and applied by the Company in paying up in full at par all of the New HBOS Shares created pursuant to paragraph (c) above, which shall be allotted and issued, credited as fully paid up, to Lloyds TSB or its nominee, in accordance with the Scheme;
  - (B) the HBOS Directors will be generally and unconditionally authorised pursuant to section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of section 80(2) of the Companies Act 1985) in the form of the New HBOS Shares, provided always that (A) the authority shall expire on the fifth anniversary of the date of this resolution; (B) the maximum nominal amount of shares which may be allotted under the resolution shall be the aggregate nominal amount of the New HBOS Shares created pursuant to paragraph (c) above; and (C) the authority shall be without prejudice to any other authority under the said section 80 previously granted and in force, or to be granted, on the date on which the resolution is passed; and

provided that, if the reduction of capital referred to in paragraph (b) above does not become effective within ten business days of the Reorganisation Record Time or such earlier date as the Company and Lloyds TSB may agree and the Company may announce through a Regulatory Information Service, the reclassifications effected by paragraph (a)(i) above shall be reversed and the A Ordinary Shares and B Ordinary Shares shall revert to ordinary shares, and the new HBOS Article 3.1 adopted and included in the articles of association of the Company pursuant to paragraph (a)(ii) above shall be amended accordingly;

- (e) forthwith upon the passing of the resolution, the HBOS Articles will be amended as a consequence of the Scheme;
- (f) forthwith upon the passing of the resolution:
  - (i) one authorised but unissued ordinary share of the Company will be reclassified as a Deferred Share, such Deferred Share to have all the rights of a HBOS Share as set out in the HBOS Articles, as amended pursuant to paragraph (ii) below;
  - (ii) the HBOS Articles will be altered as a consequence of paragraph (i) above;
  - (iii) the HBOS Directors will be generally and unconditionally authorised for the purposes of section 80 of the Companies Act 1985 to allot the Deferred Share provided that (A) this authority shall expire on the fifth anniversary of the date of this resolution and (B) this authority shall be without prejudice to any other authority under the said section 80 previously granted and in force, or to be granted, on the date on which this resolution is passed; and
  - (iv) pursuant to and during the period of the authority conferred by subparagraph (ii), the HBOS Directors will be empowered to allot the said Deferred Share wholly for cash as if section 89(1) of the Companies Act 1985 did not apply to any such allotment.



(4) Preference Shares Scheme of Arrangement

Subject to and conditional on resolution 3 above being passed and becoming unconditional:

- (a) for the purposes of giving effect to the HBOS Preference Share Scheme:
- (i) upon delivery of a certified copy of the Court order sanctioning the Preference Scheme to the Registrar of Companies in Scotland, if an interest in any Preference Scheme Shares (as defined in paragraph (b) below) of any one or more particular class (each a "**Reclassified Class**") is held by a Restricted Entity each of the Preference Scheme Shares of each Reclassified Class shall be reclassified as an A Preference Share or a B Preference Share (as defined in the HBOS Preference Share Scheme), as the case may be, on the following basis:
    - (A) each Preference Scheme Share of any Reclassified Class in respect of which an interest is held by a Restricted Entity shall be reclassified as a B Preference Share of the relevant Reclassified Class; and
    - (B) each other Preference Scheme Share of the relevant Reclassified Class shall be reclassified as an A Preference Share of that Reclassified Class of the Reclassified Class;
  - (ii) with effect from any reclassification referred to in paragraph (i) above, the HBOS Articles will be amended (accordingly);
- (b) the preference shares (including, where applicable, any A Preference Shares or B Preference Shares) that will be cancelled pursuant to the reductions of capital set out in resolution 5 will be referred to as the **Preference Scheme Shares** (provided that if a resolution relating to the cancellation of a particular class of preference share is not passed or the holders of such class of shares do not approve the Preference Share Scheme by the requisite majority at an appropriate meeting of such holders, that class of preference share shall not be reclassified or cancelled nor shall such classes of preference shares be deemed to be Preference Scheme Shares and references to Preference Scheme Shares shall be interpreted accordingly);
- (c) forthwith and contingently upon the reduction of capital in respect of the Preference Scheme Shares taking effect, the share capital of the Company will be increased to its former amount by the creation of such number of new preference shares in the capital of the Company (the "**New Preference Shares**") as is equal to the number of Preference Scheme Shares in the different classes cancelled pursuant to resolution 5 and having the same rights (as amended by this resolution) as the Preference Scheme Shares in the different classes so cancelled;
- (d) forthwith and contingently upon the reduction of capital in respect of the Preference Scheme Shares taking effect;
- (i) the reserve arising in the books of account of the Company as a result of the said reductions of capital will be capitalised and applied by the Company in paying up in full at par all of the New Preference Shares created pursuant to paragraph (c) above, which shall be issued, credited as fully paid up and treated as having the same share premium as that of the corresponding Preference Scheme Shares, to Lloyds TSB (or its nominees), in accordance with the Preference Scheme; and
  - (ii) the HBOS Directors will be generally and unconditionally authorised pursuant to and in accordance with section 80 of the Companies Act 1985 to exercise all the powers of the Company to allot relevant securities (within the meaning of section 80(2) of the Companies Act 1985) in the form of the New Preference Shares, provided always that (A) the authority shall expire on the fifth anniversary of the date of this resolution; (B) the maximum nominal amount of shares which may be allotted hereunder shall be the aggregate nominal amount of the New Preference Shares created pursuant to paragraph (c) above of this resolution; and (C) this authority shall be without prejudice to any other authority under the said section 80 previously granted and in force, or to be granted, on the date on which this resolution is passed; and
- (e) forthwith upon the passing of this resolution, the HBOS Articles will be amended (accordingly).

#### (5) HBOS Preference Share Scheme

In relation to each class of HBOS Preference Shares, subject to and conditional on resolutions 3 and 4 as set out above and the resolution set out in the notice of the **Preference Court Meeting** (as defined in the HBOS Preference Share Scheme) relating to the particular class of HBOS Preference Shares being passed, for the purpose of giving effect to the HBOS Preference Share Scheme, the share capital of the Company will be reduced by cancelling and extinguishing the particular class of HBOS Preference Shares in accordance with the terms of the Preference Scheme or, to the extent that the shares of the particular class of HBOS Preference Shares have been reclassified into A Preference Shares and B Preference Shares pursuant to resolution 4(a) as set out above, the A Preference Shares and B Preference Shares in respect of that particular class of HBOS Preference Shares.

**3.9** Pursuant to the Placing and Open Offer, 7,482,394,366 Open Offer Shares will be issued at not less than the Issue Price.

**3.10** For the purposes of Swiss securities laws, it is confirmed that the Company has not issued any participation certificates (*Partizipationsscheine*) or profit sharing certificates (*Genussscheine*).

**3.11** Details on the share capital of Lloyds TSB are set out in section 2 of Part XXI (“Additional Information”) of the Lloyds TSB Prospectus, which is incorporated by reference herein.

Details on dividends, capitalisation and other distributions of Lloyds TSB are set out in section 3 of Part XXI (“Additional Information”) of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

#### **4. Summary of the Memorandum and Articles of Association**

The HBOS Memorandum (dated 3 May 2001) and the HBOS Articles (as adopted on 29 April 2008 and as subsequently amended) are available for inspection as described in paragraph 23 of this Part XXII.

##### **4.1 HBOS Memorandum**

The Company’s objects can be found in the HBOS Memorandum at clause 4. The objects include, amongst other things, to carry on business of a holding company and to co-ordinate and regulate all or any part of the businesses and operations of any and all companies, firms and businesses controlled by the Company and or in which the Company is interested, whether as shareholder or otherwise, to carry on business as an investment holding company, and to carry on the business of banking and provision of financial services in each case in all their forms including, borrowing, raising and taking in money in any way and on any terms.

##### **4.2 HBOS Articles**

Amendments to the HBOS Articles were approved at the Company’s Annual General Meeting held on 29 April 2008. The amendments were primarily to reflect certain changes in company law introduced by the Companies Act 2006 which is being implemented in the United Kingdom in stages.

The HBOS Articles contain provisions, *inter alia*, to the following effect:

###### **A. MEMBERSHIP OF BOARD**

A.1 There must be at least 10 HBOS Directors. Subject to there being at least two HBOS Directors, the shareholders can vary this minimum, or impose a maximum, by an Ordinary Resolution.

A.2 At every Annual General Meeting one-third of the current HBOS Directors must retire as HBOS Directors. If this is not a whole number, the number of HBOS Directors to retire is the number which is nearest to, but smaller than, one-third. No HBOS Director shall continue to hold office as a HBOS Director after the third Annual General Meeting

following his election or re-election, as the case may be, without submitting himself for re-election at the third Annual General Meeting. There are specific provisions regarding the power to fill vacancies and appoint extra HBOS Directors.

- A.3 At the General Meeting at which a HBOS Director retires, the shareholders can pass an Ordinary Resolution to re-elect the HBOS Director or to elect some other eligible person in his place.
- A.4 Only the following people can be elected as HBOS Directors at a General Meeting: (a) a HBOS Director who is retiring at the meeting; (b) a person who is recommended by the HBOS Directors; or (c) any other person who has been proposed for election or re-election.
- A.5 The shareholders can pass an Ordinary Resolution to remove an HBOS Director, even though his time in office has not ended. Special notice of the resolution must be given to the Company as required by legislation. The shareholders can pass an Ordinary Resolution to appoint a person to replace a HBOS Director who has been removed in this way who will then be due to retire by rotation when the HBOS Director he replaces would have been due to retire. Otherwise, if no HBOS Director is appointed under these provisions, the vacancy can be filled in accordance with rules relating to the power to fill vacancies and appoint extra HBOS Directors. There are specific rules on automatic disqualification of HBOS Directors.
- A.6 If a situation (a “**Relevant Situation**”) arises in which an HBOS Director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and the conflict of interest does not arise in relation to a transaction or arrangement with the Company then: (a) if the Relevant Situation arises from the appointment or proposed appointment of a person as a Director of the Company, the HBOS Directors who have no interest in the matter may resolve to authorise the appointment of the HBOS Director and the Relevant Situation on terms as they may determine; (b) if the Relevant Situation arises in other circumstances, the HBOS Directors who have no interest in the matter may resolve to authorise the Relevant Situation and the continuing performance by the HBOS Director of his duties on terms as they may determine. Any terms may be imposed at the time of the authorisation or may be imposed or varied subsequently and may, for example, include: (a) whether the interested HBOS Director may vote (or be counted in the quorum at a meeting) in relation to any resolution relating to the Relevant Situation; (b) the exclusion of the interested HBOS Director from all information and discussion by the Company of the Relevant Situation; and (c) certain confidentiality restrictions. An HBOS Director must declare the nature and extent of his interest in a Relevant Situation to the other HBOS Directors.
- A.7 If an HBOS Director is in any way, directly or indirectly, interested in a proposed or existing transaction or arrangement with the Company, he must declare the nature and extent of that interest to the other HBOS Directors unless, in the case of an existing transaction or arrangement, the interest has been declared previously. Relevant provisions of the Companies Act 2006 apply.
- A.8 Subject to legislation and to declaring his interest in accordance with the HBOS Articles, an HBOS Director may: (a) enter into or be interested in any transaction or arrangement with the Company, either with regard to his tenure of any office or position in the management, administration or conduct of the business of the Company or as vendor, purchaser or otherwise; (b) hold any other office or place of profit with the Company (except that of Auditor) for a period (subject to legislation) and on terms as the HBOS Directors may decide and be paid extra remuneration for so doing; (c) act by himself or his firm in a professional capacity for the Company (except as Auditor) and be entitled to remuneration for professional services as if he were not an HBOS Director; (d) be or become a shareholder or director of, or hold any other office or place of profit under, or otherwise be interested in, any holding company or subsidiary of that holding company or any other company in which the Company may be interested; and (e) be or become a director of any other company in which the Company does not have an interest if that cannot reasonably be regarded as likely to give rise to a conflict of interest at the time of his appointment as a director of that other company. The HBOS Articles specify

circumstances in which HBOS Directors shall not vote or be counted in the quorum at a meeting, including: (a) on any resolution concerning his own appointment or the termination of his own appointment, as the holder of any office or place of profit with the Company or any other company in which the Company is interested (but special provisions apply where proposals are under consideration concerning the appointment or termination of appointment of two or more HBOS Directors to offices or places of profit with the Company or any other company in which the Company is interested); (b) on any resolution relating to any transaction or arrangement with the Company in which he has an interest which may reasonably be regarded as likely to give rise to a conflict of interest and, if he purports to do so, his vote shall not be counted, but exceptions apply so that a HBOS Director may vote (and be counted in the quorum) where the resolution relates to: (i) any transaction or arrangement in which he is interested by virtue of an interest in shares, debentures or other securities of the Company or otherwise in or through the Company; (ii) the giving of certain guarantees, security or indemnities; (iii) indemnification by the Company in relation to the performance of his duties on behalf of the Company or any subsidiaries; (iv) any issue or offer of shares, debentures or other securities of the Company or any of its subsidiaries in respect of which he is or may be entitled to participate in his capacity as a holder of any such securities or as an underwriter or sub-underwriter; (v) any transaction or arrangement concerning any other company in which he does not hold, directly or indirectly as shareholder, or through his direct or indirect holdings of financial instruments, voting rights representing 1% or more of any class of shares in the capital of that company; (vi) any arrangement for the benefit of employees of the Company or any of its subsidiaries which does not accord to him any privilege or benefit not generally accorded to the employees to whom the arrangement relates; and (vii) the purchase or maintenance of insurance for the benefit of HBOS Directors or persons including HBOS Directors. If any question arises at any meeting as to whether an interest of a HBOS Director (other than the chairman of the meeting) may reasonably be regarded as likely to give rise to a conflict of interest or as to the entitlement of any HBOS Director (other than the chairman of the meeting) to vote in relation to a transaction or arrangement with the Company and the question is not resolved by his voluntarily agreeing to abstain from voting, the question must be referred to the chairman of the meeting and his ruling in relation to the HBOS Director concerned shall be final and conclusive except in a case where the nature or extent of the interest of the HBOS Director concerned, so far as known to him, has not been fairly disclosed. If any question shall arise in respect of the chairman of the meeting and is not resolved by his voluntarily agreeing to abstain from voting, the question shall be decided by a resolution of the HBOS Directors (for which purpose the chairman shall be counted in the quorum but shall not vote on the matter) and the resolution shall be final and conclusive except in a case where the nature or extent of the interest of the chairman of the meeting, so far as known to him, has not been fairly disclosed. Subject to legislation, the Company may by ordinary resolution suspend or relax certain of these provisions or ratify any transaction or arrangement not duly authorised by reason of a breach of these provisions.

- A.9 The HBOS Directors shall conduct and manage the Company's business. They can use all the Company's powers. However, this does not apply where the HBOS Articles or legislation provide that powers can only be used by the shareholders voting at a General Meeting. In addition, the HBOS Directors are, subject to: (a) the provisions of legislation; (b) the HBOS Articles; and (c) any regulations laid down by the shareholders by Special Resolution.
- A.10 Subject to legislation, the HBOS Directors may exercise all the powers of the Company to: (a) borrow money; (b) mortgage or charge all or any of the Company's undertaking, property (present and future) and uncalled capital; (c) issue debentures and other securities; and (d) give security either outright or as collateral security for any debt, liability or obligation of the Company or of any third party.
- A.11 Any HBOS Director (other than an alternate HBOS Director) may appoint any person (including another HBOS Director) to act in his place as an alternate. The appointment requires the approval of the HBOS Directors, unless previously approved by the HBOS Directors or unless the appointee is another HBOS Director. The appointment of an

alternate ends on the happening of any event which, if he were a HBOS Director, would cause him to vacate that office. It also ends if his appointor stops being a HBOS Director, unless that HBOS Director retires at a General Meeting at which he is re-elected again. A HBOS Director can also remove his alternate Director by written notice.

## **B. RIGHTS ATTACHING TO THE SHARES OF THE COMPANY**

### **Rights of Preference Shares issued prior to 25 April 2006**

- B.1 Ranking: The rights of the Initial Preference Shares to share in profits and assets rank ahead of the rights of any other shares. The Initial Preference Shares rank equally with one another and, subject to the HBOS Articles, rank equally with Further Preference Shares to the extent that the terms of the latter provide for this. The rights of Further Preference Shares which do not rank equally with the Initial Preference Shares to share in profits and assets will rank behind the Initial Preference Shares but will otherwise rank as regards other shares as the HBOS Directors have decided before the Further Preference Shares are first allotted. These Further Preference Shares also rank equally with other shares to the extent the terms of the latter provide for this. Subject to the HBOS Articles, a series of HBOS Preference Shares will also have the specific rights the HBOS Directors give them before the series is allotted which can be different from the particular terms attached to any existing series of HBOS Preference Shares. The Company may from time to time create and issue further Preference Shares (the former are also referred to as “**Additional Preference Shares**” and together with the Initial Preference Shares are also referred to as “**Priority Preference Shares**” in the HBOS Articles) which rank equally with the Initial Preference Shares as regards their rights to share in profits and assets. Subject to the HBOS Articles, the Additional Preference Shares may either carry the same or different rights to share in profits and assets as the Initial Preference Shares, the Further Preference Shares or any other series of Additional Preference Shares. The issue of further shares which rank in priority to or equally with the Priority Preference Shares in the profits and assets will be deemed to be a variation of the rights attaching to these shares unless permitted by specific provisions in the HBOS Articles. A series of Junior Preference Shares has the rights to share in the profits and assets as the HBOS Directors decide before that series is first allotted. Junior Preference Shares may, for example, be constituted by the issue of Additional Preference Shares and Further Preference Shares ranking behind the Priority Preference Shares as regards rights to share in profits or assets whose terms provide that the HBOS Directors may determine at any time and without the consent of the holders of such Preference Shares that the rights attaching to some or all of such Additional Preference Shares or Further Preference Shares to share in profits or assets shall be varied on a date decided by the HBOS Directors so that they become Junior Preference Shares. On variation, the Junior Preference Shares shall have the rights decided by the HBOS Directors before the variation took place. To a certain extent, the HBOS Directors may also decide before any series of Junior Preference Shares is first allotted that the rights attaching to that series may conflict with the rights otherwise set out in the HBOS Articles.
- B.2 Rights to profits: A series of HBOS Preference Shares has such rights to a preferential dividend as the HBOS Directors decide to give it and the HBOS Directors can make it a term or condition that there will be no right to a dividend or only in certain circumstances or only if declared by the HBOS Directors or that there will be a right to a different amount on the first dividend payment date. The HBOS Preference Shares will not have any other rights to share in the profits.
- B.3 Specifically, the 9<sup>1</sup>/<sub>4</sub>% Preference Shares have the right to receive a non-cumulative fixed preferential dividend calculated at a rate of 9<sup>1</sup>/<sub>4</sub>% per annum on the amounts paid up or treated as paid up on the shares. The dividend will be payable in arrear in equal half yearly instalments in respect of the half years ending on the last day of February and August each year.

- B.4 The 9<sup>3</sup>/<sub>4</sub>% Preference Shares have the right to receive a non-cumulative fixed preferential dividend calculated at the rate of 9<sup>3</sup>/<sub>4</sub>% per annum on the amounts paid up or treated as paid up on the shares. The dividend will be payable in arrear in equal half yearly instalments in respect of the half years ending on the last day of February and August each year.
- B.5 The 6<sup>1</sup>/<sub>8</sub>% Preference Shares have the right to receive a non-cumulative fixed preferential dividend calculated at the rate of 6<sup>1</sup>/<sub>8</sub>% per annum on the amounts paid up or treated as paid up on the shares. The dividend will be payable in arrear in equal half yearly instalments in respect of the half years ending on the last day of December and June each year.
- B.6 Subject to certain exceptions, if on a dividend payment date the HBOS Directors consider that the distributable profits are sufficient to cover the full payment of dividends payable at the time on HBOS Preference Shares and other shares which rank equally with them in sharing the profits the relevant dividends must be declared and paid in full. The exceptions are that the HBOS Directors have decided before a particular series of HBOS Preference Shares or other relevant shares are first allotted that they will have no right to dividend or the terms of the series or other relevant shares allow HBOS Directors an option to decide this subsequently or the FSA's capital adequacy requirements would be breached (unless the FSA otherwise agrees). If the HBOS Directors consider that the profits of the Company are not enough to pay in full dividends on the HBOS Preference Shares or other shares ranking equally with them in sharing in the profits then subject to the FSA's capital adequacy requirements, the HBOS Directors must (except where there is no right to a dividend): (i) firstly, use any distributable profits to declare the dividend on the Priority Preference Shares or if there are insufficient distributable profits, a reduced dividend in proportion to the dividends which would have otherwise been due on those shares if there had been sufficient profits; and (ii) secondly, and in general, the HBOS Directors must use any remaining distributable profits to declare dividends on the Further Preference Shares (other than the Additional Preference Shares) or if there are insufficient distributable profits, a reduced dividend in proportion to the dividends which would have otherwise been due on those shares if there had been sufficient profits.
- B.7 In certain circumstances, the HBOS Directors are required or may allot and issue extra Non-Cumulative Preference Shares to holders of shares (but not holders of the 6.0884% Non-Cumulative Preference Shares of £1 each) if the whole or part of any dividend on those shares is not paid for the above reasons. The extra Non-Cumulative Preference Shares will be credited as fully paid and the total nominal value to be allotted and issued will be equal to the unpaid amount (after tax in the case of the 6<sup>1</sup>/<sub>8</sub>% Preference Shares) multiplied by a set amount or worked out using a formula. They will be allotted and issued when the unpaid amount was due to be paid. The multiple to be used in relation to the 9<sup>1</sup>/<sub>4</sub>% Preference Shares, the 9<sup>3</sup>/<sub>4</sub>% Preference Shares and the 6<sup>1</sup>/<sub>8</sub>% Preference Shares will be: (a) in relation to the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and the 9<sup>3</sup>/<sub>4</sub>% Preference Shares, <sup>4</sup>/<sub>3</sub> and the resulting product will be rounded down to the nearest £1; and (b) in relation to the 6<sup>1</sup>/<sub>8</sub>% Preference Shares, <sup>10</sup>/<sub>9</sub> and the resulting product will be rounded down to the nearest pound. The extra Non-Cumulative Preference Shares will be in the same currency as, have the same rights and restrictions as, and rank equally with the Non-Cumulative Preference Shares on which the dividend has not been declared and paid but there will be no right to receive cash on any part of the dividend which has not been paid.
- B.8 The Company cannot: (i) redeem, reduce, buy or otherwise acquire, any series of HBOS Preference Shares or any other shares which rank equally with or behind the HBOS Preference Shares in the sharing of the assets and the Company may not set aside any sum nor establish a sinking fund for their redemption, reduction, purchase or acquisition; or (ii) in general, declare or set aside any sum for the payment of any dividends on any series of HBOS Preference Shares or any other shares which rank equally with or behind the HBOS Preference Shares in sharing of the profits if, in relation to all other series of HBOS Preference Shares and other shares which rank equally with the HBOS Preference Shares and which have the benefit of these provisions and are shares to which the requirement to declare and pay dividends applies: (A) all dividends on

Cumulative Preference Shares have not been fully paid or a sum has not been set aside for full payment; or (B) where relevant, the dividends on Non-Cumulative Preference Shares have not been fully paid or a sum has not been set aside for full payment or extra Non-Cumulative Preference Shares have not been allotted and issued instead. In addition, and in general, in relation to shares which rank equally with or behind the shares referred to in the circumstances below, the Company cannot: (i) redeem, reduce, buy or otherwise acquire, any series of HBOS Preference Shares (or other shares ranking equally with these) (A) which are shares in respect of which the HBOS Directors have decided the requirement to pay a dividend will not apply and which rank equally with or (B) which, other than a series of HBOS Preference Shares which are issued to satisfy an obligation existing on 27 April 2004, rank behind the HBOS Preference Shares referred to in the circumstances below in sharing the assets and the Company may not set aside any sum or establish any sinking fund for their redemption, reduction, purchase or acquisition; or (ii) declare or set aside any sum for the payment of any dividends on any series of HBOS Preference Shares (or other shares ranking equally with these) (A) which are shares in respect of which the HBOS Directors have decided the requirement to pay a dividend will not apply and which rank equally with or (B) which, other than any series of HBOS Preference Shares which are issued to satisfy an obligation existing on 27 April 2004, rank behind the HBOS Preference Shares referred to in the circumstances below in sharing in the profits. The circumstances are that the Company cannot do any of these things if in relation to all other series of HBOS Preference Shares (and any other shares ranking equally with these and which have the benefit of these provisions) and in respect of which in either case, the HBOS Directors have decided the requirement to pay a dividend will not apply: (i) the HBOS Directors in their discretion have decided not to declare a dividend in whole or in part and not because of, for example, an absence of profits; or (ii) the HBOS Directors have discretion to allot and issue extra Non-Cumulative Preference Shares instead and have decided not to exercise this discretion.

- B.9 In the case of the Company declaring or setting aside any sum for the payment of any dividends on any series of HBOS Preference Shares which are issued to satisfy an obligation existing on 27 April 2004 and which rank behind the HBOS Preference Shares or other shares in sharing in the profits, in general, the amount which can be distributed and declared or set aside shall be calculated on the basis that the amount of the profits which can be distributed has been reduced by the amount which would have been declared and paid on the HBOS Preference Shares or other shares ranking in priority to the series of HBOS Preference Shares which have been issued to satisfy the obligation existing on 27 April 2004 had dividends been declared and paid in full on those HBOS Preference Shares or other shares.
- B.10 The Company will pay dividends on any redeemable HBOS Preference Shares on the redemption date on which they are due to be redeemed.
- B.11 Rights to capital: If capital is returned or assets distributed to shareholders, each Priority Preference Share will rank equally with every other Priority Preference Share and other shares whose terms provide they rank equally with them in sharing the assets. Other HBOS Preference Shares will rank behind the Priority Preference Shares but will rank equally with each other and other shares whose terms provide they rank equally in sharing the assets and will rank ahead all other shares for these purposes. However, these rules do not apply if there is a return of capital by redemption or buy back of any class of shares. If there is a return of capital each HBOS Preference Shareholder will be entitled to the following from the Company's assets which can be distributed to the shareholders: (i) repayment of the amount paid up or treated as paid up on the HBOS Preference Share; (ii) any premium paid or treated as paid on issue; (iii) the amount of any dividend due for payment on or after the date the winding up commenced or capital was otherwise returned which is payable for a period ending on or before that date; (iv) any dividend arrears on Cumulative Preference Shares held by that shareholder; and (v) a proportion of any dividend if the dividend period began before the winding up commenced or capital was otherwise returned but ends after that date, the proportion being the amount of any dividend that would otherwise have been payable for the period which ends on that date even if the dividend has not been declared or earned. If there

is not enough to pay the amounts due on the HBOS Preference Shares and other shares whose terms provide that they rank equally in sharing the assets then: (i) the Priority Preference Shareholders and holders of other shares ranking equally with them will share what is available in proportion to the amounts to which they are entitled and be given preference over holders of other classes which rank behind them in sharing the assets; and (ii) to the extent any assets remain, Further Preference Shareholders (other than holders of Additional Preference Shares) and holders of other shares whose terms provide that they rank equally with them will share what is available in proportion to the amounts to which they are entitled and in accordance with their respective priorities and be given preference over holders of other classes of shares which rank behind them in sharing the assets.

B.12 Redemption: Subject to legislation and the HBOS Articles, the Company can redeem each series of HBOS Preference Shares other than the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and the 9<sup>3</sup>/<sub>4</sub>% Preference Shares. A particular series of HBOS Preference Shares cannot however be redeemed if the Articles provide or the HBOS Directors have decided this before that series has first been allotted. On redemption the following will be paid on each HBOS Preference Share: (i) the amount of nominal value paid up or treated as paid up on the HBOS Preference Share; (ii) any dividend which has accrued on the redemption date if the HBOS Directors have decided that should be the case before any HBOS Preference Share of that series was first allotted or the HBOS Articles so provide; and (iii) any premium paid when the HBOS Preference Share was issued if the HBOS Directors have decided that should be the case before any Preference Share of that series was first allotted or the HBOS Articles so provide. Unless otherwise decided by the HBOS Directors, payment will be in the currency in which the HBOS Preference Share is denominated. To redeem HBOS Preference Shares of a particular series on the relevant redemption date, the Company will give notice in writing containing prescribed information. For holders of HBOS Preference Shares: (i) with a fixed rate of dividend the notice must be given at least 30 days before the redemption date but not more than 60 days before; and (ii) with a variable rate of dividend the notice must be given at least 20 days before the redemption date but not more than 60 days before. In general, unless the HBOS Directors otherwise decide before HBOS Preference Shares of the relevant series are first allotted, the redemption date will be any date on or after the date the HBOS Directors have chosen as the first date on which the HBOS Preference Shares of that series can be redeemed before shares of that series were first allotted. The first redemption date for any series of HBOS Preference Shares must not be less than five years and one day after the HBOS Preference Shares of that series were first allotted except in the case of the 750,000 6.413% Non-Cumulative Callable Fixed-to-Floating Rate Series 'A' Preference Shares of US\$1 each and the 750,000 5.92% Non-Cumulative Callable Fixed-to-Floating Rate Series 'B' Preference Shares of US\$1 each of the Company. The HBOS Directors may also decide before any HBOS Preference Shares of a particular series are first allotted that any redemption date for that particular series after the first redemption date will only occur: (i) at specified intervals after the first redemption date; (ii) after a period following the redemption date which precedes it; or (iii) on particular dates. Subject to legislation and other regulations, note that the Company may, at its option, redeem the 6<sup>1</sup>/<sub>8</sub>% Preference Shares on the first dividend payment date after 19 April 2024 or any fifth anniversary thereafter. The redemption payment will be £1 per 6<sup>1</sup>/<sub>8</sub>% Preference Share to be redeemed and an amount equal to the accrued but unpaid dividend in respect of the period from the dividend payment date preceding the date fixed for redemption. If the Company is only going to redeem some of a series of HBOS Preference Shares, it will arrange for a draw to decide which HBOS Preference Shares to redeem. If redemption payment is not wrongly withheld or refused, the dividend on any HBOS Preference Shares which are to be redeemed will stop accruing from the date on which the redemption payment is due. The HBOS Preference Shares will not be treated as having been redeemed until the redemption payment has been made. The Company cannot redeem any HBOS Preference Shares unless it has received the prior consent of the FSA, if required. If the FSA does consent to any redemption, it may impose any conditions at the time it gives the consent with which the Company must comply.



B.13 Voting rights: In general, the holders of any series of HBOS Preference Shares are entitled to receive notice of General Meetings, and to attend, speak and vote at General Meetings, if any of the following apply: (i) a resolution is going to be proposed at the meeting which would vary or abrogate the rights and restrictions attached to that series of HBOS Preference Shares in which case, they are only entitled to speak to and vote on this resolution; (ii) a resolution is going to be proposed at the meeting to wind up, or in relation to the winding up of, the Company in which case they are only entitled to speak to and vote on this resolution; or (iii) any other circumstances have arisen which the HBOS Articles provide or the HBOS Directors decided before the HBOS Preference Shares of that series were first allotted, would give them a right to attend and speak and vote at meetings. Nonetheless, the holders of the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and 9<sup>3</sup>/<sub>4</sub>% Preference Shares are entitled to receive notice of, and to attend General Meetings. They can only vote in the circumstances specified above. In addition, if, on the dividend payment date which occurs immediately before the date of notice of any General Meeting, a dividend for the relevant series of HBOS Preference Shares has not been declared and paid in cash in full or, in the case of a series of Non-Cumulative Preference Shares (other than the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and 9<sup>3</sup>/<sub>4</sub>% Preference Shares) where the HBOS Directors have decided that the provisions relating to issue and allotment of extra Non-Cumulative Preference Shares will apply and the extra Non-Cumulative Preference Shares have not been allotted and issued, the holders of the HBOS Preference Shares of that series will be entitled to speak and vote on all resolutions proposed at that meeting. These rights will continue until, in the case of Cumulative Preference Shares, the Company has paid all unpaid dividends in full or, in the case of Non-Cumulative Preference Shares, payment of dividends has been resumed in full or, if the provisions regarding issue and allotment of extra Non-Cumulative Preference Shares apply, (other than in respect of the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and 9<sup>3</sup>/<sub>4</sub>% Preference Shares) the extra Non-Cumulative Preference Shares have been allotted and issued. The HBOS Preference Shareholders of any series can also require there to be a General Meeting if the HBOS Articles provide or the HBOS Directors have decided, before the HBOS Preference Shares of that series were first allotted, that this can be done. The HBOS Directors can decide when and how those Preference Shareholders can do this and the HBOS Directors must call the meeting as soon as it is practicable to do so. Unless the HBOS Directors decide otherwise before HBOS Preference Shares of any series are first allotted, a HBOS Preference Shareholder of that series who attends personally or by proxy (other than the chairman of the meeting in his capacity as a proxy) or by a company representative in each case who is present in person, will have one vote on a show of hands. If there is a poll, a Preference Shareholder of any series who attends personally, or who appoints a proxy or a company representative, will have such number of votes for such amount of nominal value of HBOS Preference Shares of the series of which he is the holder as the HBOS Directors shall decide before the HBOS Preference Shares of that series are first allotted or in the case of a poll in relation to a resolution on which a holder of Priority Preference Shares is entitled to vote, the holders of 9<sup>1</sup>/<sub>4</sub>% Preference Shares, the 9<sup>3</sup>/<sub>4</sub>% Preference Shares and the 6<sup>1</sup>/<sub>8</sub>% Preference Shares will have one vote for each £1 of nominal value of those series of HBOS Preference Shares held by him. Other provisions in the HBOS Articles relating to voting rights will also apply to HBOS Preference Shareholders.

B.14 Conversion: If Convertible Preference Shares become due to be converted, the HBOS Directors can decide that they will be converted as set out in the HBOS Articles or in any other way which legislation allows. The HBOS Directors can decide to redeem any Convertible Preference Shares at their nominal value. The redemption must be made out of the proceeds of a fresh issue of Shares or any other shares into which they can be converted and the following will apply: (i) the Convertible Preference Shares will give their holders the right and obligation to subscribe for the number of HBOS Shares, or other shares, set by the terms of the Convertible Preference Shares; (ii) the new shares will be subscribed for at the premium (if any) which is equal to the redemption money, less the nominal amount of the new shares; (iii) each holder of Convertible Preference Shares will be treated as authorising and instructing the Secretary, or anybody else the HBOS Directors decide on, to subscribe for the shares in this way, and to borrow

money in anticipation of the redemption of the Convertible Preference Shares and this cannot be revoked; and (iv) if a holder of Convertible Preference Shares converts them, or if someone does this for him, he will be treated as authorising and instructing the HBOS Directors to pay his redemption money to the Secretary, or anybody else the HBOS Directors decide on, and to subscribe for the new shares.

#### **Rights of HBOS Preference Shares issued on or after 25 April 2006**

- B.15 Subject to legislation in force at the relevant time, a series of HBOS Preference Shares shall have such rights to share in the profits and assets and such other rights as the HBOS Directors shall decide to give it before HBOS Preference Shares of that series are first allotted but any such decision shall be without prejudice to any rights attaching to any existing HBOS Preference Shares and no such decision shall vary or abrogate the rights attaching to existing HBOS Preference Shares without consent to the variation or abrogation as is required by the HBOS Articles. In deciding the rights, the HBOS Directors shall decide upon, for example, the matters referred to below and may decide upon these matters by reference to, or by deeming the application of, all or any of the rights, obligations, benefits or other matters relevant to HBOS Preference Shares issued prior to 25 April 2006.
- B.16 Currency: Subject only to there being authorised but unissued share capital denominated in a relevant currency, a series of HBOS Preference Shares may be issued in the currency the HBOS Directors decide.
- B.17 Ranking: The HBOS Directors shall decide whether the rights attaching to a series of HBOS Preference Shares to share in the profits and assets rank equally with or behind or ahead of any other HBOS Preference Shares then in issue or to be issued and whether all or any of the rights or the ranking of such HBOS Preference Shares may be varied after HBOS Preference Shares of that series are first allotted and, if so, in what circumstances and subject to what conditions.
- B.18 Rights to share in profits: A series of HBOS Preference Shares shall have such rights to a preferential dividend as the HBOS Directors decide to give it before shares of that series are first allotted. For example, the HBOS Directors shall decide: (i) whether any dividend is payable and at what rate or how the rate is to be determined; (ii) the dividend payment dates; (iii) the dividend periods; (iv) whether the dividend is cumulative or non-cumulative or can change from one to the other; and (v) in respect of a series of HBOS Preference Shares, whether or not additional HBOS Preference Shares may or shall be allotted and issued in lieu of a dividend. No additional HBOS Preference Shares may be allotted and issued unless there is an amount in the Company's profit and loss account, or in any of the Company's reserves (including any share premium account and capital redemption reserve), which can be used for paying up the full nominal value of such HBOS Preference Shares. Additional HBOS Preference Shares allotted and issued in lieu of a dividend will be credited as fully paid. The total nominal value of the additional HBOS Preference Shares shall be determined in such manner and upon such terms as the HBOS Directors shall have decided before the HBOS Preference Shares of the relevant series in respect of which additional HBOS Preference Shares are to be allotted and issued are first allotted.
- B.19 Rights to capital: The rights to capital which apply to HBOS Preference Shares issued before 25 April 2006 also apply to determine the rights of a HBOS Preference Share to share in the Company's assets unless the HBOS Directors decide otherwise in respect of any series of HBOS Preference Shares before HBOS Preference Shares of that series are first allotted.
- B.20 Redemption: In respect of any series of HBOS Preference Shares, the HBOS Directors may decide before HBOS Preference Shares of a series are first allotted that the HBOS Preference Shares of that series are Redeemable Preference Shares and, then, the HBOS Directors may: (i) designate any redemption date(s) whatsoever or decide that there shall be no fixed redemption date or that a fixed redemption date(s) may be designated after allotment; (ii) decide that any redemption in respect of a series of Redeemable Preference Shares shall be in respect of all of the Redeemable Preference Shares of such series or of part only; and (iii) decide in their absolute discretion the terms of redemption and the manner in which these shares may be redeemed.

B.21 Voting rights: If the HBOS Directors so decide prior to the HBOS Preference Shares of any series being first allotted, the HBOS Preference Shareholders of such series shall have such rights to attend and/or speak and/or vote at such meetings as the HBOS Directors may decide. If the HBOS Directors decide that the HBOS Preference Shareholders shall have the right to vote at any meeting, they shall decide how many votes each HBOS Preference Shareholder shall have on: (i) a show of hands and (ii) a poll and shall also decide when and how HBOS Preference Shareholders of the series shall exercise the right. In addition, if the HBOS Directors so decide prior to the HBOS Preference Shares of any series being first allotted, HBOS Preference Shareholders of the series shall have the right to requisition a General Meeting of the Company. The HBOS Directors can decide when and how those HBOS Preference Shareholders can requisition a General Meeting.

B.22 Conversion: Before the HBOS Preference Shares of any series are first allotted the HBOS Directors may decide that they shall be Convertible Preference Shares which: (i) will upon certain dates or in certain circumstances; or (ii) may at the option of the Company upon certain dates or in certain circumstances; or (iii) may at the option of the HBOS Preference Shareholder upon certain dates or in certain circumstances, be converted into HBOS Shares or any other class of shares which rank equally with, or behind, or ahead of existing HBOS Preference Shares in sharing in the profits and assets or any other type of securities whatsoever. The HBOS Directors may decide the number of shares or other securities into which the HBOS Preference Shares shall be converted, or any formula or other method for calculating this number and subject to legislation, decide the manner in which the conversion shall be effected. If the Convertible Preference Shares are to be redeemed for the purposes of the conversion, the HBOS Directors may decide the person(s) who will: (i) be required to subscribe for the shares or other securities into which the Convertible Preference Shares are to be converted and to borrow money in anticipation of the redemption of the Convertible Preference Shares; and (ii) receive any redemption money payable to the relevant Preference Shareholder prior to subscription for such shares or other securities. The HBOS Directors may also decide, if the Convertible Preference Shares are not denominated in Sterling, by what method the equivalent amount of Sterling is to be calculated for the purposes of calculating any premium payable on any shares into which the Convertible Preference Shares are being converted and otherwise, decide upon any other terms whatsoever in relation to the issue of Convertible Preference Shares.

B.23 Other terms and conditions: The HBOS Directors may decide any other terms or conditions of issue of a series of HBOS Preference Shares whatsoever.

### **Rights of HBOS Shares**

B.24 Rights to income: The rights of the HBOS Shares to income are any profits of any financial year which the HBOS Directors or HBOS Shareholders (subject to the rule that no dividends can be payable other than out of distributable profits) decide to distribute to the HBOS Shareholders in proportion to the amounts paid up on their HBOS Shares. This is subject to the rights of any other class of shares which then exist.

B.25 Rights to capital: If there is a return of capital because the Company is wound up, the assets which are left after paying its liabilities will be distributed to the HBOS Shareholders in proportion to the amounts paid up on their HBOS Shares. This is subject to the rights of any other class of shares which then exist.

### **Other provisions regarding rights**

B.26 Special rights of new shares: New shares may have any rights or restrictions attached to them subject to these not varying or abrogating any special rights already given to any other class of shares unless the relevant shareholders have given their consent in accordance with the HBOS Articles. These rights and restrictions can apply to sharing in the profits or assets. Other rights and restrictions can also apply, for example, on the right to vote. These rights and restrictions can give the new shares priority over some or all of the rights of existing shares, or existing shares can have priority over the rights of new shares. Alternatively, the new shares and the existing shares can have the same

rights and restrictions. The rights and restrictions can be decided either by an Ordinary Resolution or by the HBOS Directors as long as there is no conflict with any shareholder resolution. Subject to legislation, the rights of any new shares can include a right for the holder and/or the Company to have them redeemed. The HBOS Directors can make it a term of any HBOS Preference Shares of a particular series before they are first allotted that they can only be transferred as a unit together with another right or security. This can be for a limited period, or at all times, or until an event happens. The HBOS Directors can refuse to register a transfer of any of these HBOS Preference Shares if they are not transferred with the other right or security.

- B.27 Dividends: HBOS Shareholders can declare dividends by passing an Ordinary Resolution. No dividend can exceed the amount recommended by the HBOS Directors. If the HBOS Directors consider that the profits justify such payments, they can: (i) pay the fixed dividends on any class of shares carrying a fixed dividend, including a dividend fixed by reference to or linked to a variable or floating rate or determined by or linked to a formula or index, on the dates prescribed for the payment of those dividends; and (ii) pay interim dividends on shares of any class of any amounts and on any dates and for any periods that they decide. The HBOS Directors can, with the authority of an Ordinary Resolution, offer HBOS Shareholders the right to choose to receive extra HBOS Shares, which are credited as fully paid up, instead of some or all of their cash dividend (a scrip dividend). The HBOS Directors can exclude or restrict the right to opt for new shares or make any other arrangements where they decide that this is necessary or convenient to deal with any of the following legal or practical problems: (i) problems relating to laws of any territory; or (ii) problems relating to the requirements of any recognised regulatory body or stock exchange in any territory, where in either case, special formalities would otherwise apply in connection with the offer of new shares. The new HBOS Shares rank equally in all respects with the existing fully paid-up HBOS Shares on the record date for the dividend. However, they are not entitled to share in the dividend in respect of which they were issued and do not allow the holder to opt for new shares instead of that dividend.
- B.28 Distributions in kind: If the HBOS Directors recommend this, the shareholders can pass an Ordinary Resolution to direct all or part of a dividend to be paid by distributing specific assets (and, in particular, paid-up shares or debentures of any other company). Where any difficulty arises on the distribution, the HBOS Directors can settle it as they decide.
- B.29 Deducting amounts owing from dividends and other money: If a shareholder owes any money for calls on shares or money relating in any other way to shares, the HBOS Directors can deduct any of this money from: (i) any dividend on any shares held by the shareholder; or (ii) any other money payable by the Company in connection with the shares. Money deducted in this way can be used to pay amounts owed to the Company in connection with the shares.
- B.30 Capitalising reserves: Subject to provisions relating to varying the rights of HBOS Preference Shares issued before 25 April 2006, shareholders can pass an Ordinary Resolution to capitalise any sum: (i) which is part of any of the Company's reserves (including premiums received when any shares were issued, capital redemption reserves or other undistributable reserves); or (ii) which the Company is holding as net profits. Unless the Ordinary Resolution states otherwise, the HBOS Directors will use the sum which is capitalised by setting it aside for the HBOS Shareholders on the Register at the close of business on the day the resolution is passed (or another date stated in the resolution or fixed as stated in the resolution). The sum set aside must be used to pay up in full shares of the Company which shall be allotted and distributed to shareholders as bonus shares in proportion to their holdings of HBOS Shares at the time specified in the resolution. The shares can be HBOS Shares or, if the rights of other existing shares allow this, shares of some other class. If any difficulty arises in operating these provisions, the HBOS Directors can resolve it in any way which they decide. For example, they can deal with entitlements to fractions of a share by deciding that the benefit of share fractions belong to the Company or that share fractions are ignored or deal with fractions in some other way.

- B.31 Winding up: If the Company is wound up (whether the liquidation is voluntary, under supervision of the Court or by the Court), the liquidator can, with the authority of an Extraordinary Resolution divide among the shareholders the whole or any part of the assets subject to the rights of any class of share which then exists (including the rights of any HBOS Preference Shares of any particular series). For this purpose, the liquidator can set such value as he considers fair upon any property and decide how such division is carried out as between shareholders or different groups of shareholders. No past or present shareholder can be compelled to accept any shares or other property under these provisions which carries a liability.
- B.32 Redemption: Subject to legislation and to any rights previously conferred on the holders of any other shares, any share may be issued which is to be redeemed, or is liable to be redeemed at the option of the Company or the holder.
- B.33 Voting rights: When a shareholder is entitled to attend a meeting and vote, he has only one vote on a show of hands. A proxy (other than the chairman of the meeting in his capacity as a proxy) can vote on a show of hands but does not have more than one vote even if he is also a shareholder himself or is a proxy for more than one person. When there is a poll, a shareholder (or his proxy) who is entitled to be present and to vote has one vote for every share which he holds. This is subject to any special rights or restrictions which are given to any class of shares by, or under, the HBOS Articles. The only people who can attend or vote at a General Meeting are shareholders who have paid the Company all calls and outstanding sums relating to their shares at the time of the meeting.
- B.34 Voting restrictions: If any shareholder, or any person appearing to be interested in shares held by that shareholder, has been properly served with a notice under Section 793 of the Companies Act 2006, requiring information about interests in shares, and has failed for a period of 14 days to supply to the Company the required information then, unless the HBOS Directors otherwise decide, the shareholder is not, for as long as the failure continues, entitled to attend or vote either personally or by proxy at a shareholders' meeting or to exercise any other right in relation to shareholders' meetings as holder of: (i) the shares in relation to which the default occurred; (ii) any further shares which are issued in respect of default shares; and (iii) any other shares held by the shareholder holding the default shares. Any person who acquires shares subject to these restrictions is subject to the same restrictions, unless: (i) the transfer was an approved transfer; or (ii) the transfer was by a shareholder who was not himself in default in supplying the information required by the Section 793 notice and a certificate is provided as set out below. If the default shares represent 0.25% or more of the existing shares of a class, the HBOS Directors can in their absolute discretion by notice to the shareholder direct that: (i) any dividend or part of a dividend or other money which would otherwise be payable on the default shares shall be retained by the Company without any liability to pay interest when such money is finally paid to the shareholder; and/or (ii) the shareholder shall not be entitled to elect to receive shares in place of dividends; and/or (iii) no transfer of any of the shares held by the shareholder in certificated form and, so far as it is permitted by the CREST Regulations, no transfer of the shares held by the shareholder in uncertificated form shall be registered or effected, unless either: (i) the transfer is an approved transfer; or (ii) the shareholder is not himself in default as regards supplying the information required, and in this case, the transfer is of part only of his holding; and when presented for registration, the transfer is accompanied by a certificate given by the shareholder. This certificate must be in a form satisfactory to the HBOS Directors and state that, after due and careful enquiry, the shareholder is satisfied that none of the shares included in the transfer are default shares. A direction notice has the effect which it states while the default resulting in the notice continues. It ceases to apply when the HBOS Directors decide. The Company must give the shareholder immediate written notice of the HBOS Directors' decision. A direction notice also ceases to apply to any shares which are transferred by a shareholder in a permitted transfer even where a direction notice restricts transfers. A transfer of shares is an approved transfer if: (i) it is a transfer of shares to an offeror under an acceptance of a takeover offer (as defined in Part 28 of the Companies Act 2006); or (ii) the HBOS Directors are satisfied that the transfer is made in connection

with a sale, in good faith, of the whole of the beneficial ownership of the shares to a party unconnected with the shareholder or with any person appearing to be interested in the shares. This includes a sale made through the London Stock Exchange or any other stock exchange outside the United Kingdom on which the Company's shares are normally traded.

- B.35 Calls: Shareholders may not exercise their rights until calls are paid. There are also certain rights in favour of the Company relating to forfeiture of and liens over shares if a shareholder fails to pay the whole amount of a call (or instalment) by the relevant due date.

## **C. VARIATION OF RIGHTS**

- C.1 Variation of rights of HBOS Preference Shares issued prior to 25 April 2006: The rights of the holders of any series of HBOS Preference Shares will be regarded as being varied or abrogated if: (i) the HBOS Directors seek to authorise, create or increase the amount of any class of shares, or other securities which can be converted into any class of shares, which rank ahead of the HBOS Preference Shares of the relevant series in sharing in the profits or assets other than a series of Junior Preference Shares if, and to the extent that, the HBOS Directors have so decided before Junior Preference Shares of that series are first allotted that these provisions shall not apply to such Junior Preference Shares; (ii) immediately following a capitalisation of any reserves which are capable of being distributed to shareholders (other than in the case of distributable reserves which are being capitalised for the purposes of allotting and issuing extra HBOS Shares to HBOS Shareholders as permitted by the HBOS Articles or for the purposes of allotting and issuing extra Non-Cumulative Preference Shares to Preference Shareholders as permitted under the HBOS Articles), the reserves which are held by the Company and its subsidiaries and are capable of being distributed would amount, in total, to less than a multiple (which in the case of the Priority Preference Shares is ten), decided on by the HBOS Directors before the HBOS Preference Shares of the relevant series are first allotted, of the total annual amount of any dividends payable in respect of all HBOS Preference Shares in issue at the time of that capitalisation; (iii) any other series of HBOS Preference Shares or any other class of shares which is to rank equally with the relevant series of HBOS Preference Shares in some or all respects is created or issued or any securities are created or issued which are convertible into HBOS Preference Shares or those other shares, if, where the HBOS Preference Shares of the relevant series are Cumulative Preference Shares, the dividend payment on those HBOS Preference Shares (including any dividend arrears) has not been paid in full or, where the HBOS Preference Shares of the relevant series are Non-Cumulative Preference Shares, the dividend payment on the HBOS Preference Shares of the relevant series has not been paid in full on the dividend payment date which occurs immediately before the creation or issue of those shares or securities or, in the case of Non-Cumulative Preference Shares to which the HBOS Directors have decided (or the HBOS Articles provide) that the provisions on issue and allotment of extra Non-Cumulative Preference Shares will apply if the extra Non-Cumulative Preference Shares have not been allotted and issued in respect of that dividend payment; or (iv) any resolution is passed for the reduction of the amount of capital paid up on the HBOS Preference Shares of the relevant series. Unless the HBOS Directors decide otherwise before HBOS Preference Shares of any particular series are first allotted, these events can only take place if: (i) holders of at least three quarters in nominal value of all existing HBOS Preference Shares of the relevant series agree in writing; or (ii) an Extraordinary Resolution, passed at a separate meeting of the holders of the existing HBOS Preference Shares of the relevant series approves the proposal in accordance with the HBOS Articles. Subject to legislation, in the case of the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and 9<sup>3</sup>/<sub>4</sub>% Preference Shares, the agreement in writing of the holders of a majority in nominal value of, or the approval of an Ordinary Resolution passed at a meeting of holders of the relevant class(es) of the Initial Preference Shares is sufficient. Whenever the rights attached to existing HBOS Preference Shares of any particular series differ from the rights attached to existing HBOS Preference Shares of any other series and some matter arises which would amount to a variation or abrogation of the rights attached to all the HBOS Preference Shares of those series, if the effect of that variation or abrogation on all the HBOS

Preference Shares of those series is, in the opinion of the HBOS Directors, substantially the same, the rights attached to all the HBOS Preference Shares of those series may be varied or abrogated by the agreement in writing of the holders of at least three quarters in nominal value of all the HBOS Preference Shares of those series (other than the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and the 9<sup>3</sup>/<sub>4</sub>% Preference Shares) or with the approval of any Extraordinary Resolution, passed at a separate meeting of the holders of all the HBOS Preference Shares of those series (other than the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and the 9<sup>3</sup>/<sub>4</sub>% Preference Shares). Whenever these rules apply, all the holders of the HBOS Preference Shares of the relevant series (other than the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and the 9<sup>3</sup>/<sub>4</sub>% Preference Shares) shall be treated as holding HBOS Preference Shares of a single class. Subject to legislation, a separate meeting of the holders of each of the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and the 9<sup>3</sup>/<sub>4</sub>% Preference Shares must approve the proposal by the passing of an Ordinary Resolution at each such meeting of the relevant class or the holders of the majority in nominal value of each of these classes of HBOS Preference Shares must agree in writing. Subject to the above, and unless the HBOS Directors decide otherwise before the HBOS Preference Shares of any particular series are first allotted, the special rights which apply to those HBOS Preference Shares will not be varied if: (i) any other series of HBOS Preference Shares is created or issued; (ii) any other shares are created or issued which rank equally with, or behind, the HBOS Preference Shares in sharing in the profits or assets; or (iii) the Company redeems or buys back any of its shares which rank equally with, or behind, those HBOS Preference Shares in sharing in the profits or assets. If a new series of HBOS Preference Shares, or any other class of shares, is created, or issued, which ranks equally with the existing HBOS Preference Shares in sharing in the profits or assets, these can either have the same rights as, or different rights from, existing HBOS Preference Shares and will not, of itself, be treated as varying or abrogating the rights of the existing HBOS Preference Shares.

- C.2 Variation of rights of HBOS Preference Shares issued on or after 25 April 2006: A variation or abrogation of rights attached to any particular series of HBOS Preference Shares can only take place if: (i) holders of at least three quarters in nominal value of all existing HBOS Preference Shares of the relevant series agree in writing; or (ii) an Extraordinary Resolution, passed at a separate meeting of the holders of the existing HBOS Preference Shares of the relevant series approves the proposal in accordance with the HBOS Articles. Whenever the rights attached to existing HBOS Preference Shares of any particular series differ from the rights attached to existing HBOS Preference Shares of any other series and some matter arises which would amount to a variation or abrogation of the rights attached to all the HBOS Preference Shares of those series, if the effect of that variation or abrogation on all the HBOS Preference Shares of those series is, in the opinion of the HBOS Directors, substantially the same, the rights attached to all the HBOS Preference Shares of those series may be varied or abrogated by the agreement in writing of the holders of at least three quarters in nominal value of all the HBOS Preference Shares of those series or with the approval of any Extraordinary Resolution, passed at a separate meeting of the holders of all the HBOS Preference Shares of those series. Whenever this provision applies, all the holders of the HBOS Preference Shares of the relevant series shall be treated as holding HBOS Preference Shares of a single class. Unless the HBOS Directors decide otherwise before the HBOS Preference Shares of any particular series are first allotted, the special rights which apply to those HBOS Preference Shares will not be varied or abrogated or deemed to be varied or abrogated if: (i) any other series of HBOS Preference Shares is created or issued; (ii) any other shares are created or issued which rank equally with, or behind, the HBOS Preference Shares in sharing in the profits or assets; or (iii) the Company redeems or buys back any of its shares which rank equally with, or behind, those HBOS Preference Shares in sharing in the profits or assets. The HBOS Directors may also decide, in respect of any series of HBOS Preference Shares, before shares of that series are first allotted, that any other specified matter(s) will be, or will be deemed to be, or not to be, a variation or abrogation of rights. If a new series of HBOS Preference Shares, or any other class of shares, is created, or issued, which ranks equally with the existing HBOS Preference Shares in

sharing in the profits or assets, the new shares can have the same rights as, or different rights from, existing HBOS Preference Shares. This will not, of itself, be treated as a variation or abrogation of the rights of the existing HBOS Preference Shares.

- C.3 Other provisions on variation of rights: Subject to the specific provisions relating to varying rights of HBOS Preference Shares, and if legislation allows this, the special rights which are attached to any class of shares can be changed or abrogated if this is approved by an Extraordinary Resolution. This must be passed at a separate meeting of the holders of the relevant class of shares. The special rights of a class of shares can be changed or abrogated while the Company is a going concern or while the Company is being wound up (or while its winding up is being considered). All the Articles relating to General Meetings apply, with any necessary changes, to a class meeting, but with the following changes: (i) at least two people who hold (or who act as proxies for) at least one third of the total nominal value of the existing shares of the class are a quorum, but if this quorum is not present at an adjourned meeting, one person who holds shares of the class, or his proxy, is a quorum other than in respect of the 9<sup>1</sup>/<sub>4</sub>% Preference Shares and 9<sup>3</sup>/<sub>4</sub>% Preference Shares when two people who hold shares of the relevant class, or his proxy, are a quorum; (ii) anybody who is personally present or who is represented by a proxy can demand a poll; and (iii) on a poll, the holders of shares will have one vote for every share of the class which they hold, but this is subject to any special rights or restrictions which are attached to any class of shares by the HBOS Articles or any rights which are attached to shares in some other way under the HBOS Articles. These provisions also apply to any change or abrogation of special rights of shares forming part of a class, unless the terms of those shares require changes to be approved in some other way. Each part of the class which is being treated differently is treated as a separate class in operating these provisions. The special rights of existing shares are not regarded as changed or abrogated if: (i) new shares are created or issued which rank equally with any other existing shares when sharing in profits or assets; or (ii) if the Company buys back its own shares, unless in either case the terms of the existing shares expressly say otherwise.

**D. CONDITIONS GOVERNING MANNER IN WHICH ANNUAL GENERAL MEETINGS AND GENERAL MEETINGS ARE CALLED**

- D.1 The Company must hold an Annual General Meeting in accordance with legislation. The HBOS Directors will decide when and where to hold the Annual General Meeting.
- D.2 The HBOS Directors can convene a General Meeting other than an Annual General Meeting at any time. General Meetings must also be called promptly in response to a requisition by shareholders under legislation or, in default may be convened by such requisitionists as provided by legislation.
- D.3 A General Meeting may also be convened by at least two shareholders to appoint HBOS Directors if the number of HBOS Directors falls below the prescribed minimum and the HBOS Directors fail to appoint more HBOS Directors or call a General Meeting to do so.
- D.4 At least 21 clear days' notice must be given for every Annual General Meeting. For every other General Meeting, at least 14 clear days' notice must be given. However, a shorter period of notice can be given: (a) for an Annual General Meeting, if all the shareholders who are entitled to attend and vote agree; or (b) for other General Meetings, if a majority of the shareholders agree and they hold at least 95% in nominal value of the shares giving a right to attend and vote at the meeting.
- D.5 Any notice of meeting (including any notice given by website) must contain prescribed information and be given to the shareholders unless the HBOS Articles say they are not entitled to receive it from the Company. Notice must also be given to every HBOS Director and the Auditors.
- D.6 Before a General Meeting starts to do business, there must be a quorum present. If there is not, the meeting cannot carry out any business. Unless the HBOS Articles say otherwise, a quorum for all purposes is two qualifying persons who are entitled to vote unless: (a) each is a qualifying person only because he is authorised to act as the company representative in relation to the meeting and they are representatives of the



same company; or (b) each is a qualifying person only because he is appointed as proxy of a shareholder in relation to the meeting and they are proxies of the same shareholder.

- D.7 Under legislation, shareholders of a public company, such as the Company are not permitted to pass resolutions by written resolution but must pass these in general meeting. A simple majority of shareholders may pass an Ordinary Resolution and a majority of not less than three-quarters of the shareholders may pass a Special Resolution or an Extraordinary Resolution.

## **E. RESTRICTIONS ON FREE TRANSFERABILITY OF SECURITIES**

- E.1 Every transfer of a share held in certificated form must be in writing and either in the usual standard form or in any other form approved by the HBOS Directors. Every transfer of a share held in uncertificated form must be made by means of a relevant system and must comply with the CREST Regulations. In the case of a transfer of a share held in certificated form, the transfer form together with the relevant share certificate and other evidence HBOS Directors have asked for to prove title must be delivered to the office where the Register is kept. However, if a transfer is by a recognised clearing house or its nominee or by a recognised investment exchange, a share certificate is only needed if a certificate has been issued for the shares in question. Transfers may not be in favour of more than four joint holders. The HBOS Directors can refuse to register a transfer of any shares which are held in certificated form and which are not fully paid shares. They can also refuse to register a transfer of any shares which are held in uncertificated form and which are not fully paid shares, but only in the circumstances allowed by the CREST Regulations. However, if any of those shares have been admitted to the Official List of the UK Listing Authority, the HBOS Directors cannot refuse to register a transfer if this would stop dealings in the shares from taking place on an open and proper basis.
- E.2 The HBOS Directors can decide to suspend the registration of transfers by closing the Register except that the Register cannot be closed without the consent of the Operator in respect of shares which are participating securities under the CREST Regulations. This closure can be for part of a day, a day or more than a day. Suspension periods can vary between different classes of shares. The Register cannot be closed for more than 30 days a year.

## **F. ALTERATION OF CAPITAL**

- F.1 The shareholders can increase the Company's share capital by passing an Ordinary Resolution. This resolution will fix the amount of the increase, the nominal amount of the new shares and the currency or currencies of the shares.
- F.2 The shareholders can pass Ordinary Resolutions to do any of the following: (a) consolidate, or consolidate and then divide, all or any of the share capital into shares of a larger nominal amount than the existing shares; (b) cancel any shares which have not been taken, or agreed to be taken, by any person at the date of the resolution and reduce the amount of the Company's share capital by the amount of the cancelled shares; and (c) divide some or all of its shares into shares of a smaller nominal amount than the existing shares. This is subject to any restrictions in legislation. The resolution may provide that, as between the holders of the divided shares, different rights and restrictions of a kind which the Company can apply to new shares may apply to different divided shares.
- F.3 Subject to the terms of any HBOS Preference Shares in issue, the shareholders can pass Special Resolutions to do any of the following: (a) reduce its share capital in any way; and (b) reduce any capital redemption reserve or share premium account in any way.
- F.4 Subject to the terms of any HBOS Preference Shares in issue, the Company can buy back, or agree to buy back in the future, any shares of any class (including redeemable shares), if legislation allows this. However, if the Company has existing shares which are convertible into other shares which are equity securities of the class to be purchased, then the Company can only buy back equity securities of that class if either: (a) the

terms of issue of the convertible shares permit the Company to buy back equity securities; or (b) the buy-back or agreement to buy back has been approved by an Extraordinary Resolution passed by the holders of the convertible shares.

- F.5 Subject to legislation and the terms of any relevant shareholder resolution, the HBOS Directors can decide how to deal with any shares which have not been issued and allot them on any terms, which can include the right to transfer the allotment to another person before that person is entered on the Register, and also grant options over shares.

#### **G. PRE-EMPTION RIGHTS**

Subject to HBOS Directors being authorised to allot relevant securities under Section 80 of the Companies Act 1985, the Company may resolve by Special Resolution that the HBOS Directors be given power to allot equity securities for cash as if the legislative pre-emption rights did not apply. The authority must be limited to the allotment of equity securities in connection with a rights issue and otherwise an allotment of equity securities having the nominal amount not exceeding in aggregate the sum specified in the resolution.

#### **H. NON-UK SHAREHOLDERS**

- H.1 There are no limitations in the HBOS Articles on the rights of non-UK shareholders to hold or to exercise voting rights attached to the shares of the Company. Subject to legislation, the Company may exercise powers relating to keeping an overseas branch register.
- H.2 A shareholder whose registered address is not within the UK shall not be entitled to receive any notice from the Company unless: (a) the Company is able, in accordance with legislation, to send notice to him by electronic means; or (b) he gives to the Company a postal address within the UK at which notices may be given to him.

- 4.3** Details of the memorandum and articles of association of Lloyds TSB are set out in section 4 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus and in the Memorandum of Association and Articles of Association of Lloyds TSB, which are incorporated by reference herein. See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

#### **5. Mandatory takeover bids, squeeze-out and sell-out rules**

Other than as provided by the City Code and Chapter 28 of the Companies Act 2006, there are no rules or provisions relating to mandatory bids and/or squeeze-out and sell-out rules relating to the Company.

#### **6. Public takeover bids occurring in the last and current financial year**

Other than the Acquisition, further details of which are set out in Part VIII ("Information on the Acquisition") of this document, there have been no public takeover bids by third parties in respect of the share capital of the Company in the last or current financial year.

## 7. Directors

### 7.1 The HBOS Directors and their principal functions are as follows:

<i>Name</i>	<i>Age</i>	<i>Position</i>
Dennis Stevenson	63	Chairman
Andy Hornby	41	Chief Executive
Peter Cummings	53	Chief Executive, Corporate
Jo Dawson	46	Chief Executive, Retail Distribution and Insurance & Investment
Mike Ellis	57	Group Finance Director
Philip Gore-Randall	55	Chief Operating Officer
Colin Matthew	58	Chief Executive, Strategy, International and Treasury & Asset Management
Dan Watkins	46	Chief Executive, Retail Products
Richard Cousins	49	Non-executive Director
Sir Ron Garrick	68	Non-executive Director, Deputy Chairman/Senior Independent Director
Anthony Hobson	61	Non-executive Director
Karen Jones	52	Non-executive Director
John E Mack	61	Non-executive Director
Coline McConville	44	Non-executive Director
Kate Nealon	55	Non-executive Director

Dennis Stevenson and Andy Hornby, Chairman and Chief Executive respectively, will resign from the HBOS Board upon the Scheme becoming Effective.

7.2 Brief biographical details of each of the HBOS Directors are set out below. Details of all companies (other than the Company and other members of the HBOS Group) and partnerships of which each of the HBOS Directors has been a member of the administrative, management or supervisory bodies or a partner at any time in the previous five years preceding the date of this Prospectus, are summarised under each name.

#### ***Dennis Stevenson***

Dennis Stevenson was appointed Chairman of HBOS in June 2001 (having joined the Board of Halifax in 1999) and became Governor of Bank of Scotland in January 2006. He is Chancellor of the University of the Arts London, a Non-executive Director of The Western Union Company, Loudwater Investment Partners Limited and Culture and Sport Glasgow, and President of the Employers Forum on Age.

Committee membership: Nomination Committee

<i>Company</i>	<i>Status (Current/ Previous)</i>
Glyndebourne Productions Limited	Current
The Economist Newspaper Limited	Current
The Economist Group Trustee Company Limited	Current
Aldeburgh Music <sup>(1)</sup>	Current
Tate Foundation <sup>(1)</sup>	Current
Horse's Mouth Foundation <sup>(1)</sup>	Current
The Western Union Company	Current
Loudwater Investments Partners Limited	Current
Culture and Sport Glasgow <sup>(1)</sup>	Current
Institute for Government <sup>(1)</sup>	Current
Pearson plc	Previous
Manpower Inc	Previous
Cloaca Maxima Limited	Previous
Whitehall Trust Limited	Previous
Schroder Ventures (1991) Limited <sup>(2)</sup>	Previous
The Business Development Initiative Sierra Leone Limited	Previous
Edexcel Limited	Previous

<i>Company</i>	<i>Status (Current/ Previous)</i>
<i>Partnership</i>	
Connection (Long Acre) Property LLP	Current
Connection Property LLP	Current
Crane Road Properties LLP	Current
SBH Partners 06 LLP	Current

(1) Exempt from using Limited designation.

(2) Dennis Stevenson resigned as a director of Schroder Ventures (1991) Limited on 9 May 2007. On 18 July 2007, this company entered members' voluntary liquidation.

### **Andy Hornby**

Andy Hornby became Chief Executive of HBOS in July 2006, having previously been the HBOS Group's Chief Operating Officer. He joined the board of Halifax in 1999 as Chief Executive of the Retail division. He is a Non-executive Director of Home Retail Group plc. Prior to joining Halifax, he undertook various roles at The Boston Consulting Group Inc, Blue Circle Industries plc and ASDA Stores Limited.

Committee membership: Nomination Committee

<i>Company</i>	<i>Status (Current/ Previous)</i>
Home Retail Group plc	Current
Experian Finance plc (formerly GUS plc)	Previous
Sainsbury's Bank plc	Previous

### **Peter Cummings**

Peter Cummings joined Bank of Scotland in 1973. In 1995 he became Director of Corporate Banking. He joined the HBOS Board in January 2006 as Chief Executive, Corporate. He is also a Director of The Maggie Keswick Jencks Cancer Caring Centres Trust and became Chairman of the HBOS Foundation with effect from April 2008.

Committee membership: Retail Risk Control Committee

<i>Company</i>	<i>Status (Current/ Previous)</i>
Business in the Community <sup>(1)</sup>	Current
HBOS Foundation <sup>(1)</sup>	Current
The Maggie Keswick Jencks Cancer Caring Centres Trust <sup>(1)</sup>	Current
Arma Developments Limited	Previous
AALP Galashiels Limited	Previous
Block Securities (Dunfermline) Limited	Previous
Block Securities (East Kilbride) Limited	Previous
Block Holdings Limited	Previous
Bonnyton Estates Limited	Previous
Broadway Plaza (Birmingham Children's Hospital) Limited	Previous
CALA Properties (Slateford) Limited	Previous
Clydeside Investment Properties Limited	Previous
City Inn Limited	Previous
Clickloop Limited	Previous
Continental Shelf 224 Limited	Previous
Continental Shelf 225 Limited	Previous
Duelguide Limited	Previous
Dunwilco (940) Limited	Previous
Elphinstone Halls Limited	Previous
Elphinstone Halls Development Limited	Previous
Elphinstone Halls Investment Limited	Previous
Fountainbridge Developments Limited	Previous

<i>Company</i>	<i>Status (Current/ Previous)</i>
Fountainbridge Offices Limited <sup>(2)</sup>	Previous
Fusion (Worthing) Limited	Previous
Fusion Carmarthen Limited	Previous
Fusion Securities Limited	Previous
Glasgow Harbour Limited	Previous
Glasgow Harbour Properties Limited	Previous
Halladale (Brentwood) Limited	Previous
Halladale Ventures (Scotland) Limited	Previous
Halladale Ventures Limited	Previous
Highfield Properties (No.1) Limited	Previous
Highfield Properties (No.2) Limited	Previous
Highfield Properties (No.3) Limited	Previous
Highfield Properties (Holdings) Limited	Previous
KAV Croydon Limited	Previous
KAV Chatham Limited	Previous
KAV East Grinstead Limited	Previous
KAV Elgin Limited	Previous
KAV Gloucester Limited	Previous
KAV Grantham Limited	Previous
KAV Harlow Limited	Previous
KAV Jersey Limited	Previous
KAV Milton Keynes Limited	Previous
KAV Manchester Limited	Previous
KAV Newcastle Limited	Previous
KAV Speke Limited	Previous
KAV Sutton Coldfield Limited	Previous
KAV St Johns Limited	Previous
KAV Stockton Limited	Previous
KAV Trongate Limited	Previous
KAV Watford Limited	Previous
KAV Wolverhampton Limited	Previous
Kenmore Active Value Limited	Previous
Kenmore Beneficial House Limited	Previous
Kenmore Capital Limited	Previous
Kier Developments Limited	Previous
Ledge 563 Limited	Previous
Linden Homes Surrey Limited	Previous
Linden New Homes Limited	Previous
Macdonald Hotels Limited	Previous
Midmint Limited	Previous
MS Aberdeen Limited	Previous
Moncrieffe Holdings Limited	Previous
Ocean Terminal Limited	Previous
Pacific Shelf 1055 Limited	Previous
Pavements (UK) No.1 Limited	Previous
Primary Plus (Holdings) Limited	Previous
Quail (Ashford) Limited	Previous
Quail (Chesterfield) Limited	Previous
Quail (County Square) Limited	Previous
Quail (Durham) Limited	Previous
Quail (Millburngate) Limited	Previous
Quail (Swansgate) Limited	Previous
Quail (Wellingborough) Limited	Previous
Rocco Forte & Family (Luxury Hotels) Limited	Previous
Sapphire (Burnley) Nominee Limited	Previous
Sapphire (Burnley) (No. 2) Nominee Limited	Previous
Sapphire (Cardiff) Nominee Limited	Previous

<i>Company</i>	<i>Status (Current/ Previous)</i>
Sapphire (Cardiff) (No. 2) Nominee Limited	Previous
Sapphire (Harlow) Nominee Limited	Previous
Sapphire (Harlow) (No. 2) Nominee Limited	Previous
Sapphire (High Wycombe) Nominee Limited	Previous
Sapphire (High Wycombe) (No. 2) Nominee Limited	Previous
Sapphire Retail Fund Limited	Previous
Southdawn Limited	Previous
Southtweed Limited	Previous
Sundridge Park Management Centre Limited	Previous
Thornfield Ventures Limited	Previous
Tweed Investments Limited	Previous
Tyne Limited	Previous
UK Land Estates (Partnership) Limited	Previous
UK Retail Portfolio I Limited	Previous

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(1) Exempt from using Limited designation.

(2) Peter Cummings resigned as a director of Fountainbridge Offices Limited on 12 October 2004. The company was the subject of a voluntary application to be struck off under Section 652a of the Companies Act 1985 which became effective on 13 May 2005.

<i>Partnership</i>	<i>Status (Current/Previous)</i>
Chelsfield Partners LLP	Current
Old Bailey 2005 LLP	Current

Peter Cummings resigned as a director of an HBOS Group company, British Linen Properties plc, on 31 October 2005. That company entered members' voluntary liquidation on 6 December 2004 and was struck off on 12 July 2006.

### **Jo Dawson**

Jo Dawson became Chief Executive of the Insurance & Investment division in March 2006, joining the Board of HBOS in May 2006. In August 2007 she also assumed responsibility for Retail Distribution. She joined Halifax in 2000 and became Group Risk Director in 2005. Prior to joining Halifax, she held senior positions with National Westminster Bank plc and Green Flag Limited. She is a fellow of the Chartered Institute of Bankers. Jo is a member of the Board of the Association of British Insurers.

Committee membership: None

In relation to HBOS Group companies, Jo Dawson was a director of Clerical Medical and General Life Assurance Society, which was dissolved on 31 December 2006 pursuant to the HBOS Reorganisation Act 2006.

### **Mike Ellis**

Mike Ellis rejoined the HBOS Board in September 2007 as Group Finance Director Designate becoming Group Finance Director on 1 January 2008. He previously served as Group Finance Director of HBOS between 2001 and 2004, following a long career with Halifax prior to the merger with Bank of Scotland. He is a qualified accountant and a Non-executive Director of WH Smith plc.

Committee membership: None

<i>Company</i>	<i>Status (Current/Previous)</i>
WH Smith plc	Current
MH Ellis Consulting Limited	Current
Fund Distribution Limited(1)	Previous
WH Smith Retail Holdings Limited	Previous
Smiths News plc	Previous

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(1) Mike Ellis resigned as a director of Fund Distribution Limited on 1 September 2006. On 25 January 2007 this company entered members' voluntary liquidation and was dissolved on 15 April 2008.

### **Philip Gore-Randall**

Philip Gore-Randall joined the board of HBOS in September 2007 as Chief Operating Officer. He is a Chartered Accountant with extensive experience in the UK and overseas, serving for a number of years as Managing Partner of Arthur Andersen. He joined HBOS from Aon UK Limited, where he held the role of Chief Operating Officer. He is a Non-executive Director of Compass Consulting Group Holdings Limited, an independent management consulting firm and ensure.

Committee membership: Corporate Risk Control Committee

<i>Company</i>	<i>Status (Current/Previous)</i>
Compass Consulting Group Holdings Limited	Current
4Future Holdings Limited <sup>(1)</sup>	Previous
Aon Limited	Previous
Aon UK Limited	Previous
<i>Partnership</i>	<i>Status (Current/Previous)</i>
Arthur Andersen <sup>(2)</sup>	Current

(1) Philip Gore-Randall resigned as a director of 4Future Holdings Limited on 8 August 2007 which is a non-trading company which, on 1 March 2008, made a voluntary application to be struck off, under Section 652a of the Companies Act 1985 and was officially dissolved on 13 August 2008.

(2) Arthur Andersen was placed into dissolution voluntarily by resolution of the partners in 2002. Philip Gore-Randall remains a partner until the dissolution is complete.

### **Colin Matthew**

Colin Matthew is Chief Executive, Strategy, International and Treasury & Asset Management and, since January 2006, has been Treasurer of Bank of Scotland. He joined Bank of Scotland in 1966, becoming a Director in 2000. He was appointed to the board of HBOS in June 2001 following the Company's formation.

Committee membership: None

<i>Company</i>	<i>Status (Current/Previous)</i>
International Financial Services London <sup>(1)</sup>	Current

(1) Exempt from using Limited designation.

### **Dan Watkins**

Dan Watkins was appointed to the board of HBOS in September 2007 as Chief Executive, Retail Products. He served as HBOS Group Risk Director from February 2006 and prior to that was Head of Retail Risk. He joined Birmingham Midshires in 1993, becoming Managing Director in 2001. In his early career, he worked for Morgan Grenfell.

Committee membership: None

<i>Company</i>	<i>Status (Current/Previous)</i>
Sainsbury's Bank plc	Current

In relation to HBOS Group companies: Dan Watkins was a director of Birmingham Midshires Independent Financial Services Limited when it entered members' voluntary liquidation on 12 March 2004, the company being struck off on 4 January 2005; he was a director of Pendeford Mortgages No 1 plc when it entered members voluntary liquidation on 12 March 2004, the company being struck off on 1 January 2005; and he was a director of Eastern Gate Limited when it entered members' voluntary liquidation on 12 March 2004, the company being struck off on 13 January 2005.

### **Richard Cousins**

Richard Cousins became a Non-executive Director of HBOS in March 2007. He is Chief Executive Officer of Compass Group plc. Between 1990 and 2005 he worked for BPB plc, becoming Chief Executive Officer in 2000. He was previously a Non-executive Director of P&O. His early career was spent with Cadbury Schweppes plc and BTR plc.

Committee membership: Nomination Committee, Remuneration Committee, Corporate Risk Control Committee

<i>Company</i>	<i>Status (Current/Previous)</i>
Compass Group plc	Current
Compass Group Holdings plc	Current
Hospitality Holdings Limited	Current
BPB plc	Previous
BPB United Kingdom Limited	Previous
British Gypsum Limited	Previous
BPB Group Operations Limited	Previous
BPB Group Finance Limited	Previous
Peninsular and Oriental Steam Navigation Company	Previous

### ***Sir Ron Garrick***

Sir Ron Garrick joined the board of Bank of Scotland in 2000 and was subsequently appointed to the HBOS Board in June 2001 following the Company's formation. In January 2003 he became Deputy Chairman of HBOS and since 2004 has served as the Company's Senior Independent Director. He was previously Chief Executive and Chairman of Weir Group plc.

Committee membership: Nomination Committee (Chair), Remuneration Committee, Corporate Risk Control Committee (Chair), International Risk Control Committee

### ***Anthony Hobson***

Anthony Hobson joined the board of Halifax in 2001 and HBOS in June 2001, and has been the Chairman of the Audit Committee since HBOS's formation. He is also Chairman of The Sage Group plc and of Northern Foods plc. He was Group Finance Director of Legal & General Group plc for 14 years until 2001, and is a Chartered Accountant. He is a non-executive director of esure.

Committee membership: Audit Committee (Chair), Insurance & Investment Risk Control Committee (Chair)

<i>Company</i>	<i>Status (Current/Previous)</i>
Glas Cymru Cyfyngedig	Current
Dwr Cymru Cyfyngedig	Current
Northern Foods plc	Current
The Sage Group plc	Current
Sainsbury's Bank plc	Previous
Jardine Lloyd Thompson Group plc	Previous
Liberata plc	Previous
Cenkos Securities plc	Previous

### ***Karen Jones***

Karen Jones became a Non-executive Director of HBOS in January 2006. She was previously Chief Executive of Spirit Group Limited and the co-founder and Chief Executive of Café Rouge Limited and The Pelican Group plc. She has held Non-executive positions at Gondola Holdings plc and EMAP plc.

Committee membership: Nomination Committee, Remuneration Committee (Chair)

<i>Company</i>	<i>Status (Current/Previous)</i>
Royal National Theatre Enterprises Limited	Current
Arem Foundation	Current
Food & Fuel Limited	Current
Front Page Holdings Limited	Current
Front Page Pubs Limited	Current
Virgin Active Group Limited	Current
Punch Taverns (PPCF) Limited	Previous
Barshelf 2 Limited	Previous
British Beer and Pub Association	Previous



<i>Company</i>	<i>Status (Current/Previous)</i>
EMAP plc	Previous
Gondola Holdings plc	Previous
Freehouse Limited	Previous
Spirit Acquisitions Guarantee Limited	Previous
Spirit Acquisitions Holdings Limited	Previous
Spirit (Faith) Limited	Previous
Spirit (BRB) Limited	Previous
Spirit (AKE Holdings) Limited	Previous
Spirit (SGL) Limited	Previous
Spirit (CCR) Limited	Previous
Spirit (OOL) Limited	Previous
Spirit Retail Group (North) Limited	Previous
Spirit Retail Group (Northampton) Limited	Previous
Spirit Retail Bidco Limited	Previous
Spirit (Lodges Holdings) Limited	Previous
Spirit Group Equity Limited	Previous
Spirit Managed Holdings Limited	Previous
Spirit Managed Funding Limited	Previous
Spirit Managed Inns Limited	Previous
Spirit Managed Pubs Limited	Previous
Spirit Pubs Holdings Limited	Previous
Spirit Pubs Parent Limited	Previous
Spirit Issuer Parent Limited	Previous
Spirit Issuer plc	Previous
Spirit Parent Limited	Previous
Spirit Financial Holdings Limited	Previous
Spirit (PSC) Limited	Previous
Spirit Supply Company Limited	Previous
Spirit Acquisition Properties Limited	Previous
Spirit Group Limited	Previous
Spirit Group Parent Limited	Previous
Spirit Group Retail (Pubs) No.1 Limited	Previous
Spirit Group Retail (Pubs) No.2 Limited	Previous
Spirit Group Retail (South) Limited	Previous
Spirit Group Retail Hotels Limited	Previous
Spirit Group Retail Limited	Previous
Spirit Group Retail Pubs and Restaurants Limited	Previous
Spirit Group Holdings Limited	Previous
Spirit Group Finco Limited	Previous
Spirit Intermediate Holdings Limited	Previous
Springtarn Limited	Previous
Steward and Patteson Limited	Previous
Stickpad Limited	Previous
Telscombe Tavern Limited	Previous
The Nice Pub Company Limited	Previous
Tom Cobleigh (Inns) Limited	Previous
Tom Cobleigh (Trading) Limited	Previous
Tom Cobleigh Group Limited	Previous
Tom Cobleigh Holdings Limited	Previous
Tom Cobleigh Limited	Previous
Aspect Leisure Activities Limited	Previous
Aspect Ventures Limited	Previous
AVL (Pubs) No.1 Limited	Previous
AVL (Pubs) No.2 Limited	Previous
Barnaby's Carvery Limited	Previous
Catertour Limited	Previous
The Chef & Brewer Group Limited	Previous
Chef & Brewer Hotels Limited	Previous

<i>Company</i>	<i>Status (Current/Previous)</i>
Chef & Brewer Limited	Previous
Cheshire Hotels (Developments) Limited	Previous
Cheshire Hotels Limited	Previous
City Limits Limited	Previous
Cleveland Place Holdings Limited	Previous
Country Fayre Restaurants Limited	Previous
Country Grill Restaurants Limited	Previous
CPH (R&L) No.1 Limited	Previous
CPH (R&L) No.2 Limited	Previous
CPH Palladium Limited	Previous
Dearg Limited	Previous
Freshwild Limited	Previous
Homespreads Limited	Previous
Huggins and Company Limited	Previous
John Barras & Co Limited	Previous
Little London Pubs Limited	Previous
London Pub-Restaurants Limited	Previous
London Tourist Pubs Limited	Previous
Mountloop Limited	Previous
Narnain	Previous
Open House Limited	Previous
Partstripe Limited	Previous
R.V. Goodhew Limited	Previous
Readystripe Limited	Previous
Southern Inns Limited	Previous
The Host Group Limited	Previous
Whitegate Taverns Limited	Previous
Prestbury Wentworth Intermediate Limited	Previous
Clivara Limited	Previous
Premier Inn Hotels Limited	Previous
Broadway Inns Limited	Previous
New Pubco (MC) Limited	Previous
New Pubco Holdings Limited	Previous
New Pubco (SLB) Limited <sup>(1)</sup>	Previous
Mintberg Limited	Previous

(1) Karen Jones resigned as a director of New Pubco (SLB) Limited on 18 September 2005. On 21 December 2006 the company went into administration.

### ***John E Mack***

John E Mack was appointed a Non-executive Director of HBOS in May 2007. Following a long career with Bank of America Corporation and its predecessors (during which he served as Corporate Treasurer for many years), he joined Shinsei Bank Ltd of Japan in 2002 as Senior Managing Executive Officer and Chief Financial Officer. He retired from these executive roles in 2005 but remained as a consultant for Shinsei Bank Ltd until the end of 2006.

Committee membership: Audit Committee, Treasury and Asset Management Risk Control Committee (Chair)

<i>Company</i>	<i>Status (Current/Previous)</i>
Incapital Holdings LLC	Current
New Generation Biofuels Holdings Inc.	Current
Wilson Turbopower Inc.	Current
First National Bank of Cainesville	Current
Strategic Solutions Inc.	Previous
International Power Group, Ltd	Previous
Shinsei Bank, Ltd	Previous

**Coline McConville**

Coline McConville joined the board of Halifax in 2000 and HBOS in June 2001 following the Company's formation. Until 2006 she was Chief Executive Officer, Europe of Clear Channel International Limited, prior to which she was with McKinseys and Company, management consultants in London and L.E.K. Management Consultants in Germany. She qualified as a lawyer in Australia.

Committee membership: Audit Committee, Nomination Committee, Remuneration Committee, International Risk Control Committee (Chair)

<i>Company</i>	<i>Status (Current/Previous)</i>
Adshel Street Furniture Pty Limited	Previous
Adshel Street Furniture (NZ) Pty Limited	Previous
Adshel New Zealand Limited	Previous
Clear Channel Overseas Limited	Previous
Clear Channel Outdoor Limited (formerly Clear Channel International Ltd)	Previous
Hainan White Horse Advertising Media Investment Company Limited	Previous
Clear Media Limited	Previous
China Outdoor Media Investment Inc	Previous
City Lights Limited	Previous
Clear Channel Communication India Pvt Limited	Previous
Buspak Advertising (Hong Kong) Limited	Previous
Citysites Outdoor Advertising (Albert) Pty Limited	Previous
Citysites Outdoor Advertising (S.Aust) Pty Limited	Previous
Citysites Outdoor Advertising (W.Aust) Pty Limited	Previous
Citysites Outdoor Advertising Pty Limited	Previous
Focus Panel Advertising Company Limited	Previous
Clear Channel Media Malaysia Limited	Previous
Street Furniture (NSW) Pty Limited	Previous
The Media Vehicle Group Limited	Previous
Urban Design Furniture Pty Limited	Previous
Clear Channel South Africa Investments (Pty) Limited	Previous
Clear Channel Independent Media (Pty) Limited	Previous
Clear Channel Independent (Pty) Limited	Previous
Clear Channel Bahamas Limited	Previous
Clear Channel More France SA	Previous
Defi Group SAS	Previous
AD Concessionaria Publicitas	Previous
Affitalia SRL	Previous
Clear Channel Jolly Pubblicita SpA	Previous
Clear Channel Singapore Pte Limited	Previous
Clear Channel Airport Pte Limited	Previous
Clear Channel Espana SL	Previous
Clear Channel France SA	Previous
Clear Channel Holding Italia SpA	Previous
China Outdoor Media (Hong Kong) Company Limited	Previous
Clear Channel Limited (Bermuda)	Previous
Louis Barnett & Son Limited	Previous
Clear Channel UK Limited	Previous
Premium Holdings Limited	Previous
Premium Outdoor Limited	Previous

**Kate Nealon**

Kate Nealon joined the board of HBOS in March 2004. She is a Non-executive Director of Cable & Wireless plc and Shire Limited. Previously she was Group Head of Legal and Compliance for Standard Chartered plc. She qualified as a lawyer in the US.

Committee membership: Audit Committee, Insurance & Investment Risk Control Committee, Retail Risk Control Committee (Chair)

<i>Company</i>	<i>Status (Current/Previous)</i>
Cable and Wireless plc	Current
Ashley Gardens Block 2 Limited	Current
Shire Limited	Current
Shire plc	Previous

**7.3** The business address of each of the HBOS Directors and of the Company Secretary is The Mound, Edinburgh EH1 1YZ, United Kingdom.

**7.4** At the date of this Prospectus, save as disclosed in this paragraph 7, none of the HBOS Directors has at any time within at least the past five years:

(a) been a director or a member of the administrative, management or supervisory body, or a manager of any company other than the Company or other members of the HBOS Group or a partner of any partnership; or

(b) had any convictions in relation to fraudulent offences (whether spent or unspent); or

(c) been adjudged bankrupt or entered into an individual voluntary arrangement; or

(d) been acting in the capacity of a director or a member of the administrative, management or supervisory body, or a manager of any company or a partner of any partnership at the time of or within twelve months preceding any bankruptcy, receivership or liquidation; or

(e) had his or her assets form the subject of any receivership or has been a partner of a partnership at the time of or within twelve months preceding any assets thereof being the subject of a receivership; or

(f) been subject to any official public incrimination and/or sanctions by any statutory or regulatory authorities (including designated professional bodies); or

(g) ever been disqualified by a court from acting as a director or member of the administrative, management or supervisory bodies or other officer of any company or from acting in the management or conduct of the affairs of any company.

## **7.5 Lloyds TSB Directors, Corporate Governance and Employees**

Information relating to the directors, the employees and the corporate governance of Lloyds TSB is set out in section 2 (“Directors’ Profiles”), section 5 (“Corporate Governance”) and section 6 (“Employees”) of Part XX (“Directors, Corporate Governance and Employees”) of the Lloyds TSB Prospectus, which are incorporated by reference herein.

Information relating to the interests of the Lloyds TSB Directors is set out in section 3 (“Interests of the Lloyds TSB Directors”) of Part XX (“Directors, Corporate Governance and Employees”) of the Lloyds TSB Prospectus, which is incorporate by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## **8. Corporate governance and committees**

**8.1** The Company considers that it complies with all of the provisions of the Combined Code on Corporate Governance 2006.

### **8.2 The HBOS Board**

As at the date of this document, the HBOS Board has 15 members, comprising the Chairman, seven Executive Directors and seven independent Non-executive Directors.

The Chairman leads the HBOS Board while the Chief Executive manages the HBOS Group’s businesses – these are distinct functions. The responsibilities and specific accountabilities of the Chairman, the Deputy Chairman/Senior Independent Director, the Non-executive Directors, the Chief Executive, the remaining Executive Directors and other senior executives are set out in the HBOS Group’s Board Control Manual. The Board Control Manual also encompasses the schedule of matters reserved to the HBOS Board and terms of reference for HBOS Board and Executive Committees; for those matters not specifically reserved to the HBOS Board, the Manual prescribes the cascade of authorities delegated throughout the HBOS Group.

The Board has established a committee structure including the Nomination Committee, the Remuneration Committee and the Audit Committee. Terms of reference for each of these three principal committees can be found on the Company's website.

### **8.3 Nomination Committee**

Current Membership: Sir Ron Garrick (Chair), Richard Cousins, Andy Hornby, Karen Jones, Coline McConville and Dennis Stevenson

The Nomination Committee's terms of reference require it to have a majority of independent Non-Executive Directors and for membership to include the Chairman of the Company, the Chief Executive, Deputy Chairman, Senior Independent Director and at least two further Non-executive Directors. The Deputy Chairman/Senior Independent Director chairs the Committee. The Committee meets as required but at least twice in each year.

The Nomination Committee is tasked with ensuring that there is a formal, rigorous and transparent procedure for the appointment of new HBOS Directors to the HBOS Board, and with reviewing the composition of the HBOS Board, making recommendations to ensure that it is balanced and appropriately experienced and qualified.

The Committee is also responsible for ensuring that plans are in place for orderly succession to the HBOS Board (including to the position of Chairman) and for other senior management roles. It monitors the time commitments required of Non-executive Directors and makes recommendations to the Chairman as required in respect of membership and chairmanship of the Board Committees.

### **8.4 Remuneration Committee**

Current Membership: Karen Jones (Chair), Richard Cousins, Sir Ron Garrick and Coline McConville

The Remuneration Committee is required to comprise at least three independent Non-executive Directors. At the invitation of the chair of the committee, the Chairman and Chief Executive attend Remuneration Committee meetings to provide background and context on matters relating to the remuneration of the other Executive Directors and other colleagues in the HBOS Group, but do not attend when their own remuneration or contractual terms are discussed. No HBOS Director is involved in determining his or her own remuneration or contractual terms. The Committee meets at least four times each year.

The role of the Remuneration Committee is to consider and recommend to the HBOS Board remuneration policy for Executive Directors and senior management, forming the basis of the HBOS Board's annual report to shareholders on HBOS Directors' remuneration. The Committee determines the specific remuneration arrangements for the Chairman, Executive Directors and the most senior management roles, and approves the total costs of salary reviews for the next two levels of management.

The Committee is tasked with considering eligibility for short and long term incentive schemes taking into account appropriate performance conditions. It also approves any contract of employment for any Executive Director or the Chairman, and is empowered to select, appoint and set the terms of reference of any remuneration consultants.

### **8.5 Audit Committee**

Current Membership: Anthony Hobson (Chair), Coline McConville, John E Mack and Kate Nealon

The Audit Committee's terms of reference require it to comprise at least four independent Non-executive Directors or co-opted members. The Committee currently consists of four independent Non-executive Directors.

The Audit Committee invites the Group Finance Director, Chief Operating Officer, senior executives from the Finance and Risk functions, the Head of Group Internal Audit and the external auditors to attend all of its meetings. Other senior management attend as requested by the Audit Committee to enable it to discharge its duties. The Committee meets in private session with the external auditors and, separately, with the Head of Group Internal Audit at least once each year, and can hold similar meetings with the Chief Executive, Group Finance

Director and the Group Risk Director. The Head of Group Internal Audit, the Group Risk Director and the Group Company Secretary have a right of direct access to the Committee Chair. The Committee meets at least four times each year.

The Audit Committee is charged with reviewing the financial reporting of HBOS and Bank of Scotland. It oversees the relationship with the external auditors, including the terms of their appointment and the level of their fees. The Committee also reviews the activities of the Group Internal Audit function, and reviews, on behalf of the HBOS Board, the effectiveness of the HBOS Group's system of internal control.

#### *Risk Control Committees ("RCCs")*

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

### **8.6 Executive Committee**

The Executive Committee, led by the Chief Executive Andy Hornby and consisting of all Executive Directors plus the Company Secretary and Group Counsel, Harry Baines, and the Group Risk Director, Peter Hickman, meets on a regular basis as well as holding periodic strategy days. The Executive Committee has no specific authority delegated to it by the HBOS Board, but provides advice and support to the Chief Executive, in particular in relation to strategy and matters having cross-divisional or HBOS Group-wide implications. The Committee also reviews all issues and papers requiring HBOS Board or Audit Committee approval (acting upon decisions of those bodies as appropriate).

### **9. HBOS Directors' interests in the Company**

**9.1** The interests of the HBOS Directors, or their immediate families, in the share capital of the Company (all of which are beneficial unless otherwise stated),

- (a) which have or will be required to be notified to the Company pursuant to the Disclosure and Transparency Rules; or
- (b) being interests of a person connected (within the meaning of the Disclosure and Transparency Rules) with a HBOS Director which would, if such connected person were a HBOS Director, be required to be disclosed under (a) above and the existence of which was known to or could, with reasonable diligence, be ascertained by the HBOS Director,

were as at 14 November 2008 (being the latest practicable date prior to the publication of this Prospectus), as follows:<sup>(1)</sup>

<i>Name</i>	<i>Number of Existing HBOS Shares as at 14 November 2008</i>	<i>Percentage of issued Existing HBOS Share capital as at 14 November 2008</i>
Dennis Stevenson	584,550	0.01081%
Andy Hornby	1,037,175	0.01918%
Peter Cummings	274,532	0.00508%
Jo Dawson	259,846	0.00481%
Mike Ellis	544,454	0.01007%
Philip Gore-Randall	15,331	0.00028%
Colin Matthew	627,619	0.01161%
Dan Watkins	114,396	0.00212%
Richard Cousins	8,107	0.00015%
Sir Ron Garrick	49,544	0.00092%
Anthony Hobson	10,774	0.00020%
Karen Jones	15,693	0.00029%

<i>Name</i>	<i>Number of Existing HBOS Shares as at 14 November 2008</i>	<i>Percentage of issued Existing HBOS Share capital as at 14 November 2008</i>
John E Mack	14,366	0.00027%
Coline McConville	15,672	0.00029%
Kate Nealon	21,374	0.00040%
Total	<u>3,593,433</u>	<u>0.06647%</u>

(1) The HBOS Directors may or may not take up their Open Offer Entitlements, or apply for further Open Offer Shares under the Excess Application Facility, depending on circumstances at the relevant time.

**9.2** The interests of the HBOS Directors together represent approximately 0.0665% of the issued ordinary share capital of the Company as at 14 November 2008 (the latest practicable date prior to the publication of this Prospectus) and would represent approximately 0.0665% of the issued ordinary share capital of the Company immediately following completion of the Placing and Open Offer if each of the HBOS Directors takes up in full his/her Open Offer Entitlement but does not acquire any further Open Offer Shares under the Excess Application Facility, or approximately 0.028% of the issued ordinary share capital of the Company if none of the HBOS Directors takes up any part of his/her Open Offer Entitlement or applies for any further Open Offer Shares under the Excess Application Facility. This percentage of the issued ordinary share capital of the Company is calculated based on the same assumption set out in note 1 of paragraph 9.1 above.

9.3 The interests of the HBOS Directors set out in paragraph 9.1 above includes interests in HBOS Shares issued under the free share plan (as further described in paragraph 13 of this Part XXII). The plan awards participants free shares, usually on an annual basis. At the end of three years, the HBOS Shares are transferable to participants, subject to them still being in the HBOS Group's employment at that time or earlier if they are a qualifying leaver. Details of such interests (excluding any dividend re-investment shares) as at 14 November 2008 (being the latest practicable date prior to the publication of this Prospectus) are given below:

	<i>Award effective from</i>	<i>At 31.12.07/ 01.01.08 (excluding any dividend reinvestment shares)</i>	<i>Awarded in year</i>	<i>Total (excluding any dividend reinvestment shares)</i>	<i>Releasable</i>
Mike Ellis	Aug 08	—	743	743	Sep 11
Philip Gore-Randall	Aug 08	—	743	743	Sep 11
Peter Cummings	Aug 05	329		329	Aug 08
	Aug 06	308		308	Aug 09
	Aug 07	317		317	Aug 10
	Aug 08		743	743	Sep 11
		954		1697	
Jo Dawson	Aug 05	329		329	Aug 08
	Aug 06	308		308	Aug 09
	Aug 07	317		317	Aug 10
	Aug 08		743	743	Sep 11
		954		1697	
Andy Hornby	Aug 05	329		329	Aug 08
	Aug 06	308		308	Aug 09
	Aug 07	317		317	Aug 10
	Aug 08		743	743	Sep 11
		954		1697	
Colin Matthew	Aug 05	329		329	Aug 08
	Aug 06	308		308	Aug 09
	Aug 07	317		317	Aug 10
	Aug 08		743	743	Sep 11
		954		1697	
Dan Watkins	Aug 05	329		329	Aug 08
	Aug 06	308		308	Aug 09
	Aug 07	317		317	Aug 10
	Aug 08		743	743	Sep 11
		954		1697	



9.4 As at 14 November 2008 (being the latest practicable date prior to the publication of this Prospectus) the following options and awards over Existing HBOS Shares have been granted to the HBOS Directors under the Share Plans described in paragraph 13 below:

	<i>Share Plan</i>	<i>Date of grant/award</i>	<i>Number of shares subject to option/award</i>	<i>Option exercise price</i>	<i>Market price used for award</i>	<i>Exercise period (for option)/ performance period (for awards)</i>
Dennis Stevenson <sup>(1)</sup>	Long Term	30.03.06	59,811		£9.7650	01.01.06 – 31.12.08
	Executive	15.03.07	61,670		£11.200	01.01.07 – 31.12.09
	Bonus Plan	06.03.08	101,990		£7.320	01.01.08 – 31.12.10
Andy Hornby	Sharesave	03.10.08 (effective 01.01.09)	7,599	£2.204		01.01.14 – 01.07.14
	Sharekicker (possible additional shares)	23.03.06	27,985		£9.860	HBOS Shares released on third anniversary of the relevant date of grant
		23.03.07	42,904		£10.580	
		20.03.08	117,842		£4.463	
	Long Term	30.03.06	71,254		£9.7650	01.01.06 – 31.12.08
	Executive	15.03.07	105,199		£11.200	01.01.07 – 31.12.09
	Bonus Plan	06.03.08	180,388		£7.320	01.01.08 – 31.12.10
Peter Cummings	Sharesave	23.09.05 (effective 01.01.06)	796	£6.862		01.01.11 – 30.06.11
		28.03.08 (effective 01.06.08)	1,255	£5.043		01.06.11 – 30.11.11
	Sharekicker (possible additional shares)	23.03.06	12,827		£9.860	HBOS Shares released on third anniversary of the relevant date of grant
		23.03.07	8,498		£10.580	
		20.03.08	26,146		£4.463	
	Long Term	30.03.06	52,010		£9.7650	01.01.06 – 31.12.08
	Executive	15.03.07	68,924		£11.200	01.01.07 – 31.12.09
Bonus Plan	06.03.08	122,108		£7.320	01.01.08 – 31.12.10	
Jo Dawson	Sharesave	28.03.08 (effective 01.06.08)	3,330	£5.043		01.06.13 – 30.11.13
	Sharekicker (possible additional shares)	23.03.06	12,047		£9.860	HBOS Shares released on third anniversary of the relevant date of grant
		23.03.07	17,951		£10.580	
		20.03.08	58,016		£4.463	
	Long Term	30.03.06	24,236		£9.7650	01.01.06 – 31.12.08
	Executive	25.08.06	15,668		£9.7650	01.01.06 – 31.12.08
	Bonus Plan	15.03.07	60,460		£11.200	01.01.07 – 31.12.09
	06.03.08	111,007		£7.320	01.01.08 – 31.12.10	

	<i>Share Plan</i>	<i>Date of grant/award</i>	<i>Number of shares subject to option/award</i>	<i>Option exercise price</i>	<i>Market price used for award</i>	<i>Exercise period (for option)/ performance period (for awards)</i>
Mike Ellis	Sharesave	28.03.08 (effective 01.06.08)	1,902	£5.043		01.06.11 – 30.11.11
	Sharekicker (possible additional shares)	20.03.08	10,449		£4.463	HBOS Shares released on third anniversary of the date of grant
	Long Term Executive Bonus Plan	06.03.08	20,431		£11.200	01.01.07 – 31.12.09
		06.03.08	116,558		£7.320	01.01.08 – 31.12.10
	<i>Share Plan</i>	<i>Date of grant/award</i>	<i>Number of shares subject to option/award</i>	<i>Option exercise price</i>	<i>Market price used for award</i>	<i>Exercise period (for option)/ performance period (for awards)</i>
Philip Gore-Randall	Sharekicker (possible additional shares)	20.03.08	9,870		£4.463	HBOS Shares released on third anniversary of the date of grant
	Long Term Executive Bonus Plan	06.03.08	19,013		£11.200	01.01.07 – 31.12.09
		06.03.08	99,907		£7.320	01.01.08 – 31.12.10
	<i>Share Plan</i>	<i>Date of grant/award</i>	<i>Number of shares subject to option/award</i>	<i>Option exercise price</i>	<i>Market price used for award</i>	<i>Exercise period (for option)/ performance period (for awards)</i>
Colin Matthew	Sharekicker (possible additional shares)	23.03.06	18,665		£9.860	HBOS Shares released on third anniversary of the relevant date of grant
		23.03.07	22,685		£10.580	
		20.03.08	59,467		£4.463	
	Long Term Executive Bonus Plan	30.03.06	57,211		£9.7650	01.01.06 – 31.12.08
		15.03.07	69,528		£11.200	01.01.07 – 31.12.09
		06.03.08	113,783		£7.320	01.01.08 – 31.12.10
	<i>Share Plan</i>	<i>Date of grant/award</i>	<i>Number of shares subject to option/award</i>	<i>Option exercise price</i>	<i>Market price used for award</i>	<i>Exercise period (for option)/ performance period (for awards)</i>
Dan Watkins	Sharesave	28.03.08 (effective 01.06.08)	3,330	£5.043		01.06.13 – 30.11.13
	HBOS All Employee Options	16.03.04	5,229	£7.074		16.03.07 – 15.03.10
	Sharekicker (possible additional shares)	23.03.06	6,005		£9.860	HBOS Shares released on third anniversary of the relevant date of grant
		23.03.07	13,743		£10.580	
		20.03.08	11,227		£4.463	
	Long Term Executive Bonus Plan	30.03.06	18,724		£9.7650	01.01.06 – 31.12.08
		15.03.07	32,142		£11.200	01.01.07 – 31.12.09
		06.03.08	9,669		£11.200	01.01.07 – 31.12.09
		06.03.08	92,506		£7.320	01.01.08 – 31.12.10

(1) Dennis Stevenson was granted these awards over a notional number of HBOS Shares by reference to which a cash payment would be paid.

The HBOS Board will use all reasonable endeavours to ensure that:

- (i) cash incentive awards held by those HBOS Directors who have announced that they will resign from the HBOS Board in 2008 with effect from the Scheme becoming effective will be waived, to the extent that they have not already been earned but deferred;
- (ii) share incentive awards held by those HBOS Directors who have announced that they will resign from the HBOS Board in 2008 with effect from the Scheme becoming effective will be waived, to the extent that they are referable to performance in 2008 and would otherwise vest on the date of the Scheme Court Order;
- (iii) cash incentive awards held by other HBOS Directors will be waived, to the extent that they have not already been earned but deferred; and
- (iv) share incentive awards held by other HBOS Directors will be waived to the extent that they are referable to performance in 2008 and would otherwise vest on the date of the Scheme Court Order.

**9.5** Save as set out in this paragraph 9, it is not expected that any HBOS Director will have any interest in the shares of the Company on completion of the Placing and Open Offer and there is no HBOS Director to whom any capital of any member of the HBOS Group is under option or agreed unconditionally to be put under option.

**9.6** None of the HBOS Directors has any potential conflicts of interest between their duties to the Company and their private interests and/or their duties to third parties.

**9.7** Save as disclosed in paragraph 9.3 above, there are no restrictions imposed on the HBOS Directors regarding their interests in the HBOS Shares.

**9.8** The HBOS Directors may or may not take up their Open Offer Entitlement, or apply for further Open Offer Shares under the Excess Application Facility, depending on circumstances at the relevant time.

## **10. Major shareholders**

**10.1** As at 14 November 2008 (being the latest practicable date prior to the publication of this Prospectus), in so far as it is known to the Company, the name of each person, other than a HBOS Director who, directly or indirectly, has a notifiable interest in 3% or more of the Company's issued share capital, and the amount of such person's interest, is as follows:

<i>Name</i>	<i>Number of Existing HBOS Shares as at 14 November 2008</i>	<i>Percentage of Existing HBOS Shares as at 14 November 2008</i>
Legal & General plc and/or its subsidiaries	241,715,077 (Direct)	4.47%
AXA S.A. and its group of companies	53,126,511 (Direct)	0.98%
	494,673,465 (Indirect)	9.15%

**10.2** The rules relating to the disclosure of interests in shares are contained in the Handbook and the Companies Act 2006 (these rules implement the EU Transparency Obligations Directive (No.2004/109/EC)). The major shareholding notification requirements are set out in the Disclosure and Transparency Rules within the Handbook. DTR5 requires shareholders (or those with rights to acquire shares) of the Company to simultaneously inform the Company and the FSA of changes in major holdings in the Company's HBOS Shares. The Company then has an obligation to disseminate this information to the wider market (by the end of the trading day following receipt of the information). This notification requirement will be triggered by direct or indirect shareholders of the Company if:

- (A) they have a notifiable interest in holdings of 3% or above of the Company's total voting rights and capital in issue; and
- (B) their holdings change to reach, exceed or fall below every 1% above 3% of the Company's total voting rights and capital in issue.

To assist holders in calculating their percentage holdings, the Company is required, under DTR5.6.1, to disclose, at the end of each calendar month during which an increase or decrease has occurred, the total number of voting rights and capital for its ordinary shares, and the total number of voting rights for its treasury shares.

Under DTR5.5.1R, if the Company acquires or disposes of its own shares, it is required to make public the percentage of voting rights attributable to those shares where the acquisition or disposal reaches, exceeds or falls below 5% or 10% of the total voting rights. This notification must be made within four trading days after the transaction.

Where HBOS Shareholders have combined holdings (for example of direct and indirect holdings under financial instruments) they are required to notify the Company and the FSA if there is a notifiable change in one or more categories of voting rights, even if their overall percentage level of voting rights remains the same. In addition, the holder of financial instruments is required to aggregate and, if necessary, notify all instruments relating to the Company to the FSA and to the Company. The Company may issue a Part 22 Notice pursuant to Section 793 of the Companies Act 2006 whereby it requires a person that the Company knows, or has reasonable cause to believe is or was during the preceding three years, interested in the Company's HBOS Shares to confirm whether or not that is correct. If that person does or did hold an interest in the Company's HBOS Shares, the Company may request in the Part 22 Notice that the person provide certain information as set out in the Companies Act 2006.

The City Code also contains strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and to their respective associates during the course of an offer period.

- 10.3** Save as disclosed in paragraph 10.1, the HBOS Directors are not aware of any notifiable interest (within the meaning of the Disclosure and Transparency Rules) which will represent 3% or more of the issued share capital of the Company following completion of the Placing and Open Offer.
- 10.4** So far as the Company is aware, no person or persons, directly or indirectly, jointly or severally exercise or could exercise control over the Company.
- 10.5** There are no differences between the voting rights enjoyed by the HBOS Directors or the shareholders described in paragraph 10.1 above and those enjoyed by any other holder of HBOS Shares in the Company.
- 10.6** Other than as disclosed in the HBOS financial information incorporated by reference into this document for the financial years ended 31 December 2005, 2006 and 2007, the Company has not entered into any related party transactions other than with wholly owned subsidiaries during the period covered by the historical financial information. The related party transactions during the period between 1 January 2008 and the date of this document are similar in nature to those disclosed in the audited historical financial information referred to above.
- 10.7** Details of any related party transactions entered into by Lloyds TSB during the period covered by the Lloyds TSB historical information incorporated by reference into this document are set out in paragraph 7.1 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus, Note 45 ("Related Party Transactions") in the Lloyds TSB Annual Report and Accounts 2007, Note 45 ("Related Party Transactions") in the Lloyds TSB Annual Report and Accounts 2006 and Note 49 ("Related Party Transactions") in the Lloyds TSB Annual Report and Accounts 2005 and section 10 of Part XII ("Additional Information") of the Lloyds TSB Circular, which are incorporated by reference herein.
- See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.
- 10.8** Details of the major shareholders of Lloyds TSB are set out in section 5 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus, which is incorporated by reference herein.

Details of the Lloyds TSB Shares held by the Lloyds TSB Group are set out in section 10 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## 11. Remuneration and benefits

11.1 The following table sets out the remuneration and benefits in kind granted by HBOS to the HBOS Directors for the last full financial year:

	<i>Salary including fees &amp; further remuneration</i>	<i>Taxable benefits and allowances</i>	<i>Annual cash incentive for 2007</i>	<i>Biennial cash incentive for 2006/2007</i>	<i>Total year ended 31.12.07</i>	<i>Total year ended 31.12.07 excluding the pension allowance</i>
	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>	<i>£000</i>
<b>Chairman</b>						
Dennis Stevenson	708	113			821	821
<b>Executive Directors</b>						
Peter Cummings	630	180	1,624	172	2,606	2,448
Jo Dawson	550	117	276	156	1,099	993
Mike Ellis	169	45	78		292	250
Philip Gore-Randall	159	43	73		275	235
Andy Hornby	940	283	449	254	1,926	1,691
Colin Matthew	602	170	283	160	1,215	1,065
Dan Watkins	162	51	74	42	329	289
<b>Non-executive Directors</b>						
Richard Cousins	70				70	70
Sir Ron Garrick	235				235	235
Anthony Hobson	221				221	221
Karen Jones	100				100	100
John E Mack	66				66	66
Coline McConville	151				151	151
Kate Nealon	151				151	151

11.2 The Chairman of the HBOS Group is covered by a contract which, as announced in June 2007, now extends to 30 June 2011. If the contract is terminated by the HBOS Group prior to the expiry of the term, contractual compensation equivalent to the fees payable during the balance of the term (subject to a maximum compensation equivalent to one year’s fees) may, in certain circumstances, be payable.

The Chairman will resign from the HBOS Board upon the Scheme becoming effective. He has also agreed that his consultancy agreement with HBOS will end at that time. The Chairman has waived any payment that might otherwise be due to him as compensation for loss of office or in lieu of notice, whether under the terms of his consultancy agreement as described above or otherwise. Along with the other HBOS Directors, he will not be entitled to a bonus for the financial year ending 31 December 2008.

All the Executive Directors have rolling contracts which can be terminated by the HBOS Group on one year’s notice or by the Director on six months’ notice. If any contract is terminated by the HBOS Group, contractual compensation up to the equivalent of one year’s basic salary may, in certain circumstances, be payable. There is no contractual compensation entitlement for any of the HBOS Directors beyond this. Executive Directors are expected to make reasonable efforts to mitigate any loss arising from early termination of their contracts. There are no provisions in service contracts which provide for enhanced terms on a change of control of the HBOS Group. It is the Remuneration Committee’s policy to design contracts for any newly recruited Executive Directors in a comparable form to the contracts of existing Executive Directors.

Andy Hornby, the Chief Executive, will resign from the HBOS Board upon the Scheme becoming effective. Andy Hornby’s employment by HBOS will also end at that time. He has waived any payment that might otherwise be due to him as compensation for loss of office or in lieu of notice. Along with the other HBOS Directors, he will not be entitled to a bonus for the financial year ending 31 December 2008.

Andy Hornby has agreed in principle to provide his services to Lloyds TSB on a consultancy basis to assist with integration-related matters. The appointment will commence when the Acquisition becomes effective and is terminable on one month's notice by either party. Mr Hornby's consultancy fee is £60,000 per month. The appointment will be reviewed after 3 months and monthly thereafter.

Non-executive Directors are appointed by letter for an initial term of three years. They will usually serve a further three year term. Where the HBOS Board is satisfied that it is in the interests of the HBOS Group and its shareholders, a Non-executive Director may be asked to serve a third three year term. Notwithstanding these three yearly terms, appointments of Non-executive Directors can be terminated at any time on one month's written notice given either by the individual HBOS Director or by the HBOS Group.

<i>Non-executive Directors</i>	<i>Current term expires on the date of the Annual General Meeting to be held in</i>
Richard Cousins	2010
Sir Ron Garrick	2009
Anthony Hobson	2011
Karen Jones	2009
John E Mack	2010
Coline McConville	2009
Kate Nealon	2010

**11.3** For the financial year ended 31 December 2007, the aggregate remuneration (including salaries, fees, pension contributions, bonus payments and benefits in kind) granted to the HBOS Directors by HBOS was £9,557,000.

Key management personnel and members of their related parties have undertaken transactions with HBOS and its subsidiaries, jointly controlled entities and associated undertakings in the normal course of business.

**11.4** The number of HBOS Directors together with their connected person who had transactions and balances with banking entities in the HBOS Group as at 31 December 2007 was as follows:

	<i>Number of HBOS Directors</i>	<i>£'000</i>
Loans	6	1,440
Quasi-loans and credit cards	6	14
	<u>6</u>	<u>1,454</u>

Other than these transactions as at 31 December 2007 in the normal course of business, there were no outstanding loans or guarantees granted or provided by any member of the HBOS Group to, or for the benefit of, any of the HBOS Directors.

**11.5** Other than as described in paragraphs 11.1 to 11.3, no benefit, payment or compensation of any kind is payable to any HBOS Director upon termination of his or her employment with any member of the HBOS Group.

**11.6** Information in relation to the remuneration granted by Lloyds TSB to the Lloyds TSB Directors for the financial year ending 31 December 2007 is set out in the Directors' Remuneration Report in the Lloyds TSB Annual Report and Accounts 2007, which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## 12. Employees

### 12.1 HBOS Group

The following table sets forth the number of persons (excluding subcontractors) employed by the HBOS Group, other than the esure division, as at the end of each of the financial years indicated, by location and business function:

	<i>2007</i>	<i>2006</i>	<i>2005</i>
United Kingdom	65,452	64,860	63,640
Rest of the World	9,732	8,244	6,439
	<u>75,184</u>	<u>73,104</u>	<u>70,079</u>
Retail	43,076	45,142	44,217
Corporate	9,022	7,450	7,536
Insurance & Investment	6,666	5,880	5,746
Treasury & Asset Management	1,427	1,292	1,153
HBOS Group	6,100	5,777	5,741
Strategy & International	8,893	7,563	5,686
	<u>75,184</u>	<u>73,104</u>	<u>70,079</u>

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.

As at 30 June 2008, the HBOS Group employed 75,696 persons (excluding the HBOS Directors).

Information relating to the management and employees of HBOS is set out in section 11 of Part 1 ("Letter from the Chairman of HBOS plc") of the Scheme Document which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

### 12.2 Lloyds TSB Group

The average number of staff, on a headcount basis, employed by the Lloyds TSB Group for the three years ended 31 December 2007, 31 December 2006 and 31 December 2005 is set out below:

	<i>31 December</i>		
	<i>2007</i>	<i>2006</i>	<i>2005</i>
Average staff numbers (excluding subcontractors)	<u>69,553</u>	<u>76,092</u>	<u>79,594</u>

As at 31 December in each of the three years ended 31 December 2007, 31 December 2006 and 31 December 2005, the number of staff employed by the Lloyds TSB Group on a full-time equivalent basis is as set out below:

	<i>As at 31 December</i>		
	<i>2007</i>	<i>2006</i>	<i>2005</i>
Retail Banking	29,353	29,779	32,684
Insurance and Investments	4,848	5,300	5,621
Wholesale and International Banking	15,321	18,240	18,724
Other functions	8,556	9,311	9,768
Total	<u>58,078</u>	<u>62,630</u>	<u>66,797</u>

As at 30 June 2008, the Lloyds TSB Group employed 58,493 persons on a full-time equivalent basis.

The geographical breakdown of the number of staff employed by the Lloyds TSB Group on a full-time equivalent basis at 31 December 2007, 31 December 2006 and 31 December 2005 is as set out below:

	<i>As at 31 December</i>		
	<i>2007</i>	<i>2006</i>	<i>2005</i>
United Kingdom	56,052	60,587	64,828
Continental Europe	1,032	1,020	986
Americas	537	658	664
Rest of the World	457	365	319
Total	<u>58,078</u>	<u>62,630</u>	<u>66,797</u>

### 13. The HBOS Share Schemes

The Company and its subsidiaries currently operate the following HBOS Share Schemes:

1. HBOS plc Sharesave Plan 2001 (including the Unapproved Schedule and Irish Schedule);
2. HBOS plc International Sharesave Plan 2001;
3. HBOS plc Inland Revenue Approved Employee Share Option Plan 2002 (including the Unapproved Plan, Share Appreciation Rights Schedule, Australian Plan and Irish Schedule);
4. HBOS plc Share Incentive Plan;
5. HBOS plc International Free Shares Plan;
6. HBOS plc Australian Free Shares Plan;
7. HBOS plc Long Term Executive Bonus Plan;
8. HBOS plc Annual Bonus Plan;
9. HBOS plc Approved Profit Sharing Scheme;
10. ICC Bank Employee Share Ownership Trust and the ICC Bank Approved Profit Sharing Scheme; and
11. Insight Investment Management Limited Share Option Plan.

There are also subsisting options over HBOS Shares under the following HBOS Share Schemes, although no further options will be granted under these plans:

12. Bank of Scotland 1995 Executive Stock Option Scheme; and
13. Bank of Scotland 1996 Executive Stock Option Scheme.

#### 13.1 Common provisions in the HBOS Share Schemes

##### *Amendments*

Except as specified below, the HBOS Board or the HBOS Remuneration Committee may amend the rules of each of the HBOS Share Schemes. However, no amendments may be made to the rules which are to the advantage of existing or future participants without the prior approval of HBOS Shareholders if they relate to the eligibility to participate, the overall limits on the issue of new HBOS Shares, limits on the grants of rights to individual employees, the basis for determining participants' rights to acquire HBOS Shares or the adjustment of such rights in the event of a variation of the Company's share capital.

However, HBOS Shareholder approval is not required for minor amendments necessary to benefit the administration of the HBOS Share Schemes, amendments to take account of any change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants or any member of the HBOS Group. Amendments to "key features" of any of the HMRC approved HBOS Share Schemes must be approved by HMRC.



### *Limits*

In any 10-year period, not more than 10% of the ordinary share capital of the Company may be issued or issuable under the HBOS Share Schemes and all other employee share plans adopted by the Company (excluding rights to HBOS Shares which have lapsed or been surrendered).

## **13.2 HBOS plc Sharesave Plan 2001 (the “Sharesave”), the HBOS plc International Sharesave Plan 2001 (the “International Sharesave”) and the Schedule for the operation of the HBOS plc Sharesave 2001 in Ireland (“Irish Sharesave”)**

### **The Sharesave**

The Sharesave is an all-employee HMRC approved plan which provides for the grant of options over HBOS Shares to eligible employees within the HBOS Group.

### *Monthly Savings*

The grant of options is linked to a fixed-term save-as-you-earn savings contract. Monthly savings by each participant under the savings contract may not exceed the statutory maximum of £250 and will be for a period of 3, 5 or 7 years. On the expiry of the savings contract, participants will be entitled to receive a tax-free bonus in addition to the repayment of their savings contributions.

At the end of the savings contract period, participants may elect to apply the proceeds of their savings contract to exercise their option and acquire HBOS Shares. Alternatively, participants may choose to withdraw the proceeds of their savings contract, in which case their option will lapse.

### *The Exercise Price*

The price per HBOS Share payable on the exercise of an option is determined by the Company when options are granted, but may not be less than 80% of the middle market quotation of a HBOS Share on the dealing day before the date of issue of invitations, or, if the HBOS Board determines, the average of the middle market quotations over the three consecutive dealing days immediately preceding such date.

### *The Exercise of Options*

Options may normally only be exercised within a six month period after the maturity of the relevant savings contract, but earlier exercise is permitted in certain circumstances, in accordance with the rules of the Sharesave.

### *Variation of Share Capital*

If there is a variation in the ordinary share capital of the Company, the HBOS Board may adjust the aggregate number of HBOS Shares subject to any option and/or the exercise price payable upon the exercise of any option. However, no adjustment to options may be made without the prior approval of HMRC.

### **The International Sharesave**

The International Sharesave is substantially the same as the Sharesave, except that it is not approved by HMRC in the UK or by a tax authority in any other jurisdiction. The HBOS Board may adopt schedules to the International Sharesave which relate to any jurisdictions in which any participants reside.

Awards of the phantom options can also be made whereby participants receive a cash amount equivalent to the amount by which the market value, on the exercise date, of the number of HBOS Shares in respect of which the phantom option is exercised exceeds the aggregate phantom option price.

### **The Irish Sharesave**

The Irish Sharesave is a schedule to the Sharesave and is approved by the Irish Revenue Commissioners. The Irish Sharesave is substantially the same as the Sharesave.

### **13.3 HBOS plc Inland Revenue Approved Employee Share Option Plan 2002 (the “Approved ESOP”), the HBOS plc Inland Revenue (Unapproved) Employee Share Option Plan 2002 (the “Unapproved ESOP”) and the Irish Schedule to the Approved Employee Share Option Plan 2002 (the “Irish Schedule”)**

#### **The Approved ESOP**

The Approved ESOP provides for the grant of options over HBOS Shares to eligible employees within the HBOS Group.

The option price must not be less than either the market value of the HBOS Shares on the business day before the date of grant or, if the HBOS Board so decide, the average market value of the HBOS Shares over the three business days before the date of grant.

#### *Individual Limit*

The aggregate market value of HBOS Shares under options held by each participant at any one time under the Approved ESOP and any other discretionary HMRC approved plans adopted by the Company must not exceed £30,000.

#### *Exercise of Options*

Options will usually become exercisable, subject to the satisfaction of any performance conditions, between the third and sixth anniversary of the date of grant, though options may be exercised early in certain specified circumstances, subject to the satisfaction or waiver of performance conditions, in accordance with the rules of the Approved ESOP.

#### *Variation of Share Capital*

If there is a variation in the ordinary share capital of the Company, the HBOS Board may adjust the aggregate number of HBOS Shares subject to any option and/or the exercise price payable upon the exercise of any option. However, no adjustment to options may be made without the prior approval of HMRC.

#### **The Unapproved ESOP**

The rules of the Unapproved ESOP are broadly the same as the Approved ESOP, except that the Unapproved ESOP is not approved by HMRC and the £30,000 limit on the aggregate market value of HBOS Shares under option does not apply to the Unapproved ESOP. In addition, the exercise of options under the Unapproved ESOP may (where appropriate) be satisfied by a payment (either in shares or in cash) equal to the value of the difference between the aggregate option price and the aggregate market value of the HBOS Shares in respect of which an option is exercised.

The rules of the Unapproved ESOP as they apply to participants based in Australia have been amended so that HBOS Board will have no discretion to pay a cash amount as an alternative to the transfer or issue of HBOS Shares on the exercise of an option.

Under a separate schedule to the Approved ESOP, awards of share appreciation rights (“SARs”) may also be made whereby a cash amount, equivalent to the amount by which the market value, on the exercise date, of the number of HBOS Shares in respect of which the SAR is exercised exceeds the SAR price, will be payable to a participant instead of HBOS Shares.

#### **The Irish Schedule**

The Irish Schedule to the Approved ESOP is approved by the Irish Revenue Commissioners and is substantially based on the rules of the Approved ESOP.

### **13.4 HBOS plc Share Incentive Plan (the “SIP”)**

The SIP is an all-employee HMRC approved share incentive plan. Under the SIP, eligible employees may be offered free, partnership, matching and dividend shares, as determined by the HBOS Board (although the HBOS Board does not currently offer matching shares under the SIP). Such shares (other than partnership shares) will normally be held by the trustees of the SIP for a minimum period after being allocated, though in some circumstances they may be released from the trust early.

#### *Free Shares, Partnership Shares and Matching Shares*

Employees may be offered free shares with a value not exceeding the HMRC limit of £3,000 per annum. The award of free shares may be subject to performance targets as determined by the HBOS Board. In addition, the free shares awarded must normally be held in trust for a period determined by the HBOS Board which must be a period between three and five years from the date of award.

Employees may be offered the opportunity to buy partnership shares through deductions from their pre-tax salary, subject to the HMRC limit of £1,500 per annum (or 10% of their salary, if less).

In addition, at the discretion of the HBOS Board, up to two matching shares may be awarded for each partnership share acquired by participants. Matching shares must normally be held in trust for a period determined by the HBOS Board which must be a period between three and five years from the date of award.

#### *Dividends Shares*

The HBOS Board may also direct that dividends payable on HBOS Shares held by the participants may be reinvested in additional shares which are to be held on behalf of the participants. The total amount reinvested is subject to a limit set by HMRC of £1,500 per annum.

#### *General Provisions*

The trustees of the SIP trust will be able to vote in respect of the SIP shares held in the trust in accordance with the participants' instructions. Participants may also direct the trustees on what action to take in relation to any rights attaching to SIP shares to receive other shares.

### **13.5 HBOS plc International Free Shares Plan (the "International Free Shares Plan")**

Under the International Free Shares Plan, awards over HBOS Shares may be granted to any employees selected by the HBOS Board. The market value of the HBOS Shares allotted to each eligible employee must not exceed the limit of £3,000 per annum (or any other greater amount permitted under the SIP – see paragraph 13.4 above).

#### *General Provisions*

Awards vest at the end of a specified period, though they may vest earlier in certain circumstances in accordance with the rules of the International Free Shares Plan. The vesting of an award may be subject to performance targets as determined by the grantor. Although participants will not be able to vote or have any rights of a Shareholder in respect of HBOS Shares subject to awards during the vesting period, a dividend equivalent paid in either cash or HBOS Shares may be payable to participants in respect of HBOS Shares subject to awards during the vesting period, as determined by the grantor of the awards and as approved by the HBOS Board. The grantor may also satisfy awards by providing participants with a cash sum equivalent, subject to the approval of HBOS Board.

#### *Variation of Share Capital*

Where there is a variation in share capital, the number of HBOS Shares subject to an award may be adjusted by the HBOS Board.

#### *Other Rights under the International Free Shares Plan*

Phantom awards may also be granted under the International Free Shares Plan whereby a cash sum equivalent to the market value of the HBOS Shares subject to the award will be payable to participants upon the vesting of awards instead of the transfer of HBOS Shares.

### **13.6 HBOS plc Australian Free Shares Plan (the "Australian Plan")**

The Australian Plan operates on a similar basis to the free shares granted under the SIP (see 13.4 above). Employees selected by the HBOS Board may be offered free shares with a value not exceeding the limit of £3,000 per annum (or any other greater amount permitted under the SIP). A trustee appointed by the HBOS Board holds the free shares on behalf of the participants for a pre-determined restricted period (the trading lock period), which is usually three years but may be shortened in certain circumstances in accordance with the rules of the Australian Plan. However, the Company may permit the trustee to transfer the

free shares to the participants in certain circumstances, so long as such HBOS Shares are not disposed of by the participants during the trading lock period. The trustee may also acquire additional HBOS Shares on the participants' behalf by using the proceeds of any cash dividends received in respect of the participants' free shares.

Where a participant's termination of employment occurs before the trading lock period has expired, free shares will be forfeited, except in certain specified circumstances.

#### *Variation of Share Capital*

Where there is a variation in share capital, the trustee may exercise any rights conferred on the participants, as the participants direct.

### **13.7 HBOS plc Long Term Executive Bonus Plan (the "Long Term Plan")**

The Long Term Plan is a discretionary plan under which selected employees are granted conditional awards over HBOS Shares.

#### *Conditional Awards*

Awards may be granted under the Long Term Plan either by the Company, another company within the HBOS Group or the trustee of an employee benefit trust (the "**Grantor**"). The vesting of awards is subject to the satisfaction of performance conditions at the end of "lock up" period, as determined by the Grantor. The total market value of HBOS Shares subject to a proposed award when aggregated with any other awards granted to a participant under the Long Term Plan in the same financial year must not exceed 133.33 % of his annual salary.

HBOS Shares subject to an award will be transferred to participants at the end of the lock-up period, subject to the applicable performance conditions having been satisfied, together with any such additional number of HBOS Shares due to participants in respect of dividends payable on the HBOS Shares subject to the award during the lock-up period. Awards may vest before the end of the lock-up period in certain circumstances, in accordance with the rules of the Long Term Plan.

#### *Limit*

The Company may not issue, or grant rights to issue, more than 5% of its issued ordinary share capital pursuant to the Long Term Plan in any 10 year period when aggregated with HBOS Shares issued or issuable under all other discretionary share plans operated by the Company (excluding rights to HBOS Shares which have lapsed or been surrendered).

#### *Variation in Share Capital*

Where there is a variation in share capital, the number of HBOS Shares subject to an award may be adjusted in such manner as the HBOS Remuneration Committee determines appropriate.

#### *Other Rights under the Long Term Plan*

The Grantor may grant nil-cost options to participants in respect of their vested awards at the end of the lock-up period.

The Grantor may also make a cash award under the Long Term Plan instead of an award over HBOS Shares. Such awards will be subject to the same lock-up period and other conditions as conditional awards and at the end of such period, participants will receive a cash sum equal to the market value of the HBOS Shares subject to an award as well as a sum equal to the dividends payable on the HBOS Shares during the lock-up period.

The Remuneration Committee may also grant retention awards under the Long Term Plan, which are not subject to any performance conditions.

### **13.8 HBOS plc Annual Bonus Plan (the "Bonus Plan")**

The Company, another company within the HBOS Group or the trustee of an employee benefit trust (the "**Grantor**"), may offer participation in the Bonus Plan to any selected employee. The Bonus Plan operates in connection with the payment of annual bonuses to such employees. A proportion, of an employee's net annual bonus may be used to acquire HBOS Shares in the Company ("**Bonus Shares**"), as determined by the Grantor.

### *Bonus Shares*

The grant of a bonus award may be subject to performance targets in respect of a single financial year of the Company, as determined by the Grantor. Following the end of the financial year the Grantor will determine whether the performance target has been satisfied and the extent to which participants will be able to apply their bonus in acquiring Bonus Shares. Bonus Shares are held in a trust and will be released at the end of a lock-up period, which is determined by the Grantor. Participants will be entitled to dividends paid on the Bonus Shares and may instruct the trustee how to vote in respect of their Bonus Shares. Bonus Shares may be transferred to participants before the end of the lock-up period in certain circumstances, in accordance with the rules of the Bonus Plan.

### *Matching Shares*

In respect of participants who acquire Bonus Shares, the Grantor may also determine that participants will be entitled to Matching Shares at the end of the lock-up period. The number of Matching Shares to which participants will be entitled will be determined by the Grantor. Matching Shares will normally be issued or transferred to participants at the end of a lock-up period, provided they are still employed within the HBOS Group and their Bonus Shares are still held in trust. The delivery of Matching Shares may also be subject to performance conditions being satisfied. Matching Shares may be transferred to participants before the end of the lock-up period in certain circumstances, in accordance with the rules of the Bonus Plan. If Matching Shares cannot be transferred to participants due to legislative or administrative reasons, participants may receive a cash equivalent as an alternative.

### *Variation of Share Capital*

On a variation of share capital, the Grantor may vary the number of HBOS Shares subject to awards under the Bonus Plan.

### *Other Provisions under the Bonus Plan*

Under the rules of the Bonus Plan, phantom share awards may be granted to participants. The phantom awards will be subject to the same lock-up period and other terms as awards which deliver HBOS Shares except that participants will receive a cash sum equivalent to the market value of the HBOS Shares subject to such awards at the date of vesting.

The rules of the Bonus Plan also allow for awards to be made under the Extended Short-Term Incentive Plan, the rules of which are the same as the Bonus Plan except that the applicable performance period will not normally be less than two financial years of the Company.

## **13.9 HBOS plc Approved Profit Sharing Scheme (the “PSS”)**

The PSS has been approved by the Irish Revenue Commissioners and is operated by a trustee. Under the PSS, eligible employees may be awarded HBOS Shares and/or may also forgo part of their basic salary or bonus in order to acquire HBOS Shares. The number of HBOS Shares allocated to each eligible employee is determined by the HBOS Board and is subject to a statutory maximum. The HBOS Shares will normally be held for a minimum period by the trustee. The transfer of HBOS Shares out of the trust before the expiry of the holding period may only be permitted in certain specified circumstances.

The trustee may vote in respect of the HBOS Shares held in the trust as directed by the participants.

### *Variation of Share Capital*

Where there is a variation in share capital, the trustee may, in respect of the participants' HBOS Shares, exercise any rights as the participants direct.

### *Amendments to the PSS rules*

The prior written approval of the Irish Revenue Commissioners is required before the Company may amend the rules of the PSS.

### **13.10 The ICC Bank Employee Share Ownership Trust and the ICC Bank Approved Profit Sharing Scheme (the “ICC PSS”)**

The ICC PSS is operated by ICC Bank plc and is approved by the Irish Revenue Commissioners. The terms of the ICC PSS are substantially the same as the terms of the PSS (see 13.9 above) except for the fact that eligible employees may not forgo part of their basic salary or bonus in order to acquire HBOS Shares. However, under the ICC PSS the trustee also has the ability to make notional allocations of HBOS Shares. A notional allocation only gives participants a conditional right to receive HBOS Shares at some point in the future and until then participants do not have a beneficial entitlement to HBOS Shares and may not direct the trustee how to vote or exercise other rights in respect of any HBOS Shares held by the trustee.

### **13.11 Insight Investment Management Limited Share Option Plan (the “Insight Plan”)**

The Insight Plan provides for the grant of options over B ordinary shares in Insight Investment Management Limited (“Insight”) to eligible employees within the HBOS Group. The exercise price is determined by Insight or the trustee and options will usually become exercisable on the date specified on the option certificate. Options may be exercised early in certain specified circumstances in accordance with the rules of the Insight Plan. The aggregate number of B ordinary shares subject to options may not exceed a limit agreed by the remuneration committee of Insight and the HBOS Remuneration Committee.

Under the articles of association of Insight, within certain specified periods, HBOS has the right to purchase B ordinary shares and holders of B ordinary shares have the right to sell B ordinary shares to HBOS. The consideration for the B ordinary shares will be in the form of HBOS Shares and the number of HBOS Shares will be calculated by reference to the value of Insight.

The remuneration committee may amend the rules of the Insight Plan, though the approval of a certain proportion of participants is required for any amendments which adversely affect the rights of existing participants.

### **13.12 Bank of Scotland 1995 Executive Stock Option Scheme (“1995 ESOS”) and the Bank of Scotland 1996 Executive Stock Option Scheme (“1996 ESOS”) (together, the “ESOS Schemes”)**

All options under the ESOS Schemes have vested and no further options will be granted. Some options granted under the 1995 ESOS are HMRC approved options, whilst options granted under the 1996 ESOS are unapproved.

On a variation of share capital, the HBOS Board may make the adjustment it considers appropriate to the aggregate number of HBOS Shares subject to any option and the exercise price payable upon the exercise of such option, subject to the confirmation of the Company’s auditors that such adjustment is fair and reasonable. In respect of the 1995 ESOS Scheme, any adjustment must be made with the approval of HMRC.

## **14. Pension schemes**

**14.1** Save as disclosed in Part XVII (“Historical Financial Information relating to HBOS”), HBOS has not set aside or accrued any amounts to provide pension, retirement or similar benefit.

**14.2** Details of Lloyds TSB pension schemes are set out in section 13 of Part XXI (“Additional Information”) of the Lloyds TSB Prospectus which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## 15. Significant subsidiary and associated undertakings

15.1 The Company is the principal holding company of the HBOS Group.

15.2 The following table shows the significant subsidiaries of the HBOS Group and the associated undertakings of the HBOS Group which HBOS considers are likely to have a significant effect on the assessment of the Enlarged Group's assets and liabilities, financial position or profit and losses:

<i>Name</i>	<i>Percentage ownership interest and voting power</i>	<i>Field of activity</i>	<i>Country of incorporation</i>	<i>Registered office</i>
Bank of Scotland plc	100	Banking, financial and related services	Scotland	The Mound Edinburgh EH1 1YZ
Bank of Scotland (Ireland) Limited	100	Banking	Ireland	Bank of Scotland House 124-127 St. Stephen's Green Dublin 2 Ireland
HBOS Covered Bonds LLP	100	Residential mortgage funding	England	Trinity Road Halifax West Yorkshire HX1 2RG
HBOS Australia Pty Limited	100	Banking	Australia	BankWest Tower 108 St George's Terrace Perth Australia WA 6000
Bank of Western Australia Limited	100	Banking	Australia	BankWest Tower 108 St George's Terrace Perth Australia WA 6000
Halifax Share Dealing Limited	100	Execution only stockbroking	England	Trinity Road Halifax West Yorkshire HX1 2RG
HBOS Insurance & Investment Group Limited	100	Investment holding	England	33 Old Broad Street London EC2N 1HZ
Halifax General Insurance Services Limited	100	General insurance brokerage	England	Trinity Road Halifax West Yorkshire HX1 2RG
St Andrew's Insurance plc	100	General insurance	England	St Andrew's House Portsmouth Road Esher Surrey KT10 9SA
Clerical Medical Investment Group Limited	100	Life assurance	England	33 Old Broad Street London EC2N 1HZ
Clerical Medical Managed Funds Limited	100	Life assurance	England	33 Old Broad Street London EC2N 1HZ
Halifax Life Limited	100	Life assurance	England	Trinity Road Halifax West Yorkshire HX1 2RG
HBOS Investment Fund Managers Limited	100	OEIC management	England	Trinity Road Halifax West Yorkshire HX1 2RG
Insight Investment Management Limited	100	Investment management	England	33 Old Broad Street London EC2N 1HZ
Invista Real Estate Investment Management Holdings plc	55	Property investment	England	Exchequer Court 33 St. Mary Axe London EC3A 8AA

<i>Name</i>	<i>Percentage ownership interest and voting power</i>	<i>Field of activity</i>	<i>Country of incorporation</i>	<i>Registered office</i>
St. James's Place plc	60	Financial services	England	St. James's Place House Dollar Street Cirencester GL7 2AQ
St Andrew's Life Assurance plc	100	Pensions	England	St Andrew's House Portsmouth Road Esher Surrey KT10 9SA
Automobile Association Personal Finance Limited	50	Finance	England	Trinity Road Halifax West Yorkshire HX1 2RG
esure Holdings Ltd	70	Insurance	England	The Observatory Reigate Surrey RH2 0SG
Green Property Investment Fund 1 Plc	50	Investment	Ireland	Styne House Hatch Street Upper Dublin 2 Ireland
Sainsbury's Bank plc	50	Banking	England	33 Holborn London EC1N 2HT

**15.3** Information relating to the significant subsidiaries of Lloyds TSB is set out in paragraph 9 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **16. Property and environmental**

As at 31 December 2007, the HBOS Group operated throughout the world, principally in the UK, from both freehold and leasehold properties. The Company is of the opinion that there are currently no material environmental issues that affect the HBOS Group's utilisation of any property or other tangible fixed assets.

Details of property and environmental issues in relation to Lloyds TSB are set out in section 18 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **17. Material contracts**

### **17.1 HBOS**

The following are all of the contracts (not being contracts entered into in the ordinary course of business) that have been entered into by members of the HBOS Group: (i) within the two years immediately preceding the date of this document which are, or may be, material to the HBOS Group; or (ii) at any time and contain obligations or entitlements which are, or may be, material to the HBOS Group as at the date of this document:

#### **17.1.1 Implementation Agreement**

On 18 September 2008, Lloyds TSB and HBOS entered into the Implementation Agreement, as subsequently amended and restated on 13 October 2008. Please see the summary in paragraph 9.1.1 of Part XII (Additional Information) of the Lloyds TSB Circular.

#### **17.1.2 HBOS Rights Issue Underwriting Agreement**

Under an Underwriting Agreement dated 29 April 2008, HBOS appointed each of Morgan Stanley and Dresdner Bank AG, London Branch, on a several basis, as joint



underwriters to the HBOS rights issue and appointed each of Morgan Stanley and Dresdner Kleinwort as joint sponsors in connection with admission.

Whilst the HBOS rights issue was completed in accordance with its terms, HBOS gave certain customary representations and warranties to the underwriters and customary indemnities to the underwriters and certain persons connected with the underwriters and joint sponsors. The representations, warranties and indemnities given by HBOS are uncapped as to duration and amount.

### ***17.1.3 Agreement for the Sale of BankWest and St Andrew's to Commonwealth Bank of Australia***

On 8 October 2008, HBOS Australia Pty Ltd (for the purposes of this paragraph 17.1.3, the "**Seller**") and Commonwealth Bank of Australia (for the purposes of this paragraph 17.1.3, the "**Buyer**") entered into a deed (for the purposes of this paragraph 17.1.3, the "**Share Sale Deed**") pursuant to which the Seller has agreed to sell to the Buyer the issued ordinary share capital in each of Bank of Western Australia Ltd (for the purposes of this paragraph 17.1.3, "**BankWest**"), St Andrew's Australia Pty Ltd (for the purposes of this paragraph 17.1.3, "**St Andrew's**") and HBOS Australia Group (Services) Pty Ltd (for the purposes of this paragraph 17.1.3, "**HBOSGS**").

The purchase price for the shares will be AUS\$2.1 billion (for the purposes of this paragraph 17.1.3, the "**Purchase Price**"), apportioned as AUS\$2.037 billion for the BankWest shares, AUS\$63 million for the St Andrew's shares and AUS\$2 for the HBOSGS. The Purchase Price is subject to adjustment after completion based on the net assets of the BankWest, St Andrews and HBOSGS businesses at completion.

Under the terms of the Share Sale Deed, BankWest will also redeem 530,000,000 redeemable preference shares in the capital of BankWest held by HBOS for the sum of AUS\$530 million payable to HBOS at completion.

Completion is conditional upon the approval of the Australian Competition and Consumer Commission, the Australian Treasurer and the Australian Prudential Regulatory Authority.

HBOS has guaranteed all of the obligations of the Seller under the Share Sale Deed. HBOS has also given customary business warranties in favour of the Buyer.

### ***17.1.4 HBOS Placing and Open Offer Agreement entered into with effect from 13 October 2008***

HBOS, certain placing agents (the "**HBOS Placing Agents**") and HM Treasury entered into the Placing and Open Offer Agreement with effect from 13 October 2008, pursuant to which (i) HBOS has agreed to invite Qualifying Shareholders to apply to acquire 7,482,394,366 Open Offer Shares at the Issue Price by way of the Open Offer, (ii) the HBOS Placing Agents were appointed as joint sponsors, joint bookrunners and joint placing agents and have agreed to use reasonable endeavours to procure placees to acquire the Open Offer Shares at not less than the Issue Price on the basis that the Open Offer Shares placed will be subject to clawback to the extent they are taken up under the Open Offer and (iii) HM Treasury has agreed that, to the extent not placed or taken up under the Open Offer, HM Treasury will acquire such Open Offer Shares itself at the Issue Price.

In consideration of its services under the Placing and Open Offer Agreement, HM Treasury will be paid (i) a commission of 0.5 per cent. of the aggregate value of the Open Offer Shares at the Issue Price per Open Offer Share payable on the earlier of the issue of the Open Offer Shares and the second business day after the day on which the Placing and Open Offer Agreement is terminated and (ii) a further commission of 1 per cent. of the aggregate value of the Open Offer Shares acquired by placees (including HM Treasury) at the Issue Price per Open Offer Share, payable on the issue of the Open Offer Shares. HBOS will pay all legal and other costs and expenses of HM Treasury and the HBOS Placing Agents, and the costs and expenses of HM Treasury's financial advisers incurred in connection with the Placing and Open Offer and the New HBOS Preference Share Issue.

HBOS shall also bear all costs and expenses relating to the Placing and Open Offer and the New HBOS Preference Share Issue, including (but not limited to) the fees and expenses of its professional advisers, the cost of preparation, advertising, printing and distribution of the issue documents and all other documents connected with the Placing and Open Offer and the HBOS Preference Share Subscription Agreement, the registrars' fees, any listing fees payable to the UK Listing Authority, any charges by CREST and any fees of the London Stock Exchange, as applicable.

The obligations of HM Treasury and the HBOS Placing Agents under the Placing and Open Offer Agreement are subject to certain conditions including, among others:

- (i) in the opinion of HM Treasury (acting in good faith) no event having occurred or being reasonably likely to occur which has resulted in or may result in a material adverse change in or affecting the condition (financial, operational, legal or otherwise), profitability, prospects, solvency, business affairs or operations of the HBOS Group, taken as a whole, whether or not arising in the ordinary course of business;
- (ii) the Acquisition having been made on terms such that, if the Acquisition becomes effective in accordance with its terms, the Open Offer Shares shall be acquired by Lloyds TSB on terms such that in consideration of the cancellation or transfer of the Open Offer Shares, the holders of Open Offer Shares shall receive ordinary shares in the capital of Lloyds TSB;
- (iii) the passing of the resolutions to be proposed at the HBOS Court Meeting and the HBOS General Meeting and to approve and implement the Acquisition and the Placing and Open Offer and the Scheme having been sanctioned by the Court at the Scheme Hearing; and
- (iv) the obtaining of all applicable regulatory approvals and authorisations.

HM Treasury is entitled to waive certain conditions in its absolute discretion. HM Treasury may only invoke a condition where HM Treasury does not consider it to be necessary that the arrangements contemplated by the Placing and Open Offer Agreement and by the HBOS Preference Share Subscription Agreement proceed to completion in order to maintain the financial stability of the United Kingdom.

HM Treasury may terminate the Placing and Open Offer Agreement in certain specified circumstances, but only where HM Treasury does not consider it to be necessary that the arrangements contemplated by the Placing and Open Offer Agreement and by the HBOS Preference Share Subscription Agreement proceed to completion in order to maintain the financial stability of the United Kingdom.

Each of the HBOS Placing Agents may terminate its obligations under the Placing and Open Offer Agreement in certain circumstances. On termination by any of the HBOS Placing Agents, the Placing and Open Offer Agreement will continue to be in force as between the non-terminating parties.

The proceeds of the Placing and Open Offer are to be used by HBOS for such regulatory capital purposes as may be agreed with HM Treasury, the Bank of England and the Financial Services Authority.

HBOS has given certain customary representations and warranties and indemnities to each of HM Treasury and the HBOS Placing Agents under the Placing and Open Offer Agreement. The liabilities of HBOS are unlimited as to time and amount.

HBOS has undertaken not to declare or pay any dividend or make any distribution on or in respect of its ordinary shares or set aside any sum to provide for payment of any such dividend or distribution; or redeem, purchase, cancel or otherwise acquire in any way any of its ordinary shares or effect a reduction of its ordinary share capital which involves distribution to holders of the ordinary shares until the New HBOS Preference Shares are redeemed or repurchased in full.

HBOS has, under the Placing and Open Offer Agreement, undertaken to comply with certain conditions which are discussed in Part 6 ("Conditions relating to the Proposed Government Funding") of the Scheme Document which is incorporated by reference into this document.

It is anticipated that following completion of the Acquisition the conditions given by Lloyds TSB relating to the Proposed Government Funding set out in Part V ("Conditions Relating to the Proposed Government Funding") of the Lloyds TSB Circular, which is incorporated by reference into this document, (and not the conditions set out in the Placing and Open Offer Agreement) will apply to the Enlarged Group.

HM Treasury is entitled to novate its rights and obligations under the Placing and Open Offer Agreement to any entity which is wholly owned, directly or indirectly, by HM Treasury.

#### **17.1.5 HBOS Preference Share Subscription Agreement entered into with effect from 13 October 2008**

HBOS and HM Treasury entered into the HBOS Preference Share Subscription Agreement with effect from 13 October 2008, pursuant to which HM Treasury agreed to acquire, and HBOS agreed to allot and issue to HM Treasury, the New HBOS Preference Shares for a total consideration of £3,000,000,000 (before costs and expenses). HBOS has agreed to pay the costs and expenses of HM Treasury in relation to the negotiation of the HBOS Preference Share Subscription Agreement and the subscription for, and allotment and issue of, the New HBOS Preference Shares (including, without limitation, any stamp duty or stamp duty reserve tax).

Under the HBOS Preference Share Subscription Agreement, the issue and allotment of the New HBOS Preference Shares is conditional upon the Placing and Open Offer Agreement becoming wholly unconditional in accordance with its terms. Once issued, the New HBOS Preference Shares will be subject to the Preference Share Scheme and acquired by Lloyds TSB in accordance with the Preference Share Scheme in exchange for Replacement Lloyds TSB Preference Shares.

The New HBOS Preference Shares will pay a fixed non-cumulative dividend of 12 per cent., payable semi-annually in arrear, for the first five years after their issue. Thereafter, they will pay a per annum variable dividend, equal to three month sterling LIBOR plus 7 per cent., payable quarterly in arrear. The payment of such dividends is at the sole discretion of the HBOS Board.

For so long as dividend payments have not been made on the New HBOS Preference Shares, HBOS may not (subject to certain exceptions) declare or pay dividends or other distributions upon any parity or junior securities, or redeem, purchase or otherwise acquire any such securities. In addition, until the New HBOS Preference Shares are redeemed or purchased in full, HBOS may not declare or pay any dividend on its ordinary shares or redeem, purchase, cancel or otherwise acquire any of its ordinary shares or effect a reduction of its ordinary share capital which involves a distribution to holders of the ordinary shares.

The New HBOS Preference Shares do not carry voting rights, and holders may not speak at general meetings of HBOS, save for in the following limited circumstances:

- (i) if a resolution is proposed either varying or abrogating any of the rights and restrictions attached to the New HBOS Preference Shares or to wind up, or in relation to the winding up of, HBOS (and then in each such case only to speak and vote upon any such resolution); and
- (ii) if on the applicable dividend payment date immediately preceding the date of notice of any general meeting of HBOS Shareholders, the dividend on the New HBOS Preference Shares has not been declared and paid in full, holders of the New HBOS Preference Shares will be entitled to speak and to vote upon all resolutions proposed at such general meeting. In these circumstances only, the rights of the holders of the New HBOS Preference Shares to speak and vote will continue until HBOS has resumed the payment in full of dividends on the New HBOS Preference Shares.

Subject to notifying the FSA and being in compliance with its capital adequacy requirements (to the extent they apply at the time), HBOS has the right to redeem the New HBOS Preference Shares at the liquidation preference of £1,000 plus accrued dividends, in whole or in part, with effect from the date five years and one day after their issue.

The New HBOS Preference Shares will be issued credited as fully paid and will rank *pari passu* in all respects with the most senior preference shares then in issue and any other class of shares in issue at the time the New HBOS Preference Shares are issued pursuant to the HBOS Preference Share Subscription Agreement, or subsequently issued and which are expressed to rank equally with the New HBOS Preference Shares. The New HBOS Preference Shares rank ahead of the HBOS Shares.

The HBOS Preference Share Subscription Agreement is conditional upon the Placing and Open Offer Agreement described elsewhere herein becoming unconditional in accordance with its terms. In addition, HBOS is giving the same warranties to HM Treasury as are contained in the Placing and Open Offer Agreement. The HBOS Preference Share Subscription Agreement will terminate upon termination of the Placing and Open Offer Agreement in accordance with its terms.

HM Treasury is entitled to novate its rights and obligations under the HBOS Preference Share Agreement to any entity which is wholly-owned, directly or indirectly, by HM Treasury.

#### **17.1.6 Subscription and Transfer Agreements**

In connection with the Placing and Open Offer, the Company, Dresdner Bank AG, London Branch, Morgan Stanley and Jersey NewCo have entered into two agreements dated 18 November 2008, in respect of the subscription and transfer of ordinary shares and redeemable preference shares in Jersey NewCo. Under the terms of these agreements:

- (a) the Company and Dresdner Bank AG, London Branch and/or Morgan Stanley (and/or a third party nominated by the Company) (the “**NewCo Subscriber**”) will acquire ordinary shares in Jersey NewCo and enter into put and call options in respect of those ordinary shares that are exercisable if the Placing and Open Offer does not proceed;
- (b) Dresdner Bank AG, London Branch or Morgan Stanley or a third party nominated by the Company, as applicable, will apply monies received from Qualifying Shareholders or HM Treasury under the Placing and Open Offer to subscribe for redeemable preference shares in Jersey NewCo to an aggregate value equal to such monies, after deduction of the amount of certain commissions and expenses; and
- (c) the Company will allot and issue the HBOS Shares to those persons entitled thereto in consideration of the NewCo Subscriber transferring its holding of ordinary shares in Jersey NewCo to the Company, and Dresdner Bank AG, London Branch or Morgan Stanley or a third party nominated by the Company, as applicable, transferring its holdings of redeemable preference shares in Jersey NewCo to the Company.

Accordingly, instead of receiving cash as consideration for the issue of the HBOS Shares, at the conclusion of the Placing and Open Offer, the Company will own the entire issued ordinary and redeemable preference share capital of Jersey NewCo, whose only assets will be its cash reserves, which will represent an amount equivalent to the net proceeds of the Placing and Open Offer. The Company will be able to utilise this amount equivalent to the Placing and Open Offer net proceeds by exercising its right of redemption over the redeemable preference shares it will hold in Jersey NewCo.

Qualifying Shareholders are not party to these arrangements and so will not acquire any direct right against Dresdner Bank AG, London Branch or Morgan Stanley pursuant to these arrangements. The Company will be responsible for enforcing the other parties’ obligations thereunder.

#### **17.2 Lloyds TSB Material Contracts**

A summary of the material contracts of Lloyds TSB is set out in paragraph 9.1 of Part XII (“Additional Information”) of the Lloyds TSB Circular and paragraphs 8.1 and 8.2 of Part XXI

("Additional Information") of the Lloyds TSB Prospectus and each is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **18. Litigation**

### **18.1 HBOS**

**18.1.1** Save as set out in paragraphs 18.1.2, 18.1.3 and 18.1.4 below there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which HBOS is aware) during the year preceding the date of this document which may have, or have had in the recent past, significant effects on the financial position or profitability of HBOS and/or the HBOS Group.

#### **18.1.2 UK Competition Commission investigation of payment protection insurance**

The Competition Commission is formally investigating the supply of PPI services (except store card PPI) to non-business customers in the UK.

On 5 June 2008, the Competition Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with resulting detriments to consumers.

The Competition Commission has therefore also considered what remedies should be adopted to regulate the future supply of PPI and, on 13 November 2008, published for consultation its provisional decision on remedies. The Competition Commission's proposed package of remedies includes: (i) a prohibition on the sale of PPI by a distributor to a customer within 14 days of the distributor selling credit to that customer (although the customer would be able proactively to contact the distributor and purchase a PPI policy 24 hours after the credit sale); (ii) a requirement on credit providers to provide a 'personal PPI quote' to customers; (iii) a requirement on PPI providers to provide certain information and messages in PPI marketing materials and a requirement on distributors to advertise PPI on personal loans and second-charge mortgages in close proximity to their personal loan advertisements; (iv) a requirement on PPI providers to provide certain information on PPI policies to the FSA and a recommendation to the FSA that it uses this information for its PPI price comparison tables; (v) a requirement that distributors of PPI should provide an annual statement to customers; and (vi) a prohibition on the sale of single premium PPI policies.

The Competition Commission has invited comments on the proposed remedies. The Commission expects to issue its final report in mid-January 2009. Its final report will include its decision on the remedy measures to be introduced.

On 1 July 2008, the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The Lloyds TSB Group, the HBOS Group and other industry members and trade associations have made submissions to the FSA regarding this referral. The matter was considered at the FSA Board meeting on 25 September 2008. We are awaiting further developments.

On 30 September 2008, the FSA published a statement arising from its ongoing thematic review of PPI sales. In the statement, which was directed at the industry generally, the FSA highlighted certain concerns and indicated that it was escalating its regulatory intervention and considering appropriate action to deal with on-going non-compliant sales practices and to remedy non-compliant past sales. The FSA plans to publish an update on the third phase of the thematic work in the first quarter of 2009. The ultimate impact on the HBOS Group and, after the Effective Date, the Enlarged Group can only be known at the conclusion of the Competition Commission's investigations and the FSA's review, respectively.

#### **18.1.3 UK Office of Fair Trading**

**18.1.3.1** *The following reviews and inquiries are being carried out:*

In April 2007, the UK Office of Fair Trading ("**OFT**") commenced an investigation into the fairness of current account overdraft charges. At the

same time it commenced a market study into wider questions about competition and price transparency in the provision of personal current accounts.

On 27 July 2007, following agreement between the OFT and eight UK financial institutions, the OFT issued High Court legal proceedings against those institutions, including the HBOS Group and the Lloyds TSB Group, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to requests for unarranged overdrafts.

On 24 April 2008, the High Court ruled on the preliminary issues of whether the financial institutions' terms and conditions in relation to unarranged overdraft charges are capable of being assessed for fairness under the Unfair Terms in Consumer Contracts Regulations 1999 or are capable of amounting to penalties at common law. The High Court determined, in relation to the financial institutions' current terms and conditions, that the relevant charges are not capable of amounting to penalties but that they are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. On 22 May 2008, the Lloyds TSB Group and the HBOS Group, along with the other relevant financial institutions, were given permission to appeal the finding that unarranged overdraft charges are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. The appeal hearing concluded on 5 November 2008. The judgment is awaited.

A further hearing was held on 7 to 9 July 2008 to consider whether the financial institutions' historical terms and conditions are similarly not capable of being penalties, and to consider whether their historical terms are assessable for fairness. On 8 October 2008, the High Court issued its judgment broadly holding that these unarranged overdraft charges are not capable of being penalties, although it has invited further clarification from a number of banks, including the Lloyds TSB Group, before making any formal ruling on their historical terms and conditions.

On 16 July 2008, the OFT released a report following the market study referred to above. The OFT is now engaging in a period of consultation. The OFT has stated that at the conclusion of the consultation period, it will publish a summary of the responses received, and that it will then aim to publish a further or final report in early 2009 which will contain recommendations for the banking industry.

The FSA has agreed, subject to certain conditions, that the handling of customer complaints on this issue can be suspended until the earlier of either conclusion of the proceedings or 26 January 2009, subject to any renewal or extension which the FSA may agree. Cases before the Financial Ombudsman Service and the County Courts are also currently stayed pending the outcome of the legal proceedings initiated by the OFT.

It is expected that there will be further substantive hearings to establish whether the charges are fair. If various appeals are pursued, the proceedings may take a number of years to conclude.

The HBOS Group intends to continue to defend its position strongly. Accordingly, no provision in relation to the outcome of this litigation has been made. Depending on the High Court's determinations, a range of outcomes is possible, some of which could have a significant financial impact on the Lloyds TSB Group and the HBOS Group. The ultimate impact of the litigation on the HBOS Group or the Enlarged Group can only be known at its conclusion. Consistent with HBOS's obligations as a company admitted to the Official List, HBOS will give further details in relation to this matter when they become available.

#### *18.1.3.2 Interchange Fees*

The European Commission has adopted a formal decision finding that an infringement of EC competition laws has arisen from arrangements whereby

MasterCard issuers charged a uniform fallback interchange fee in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the EEA. This decision has been appealed to the European Court of First Instance. The HBOS Group and the Lloyds TSB Group (along with certain other MasterCard issuers) have applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with EC competition laws. The European Commission has objected to these proposed interventions. The Court of First Instance has not yet decided whether to allow the proposed interventions to proceed. Meanwhile, the European Commission and the OFT are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions also infringe EC and/or UK competition laws. The ultimate impact of the investigations on the HBOS Group or the Enlarged Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

**18.1.4** Further details of governmental, legal or arbitration proceedings in relation to HBOS are set out in paragraph 18 ("Litigation") of Part XVIII ("Additional Information") of the HBOS Rights Issue Prospectus, which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **18.2 Lloyds TSB**

Details of governmental, legal or arbitration proceedings in relation to Lloyds TSB are set out in paragraph 11.1 of Part XII ("Additional Information") on pages 263 to 265 of the Lloyds TSB Circular and paragraph 12 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus, each of which is incorporated by reference herein.

See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

## **19. Capital Resources and Liquidity**

It is the HBOS Group's policy to maintain a strong capital base to support the development of its business and to meet regulatory capital requirements at all times. The HBOS Group recognises the impact on shareholder returns of the level of capital employed, and seeks to maintain a prudent balance between a strong capital position and the underlying risks of the business. The HBOS Group's capital is managed via the HBOS Board through the 5 year Group Business Plan, and a detailed Funding Plan, with the objective of maintaining both the optimal amount of capital and the most appropriate mix between the different components of capital, whilst following the supervisory requirements of the FSA.

HBOS's current capital ratios benefit from the proceeds of the rights issue completed earlier in 2008 and the capitalisation of the interim dividend for 2008; as at 30 September 2008, HBOS had a core Tier 1 ratio of 6.0 per cent. and a Tier 1 ratio of 8.1 per cent.

The liquidity management framework of HBOS focuses on both overall balance sheet structure and the control, within prudent limits, of risk arising from the maturity mismatch of assets and liabilities across the balance sheet, as well as from undrawn commitments and other contingent obligations. The aim is to maintain substantial diversification, minimise concentration across various deposit sources and control the level of reliance on total short-term wholesale sources of funds (both secured and unsecured). As part of the planning process, HBOS regularly reviews the forecast structure of its balance sheet over the planning period, and updates the Funding Plan as appropriate and monitors the level and availability from retail and wholesale sources.

As a result of the increasingly turbulent conditions in global financial markets, there has been a significant deterioration in the inter-bank and term funding markets and a consequent material reduction in the availability of longer-term funding. As a result, banks such as HBOS have had to source more shorter-term and overnight funding with a consequent reduction in overall liquidity.

In recent months the strain in the financial system has increased substantially leading to a significant tightening in market liquidity and the threat of a more marked deterioration in the global economic outlook. In response to the recent market deterioration, on 8 October 2008 the UK Government announced a package of significant measures intended to address the systemic problems that have developed within the UK banking sector; committing to support banks through facilitating access to capital and a Government guarantee with respect to new debt issuance (intended to repay maturing wholesale funds).

In order to secure access to the Government guaranteed funding arrangements announced as part of this coordinated package of measures, HBOS announced the Placing and Open Offer of £8.5 billion in HBOS Shares and the issue of £3 billion of New HBOS Preference Shares to the UK Government, to raise £11.5 billion of new capital in aggregate.

The Capital Raising will, at its completion in January 2009, increase the relevant capital ratios at that time by approximately 340bps for Tier 1 and 250bps for Core Tier 1. Actual capital ratios at completion of the Capital Raising will depend on a number of factors, including earnings retention, movements in risk-weighted assets, further possible credit market write-downs and disposals, and therefore cannot be accurately predicted.

Whilst the HBOS Group's existing capital ratios are capable of sustaining its business through economic cycles, the substantial increase in Tier 1 capital resources is designed to sustain higher levels of capital in more extreme stressed scenarios over a prolonged period. Importantly, the commitment to strengthen the Group's capital ratios has immediately secured access to the UK Government's guarantee for short term and medium term debt issuance, providing the HBOS Group with significant additional funding strength.

Various governments have taken substantial measures to ease the current crisis in liquidity. In the UK a range of measures intended to ease both the causes and the symptoms of the current difficulties in money markets have been implemented. These include the provision of support to banks with respect to liquidity and funding. In September and October, the Bank of England, the European Central Bank and the US Federal Reserve announced a number of tools for the provision of liquidity to banks (including HBOS) in their respective jurisdictions. Such global measures include entering into weekly and longer term repurchase agreements, expanding the types of collateral accepted by these central banks as security for funding and co-ordinating global action to strengthen the banking system and functioning of the interbank markets. In the current market conditions, central bank and government facilities are an important tool in the liquidity management solutions for banks, including HBOS, and are in addition to the other funding sources available to HBOS, such as retail and corporate customer deposits.

There can be no assurance that these global measures will succeed in improving the funding and liquidity of the markets in which the major UK banks, including HBOS, operate. There is a range of different central bank funding arrangements in which HBOS is eligible to participate, both within the United Kingdom and overseas. As with many other banks, HBOS makes use of a number of these arrangements to assist with its funding and liquidity management. The general purpose of such arrangements is to allow a bank to pledge or enter into a repurchase agreement in respect of collateral for varying periods of time in exchange for Treasury Bills or cash funding.

The HBOS Group expects that it will substantially rely for the foreseeable future on the continued availability of these government sponsored arrangements, including central bank liquidity facilities (such as those offered by the Bank of England) as well as HM Treasury's guarantee scheme for short- and medium-term debt issuance.

Due to the severity of the dislocation of global markets for short- and medium-term funding sources, which has catalysed unprecedented levels of government intervention around the world, together with the extraordinary uncertainty facing the global banking industry in the medium term, and because the Acquisition and the Capital Raising (and the consequent access to certain UK government sponsored liquidity support) are inter-conditional, the UK Listing Authority has agreed that a statement regarding the adequacy of working capital for at least the next twelve months should not be required in this document. There is therefore no working capital statement in this document.

Details of the capital resources and liquidity in relation to Lloyds TSB are set out in section 11 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus, which is incorporated by reference herein.



See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## **20. Statutory auditors**

**20.1** KPMG Audit Plc, whose address is Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EG, has been the auditor of the Company for the period of historical financial information set out in this Prospectus.

**20.2** KPMG Audit Plc, Chartered Accountants and Registered Auditor, is regulated by the Institute of Chartered Accountants in England and Wales.

## **21. No significant change**

Save for the £4 billion net cash proceeds raised by the Company in the Rights Issue and save as disclosed in the sections headed “Group Overview”, “Divisional Review” and “Outlook” in Part IX (“HBOS Trading Update”) of this document, there has been no significant change in the financial or trading position of the HBOS Group since 30 June 2008, the date to which HBOS’s last published interim financial information (which is set out in Part B of Part XVII (“Historical Financial Information relating to HBOS”) of this document) was prepared.

Details of any significant changes in the financial or trading position of the Lloyds TSB Group since 30 June 2008 are set out in paragraph 16.1 of Part XXI (“Additional Information”) of the Lloyds TSB Prospectus which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

## **22. General**

**22.1** The Company has appointed the Joint Sponsors to act as joint sponsors for the purposes of the Placing and Open Offer.

**22.2** The total costs and expenses of, and incidental to, the Placing and Open Offer (including professional fees and expenses, fees and commissions payable to HM Treasury in respect of the Capital Raising and the costs of printing documents) are estimated to be up to an amount to £155 million (including fees and commissions payable to HM Treasury with respect to the Capital Raising) and are payable by the Company.

Details of costs of the Acquisition and the Lloyds TSB Placing and Open Offer in relation to Lloyds TSB are set out in section 14 of Part XXI (“Additional Information”) of the Lloyds TSB Prospectus, which is incorporated by reference herein.

See Part XXIV (“Information Incorporated by Reference”) for further details about information that has been incorporated by reference into this document.

**22.3** Each of Dresdner Kleinwort Limited, Dresdner Bank AG, London Branch and Morgan Stanley has given and has not withdrawn its written consent to the inclusion in this Prospectus of its name and reference thereto in the forms and contexts in which they appear.

**22.4** The financial information contained in this Prospectus which relates to the Company for the three financial years ended 31 December 2005, 31 December 2006 and 31 December 2007 does not constitute full statutory accounts as referred to in Section 240 of the Companies Act 1985. Statutory consolidated audited accounts of the Company, prepared under IFRS on which the auditors have given unqualified reports and which contained no statement under Section 237(2) or (3) of the Companies Act 1985, have been delivered to the Registrar of Companies in respect of the three financial years ended 31 December 2005, 31 December 2006 and 31 December 2007.

**22.5** The Company communicates announcements to its shareholders in the UK by notifying a Regulatory Information Service.

**22.6** Pursuant to the Placing and Open Offer, none of the Open Offer Shares has been marketed or is available to the public.

**22.7** The following table sets out the five-year dividend history for HBOS.

<i>Year ended 31 December</i>	<i>Dividend per HBOS Share (pence)</i>
2003	30.90
2004	32.95
2005	36.10
2006	41.40
2007	48.90

Note: The above table sets out unaudited data extracted without material adjustment from HBOS's Annual Report and Accounts 2007 (in respect of the data for 2007), its Annual Report and Accounts 2006 (in respect of the data for 2006) and its Annual Report and Accounts 2005 (in respect of the data for 2005, 2004 and 2003).

**22.8** Details of sources and bases of selection financial information in relation to Lloyds TSB are set out in section 16.1 of Part XXI ("Additional Information") of the Lloyds TSB Prospectus, which is incorporated by reference herein.

**22.9** See Part XXIV ("Information Incorporated by Reference") for further details about information that has been incorporated by reference into this document.

### **23. Documents available for inspection**

Copies of the following documents are available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for a period of twelve months from the date of publication of this Prospectus at the offices of Allen & Overy LLP, One Bishops Square, London E1 6AD and at the Company's registered office at The Mound, Edinburgh EH1 1YZ:

- (a) the Memorandum and the Articles of the Company;
- (b) the Annual Reports and audited consolidated accounts of the HBOS Group for the three financial years ended 31 December 2005, 2006 and 2007;
- (c) the unaudited interim financial statements of the HBOS Group for the six months ended 30 June 2007 and 30 June 2008;
- (d) the annual reports and audited consolidated accounts of the Lloyds TSB Group for the three financial years ended 31 December 2005, 2006 and 2007;
- (e) the annual reports and audited consolidated accounts of the Lloyds TSB Group on Form 20-F for the financial year ended 31 December 2007;
- (f) the unaudited interim financial statements of the Lloyds TSB Group for the six months ended 30 June 2008;
- (g) the unaudited interim financial statements of the Lloyds TSB Group for the six months ended 30 June 2007 and 30 June 2008 on Form 6-K;
- (h) the consent letters referred to in paragraph 22.3 above;
- (i) the HBOS Rights Issue Prospectus;
- (j) the Scheme Document;
- (k) the material contracts described in paragraph 17 above;
- (l) this Prospectus;
- (m) a *pro forma* Application Form; and
- (n) all other documents incorporated (in whole or in part) by reference into this document.

### **24. Announcement of results of the Placing and Open Offer**

The Company will make an appropriate announcement to a Regulatory Information Service giving details of the results of the Placing and Open Offer.

## PART XXIII

### DEFINITIONS

The following definitions apply throughout this document unless the context otherwise requires:

<b>“A Ordinary Shares”</b>	the A ordinary shares of 25 pence each in the capital of HBOS, as created on the reclassification of HBOS share capital pursuant to the Scheme Special Resolution and the Scheme, and <b>“A Ordinary Share”</b> means any one of them;
<b>“Acquisition”</b>	the proposed acquisition by Lloyds TSB of HBOS by means of the Scheme;
<b>“Admission”</b>	the admission of the New Lloyds TSB Shares to the Official List, in accordance with the Listing Rules, and the admission of the New Lloyds TSB Shares to trading on the London Stock Exchange’s main market for listed securities in accordance with the Admission and Disclosure Standards of the London Stock Exchange;
<b>“Admission and Disclosure Standards”</b>	the requirements contained in the publication “Admission and Disclosure Standards” (as amended from time to time) containing, amongst other things, the admission requirements to be observed by companies seeking admission to trading on the London Stock Exchange’s main market for listed securities;
<b>“Announcement”</b>	the announcement issued pursuant to Rule 2.5 of the Takeover Code released by Lloyds TSB and HBOS on 18 September 2008, such announcement, as supplemented by the announcement made on 13 October 2008 of the revised terms of the Acquisition, by Lloyds TSB;
<b>“Application Form”</b>	the personalised application form on which Qualifying Non-CREST Shareholders may take up and apply for Open Offer Shares under the Open Offer;
<b>“B Ordinary Shares”</b>	the B ordinary shares of 25 pence each in the capital of HBOS, as created on the reclassification of HBOS share capital pursuant to the Scheme Special Resolution and the Scheme, and <b>“B Ordinary Share”</b> means any one of them;
<b>“BSP Act”</b>	the Banking (Special Provisions) Act 2008;
<b>“Basel II”</b>	the New Capital Adequacy Framework issued in June 2004 by the Basel Committee, as implemented by Directive 2006/48/EC and Directive 2006/49/EC;
<b>“Business Day”</b>	a day (excluding Saturdays, Sundays and public holidays in the UK) on which banks are generally open for business in London or Edinburgh;
<b>“Capital Raising”</b>	means the proposed Placing and Open Offer and HBOS HM Treasury Preference Share Subscription;
<b>“Capital Reduction”</b>	the proposed reduction of share capital of HBOS pursuant to the Scheme;
<b>“Capitalisation Issue”</b>	the issue of the Capitalisation Issue Shares as further described in Part VI (“Principal Terms of the Capitalisation Issue”) of the Lloyds TSB Circular which is incorporated by reference into this document;
<b>“Capitalisation Issue Shares”</b>	the Lloyds TSB Shares to be issued in connection with the Capitalisation Issue;
<b>“City Code”</b>	the City Code on Takeovers and Mergers;

<b>“Closing Price”</b>	the closing middle-market quotations of an HBOS Share or a Lloyds TSB Share as derived from the Daily Official List (as the context requires);
<b>“Companies Act”</b>	the Companies Act 2006 (as amended);
<b>“the Company” or “HBOS”</b>	HBOS plc, registered in Edinburgh (no. SC218813);
<b>“Competition Commission”</b>	the body corporate known as the Competition Commission as established under section 45 of the Competition Act 1998, as amended;
<b>“Conditions”</b>	the conditions to the Scheme becoming Effective, set out in Part VIII (“Information on the Acquisition”) of this document;
<b>“Consideration Shares”</b>	the Lloyds TSB Shares proposed to be issued (or delivered in full or in part from treasury stock) and credited as fully paid pursuant to the Acquisition;
<b>“Court”</b>	the Court of Session in Edinburgh, Scotland;
<b>“Court Hearings”</b>	the Scheme Court Hearing and the Reduction Court Hearing;
<b>“Court Meeting”</b>	the meeting of the Scheme Shareholders as convened by order of the Court under section 896 of the Companies Act to be held on 12 December 2008 at 10.00 a.m., and any adjournment thereof;
<b>“Court Orders”</b>	the Scheme Court Order and the Reduction Court Order;
<b>“CREST”</b>	a relevant system (as defined in the CREST Regulations) in respect of which Euroclear UK & Ireland is the operator (as defined in the CREST Regulations);
<b>“CREST Manual”</b>	the rules governing the operation of CREST, consisting of the CREST Reference Manual, CREST International Manual, CREST Central Counterparty Service Manual, CREST Rules, Registrars Service Standards, Settlement Discipline Rules, CCSS Operations Manual, Daily Timetable, CREST Application Procedure and CREST Glossary of Terms (all as defined in the CREST Glossary of Terms);
<b>“CREST participant”</b>	a person who is, in relation to CREST, a system-participant (as defined in the CREST Regulations);
<b>“CREST Regulations”</b>	the Uncertificated Securities Regulations 2001 (SI 2001 No. 3755), including and modification thereof or any regulations in substitution thereof made under section 207 of the Companies Act and for the time being in force;
<b>“Daily Official List”</b>	the daily official list of the London Stock Exchange;
<b>“DBRS”</b>	Dominion Bond Rating Service (a rating agency);
<b>“Deferred Share”</b>	one unissued ordinary share of 25 pence in the share capital of HBOS that is to be reclassified as a non-voting deferred share of 25 pence and issued to Lloyds TSB prior to the Scheme Record Time;
<b>“Disclosure and Transparency Rules” or “DTRs”</b>	the disclosure and transparency rules made by the FSA under Part VI of FSMA;
<b>“Discount Window”</b>	the US Federal Reserve facility for lending to financial institutions at a rate discounted to the federal funds rate;
<b>“Effective”</b>	in the context of the Acquisition: <ul style="list-style-type: none"> <li>(i) if the Acquisition is implemented by way of the Scheme, the Scheme having become effective pursuant to its terms; or</li> </ul>

	(ii) if the Acquisition is implemented by way of a takeover offer under section 974 of the Companies Act, the takeover offer having been declared or become unconditional in all respects in accordance with the requirements of the City Code;
<b>“Effective Date”</b>	the date on which the Scheme becomes effective in accordance with its terms;
<b>“Enlarged Group”</b>	the combined Lloyds TSB Group and HBOS Group from the Effective Date;
<b>“Enlarged Group Ordinary Share Capital”</b>	all of the issued Lloyds TSB ordinary share capital immediately following the Acquisition becoming Effective;
<b>“Enlarged Group HMT Preference Shares”</b>	the New Lloyds TSB Preference Shares to be issued by Lloyds TSB to HM Treasury and the Lloyds TSB 12% Preference Shares and <b>“Enlarged Group HMT Preference Share”</b> means any one of them;
<b>“Euroclear UK &amp; Ireland”</b>	Euroclear UK & Ireland Limited (previously CRESTCo Limited);
<b>“Excess Application Facility”</b>	the arrangement pursuant to which Qualifying Shareholders may apply for Open Offer Shares in excess of their Open Offer Entitlements;
<b>“Excess CREST Open Offer Entitlement”</b>	in respect of each Qualifying CREST Shareholder, the entitlement to apply for Open Offer Shares in addition his Open Offer Entitlement, credited to his stock account in CREST, pursuant to the Excess Application Facility, which is conditional on him taking up his Open Offer Entitlement in full and which may be subject to scaling back in accordance with the provisions of this document;
<b>“Excess Open Offer Entitlement”</b>	in respect of each Qualifying Non-CREST Shareholder, the entitlement to apply for Open Offer Shares in addition to his Open Offer Entitlement pursuant to the Excess Application Facility, which is conditional on him taking up his Open Offer Entitlement in full and which may be subject to scaling back in accordance with the provisions of this document;
<b>“Excluded Shares”</b>	any HBOS Shares: (i) registered in the name of or beneficially owned by Lloyds TSB, or (ii) held by HBOS in treasury;
<b>“Existing HBOS Shares”</b>	the HBOS Shares in issue as at the Open Offer Record Date and <b>“Existing HBOS Share”</b> means any one of them;
<b>“Existing Lloyds TSB Ordinary Shares”</b>	the Lloyds Shares in issue at the Open Offer Record Date and <b>“Existing Lloyds TSB Ordinary Share”</b> means any one of them;
<b>“Financial Services Authority” or “FSA”</b>	the Financial Services Authority of the United Kingdom;
<b>“FSMA”</b>	the Financial Services and Markets Act 2000, as amended;
<b>“GAAP”</b>	Generally Accepted Accounting Principles;
<b>“HBOS” or “the Company”</b>	HBOS plc, registered in Edinburgh (no. SC218813);
<b>“HBOS 9¼% Preference Shares”</b>	the 9¼% non-cumulative irredeemable preference shares of £1 each in the capital of HBOS;
<b>“HBOS 9¾% Preference Shares”</b>	the 9¾% non-cumulative irredeemable preference shares of £1 each in the capital of HBOS;
<b>“HBOS 6.0884% Preference Shares”</b>	the 6.0884% non-cumulative preference shares of £1 each in the capital of HBOS;
<b>“HBOS 6.475% Preference Shares”</b>	the 6.475% non-cumulative preference shares of £1 each in the capital of HBOS;
<b>“HBOS 6.3673% Preference Shares”</b>	the 6.3673% fixed-to-floating non-cumulative preference shares of £1 each in the capital of HBOS;

<b>“HBOS 6.413% Preference Shares”</b>	the 6.413% non-cumulative callable fixed-to-floating rate Series ‘A’ preference shares of US\$1 each in the capital of HBOS;
<b>“HBOS 5.92% Preference Shares”</b>	the 5.92% non-cumulative callable fixed-to-floating rate series ‘B’ preference shares of US\$1 each in the capital of HBOS;
<b>“HBOS 6.657% Preference Shares”</b>	the 6.657% non-cumulative callable preference shares of US\$1 each in the capital of HBOS;
<b>“HBOS 12% Preference Shares”</b>	the 12% fixed-to-floating callable non-cumulative preference shares of £1 each in the capital of HBOS;
<b>“HBOS ADSs”</b>	the American Depositary Shares of HBOS, each representing one HBOS Share;
<b>“HBOS Articles”</b>	the articles of association of HBOS in force from time to time;
<b>“HBOS Board”</b>	the board of directors of HBOS;
<b>“HBOS Directors”</b>	the directors of HBOS as set out in paragraph 7 of Part XXII (“Additional Information”) of this document except where otherwise indicated, and <b>“HBOS Director”</b> means any one of them;
<b>“HBOS General Meeting”</b>	the general meeting of HBOS to be held on 12 December 2008 at 10.10 a.m., and any adjournment thereof;
<b>“HBOS Group”</b>	HBOS and its subsidiary undertakings from time to time;
<b>“HBOS HM Treasury Preference Share Subscription”</b>	means the subscription by HM Treasury for the New HBOS Preference Shares on the terms of the HBOS Preference Share Subscription Agreement;
<b>“HBOS Interim Management Statement”</b>	the statement issued by HBOS on 3 November 2008 commenting on trading since 30 June 2008;
<b>“HBOS Interim Results”</b>	the condensed consolidated Half Year unaudited financial statements of HBOS prepared in accordance with the Disclosure and Transparency Rules and with IAS 34 “Interim Financial Reporting” as adopted by the European Union;
<b>“HBOS Memorandum”</b>	the memorandum of association of the Company as at the date of this Prospectus;
<b>“HBOS Preference Shareholders”</b>	means the registered holders of the HBOS Preference Shares and <b>“HBOS Preference Shareholder”</b> means any one of them;
<b>“HBOS Preference Shares”</b>	the HBOS 9 <sup>1</sup> / <sub>4</sub> % Preference Shares, the HBOS 9 <sup>3</sup> / <sub>4</sub> % Preference Shares, the HBOS 6.0884% Preference Shares, the HBOS 6.475% Preference Shares, the HBOS 6.3673% Preference Shares, the HBOS 6.413% Preference Shares, the HBOS 5.92% Preference Shares, the HBOS 6.657% Preference Shares and the HBOS 12% Preference Shares and <b>“HBOS Preference Share”</b> means any one of them;
<b>“HBOS Preference Share Scheme”</b>	the proposed scheme of arrangement under sections 895 to 899 of the Companies Act between HBOS and HBOS Preference Shareholders as specified therein, (with or subject to any modification thereof or addition thereto or condition agreed by HBOS and Lloyds TSB and which the Court may think fit to approve or impose);
<b>“HBOS Preference Share Scheme Circular”</b>	the document sent to HBOS Preference Shareholders dated 14 November in relation to the HBOS Preference Share Scheme;
<b>“HBOS Preference Share Subscription Agreement”</b>	the agreement entered into between HBOS and HM Treasury, effective as of 13 October 2008, in connection with the issue of New HBOS Preference Shares;
<b>“HBOS Resolutions”</b>	each of the resolutions to be proposed at the Court Meeting and the HBOS General Meeting;

“ <b>HBOS Rights Issue Prospectus</b> ”	the prospectus dated 19 June 2008 published by HBOS in relation to the Rights Issue;
“ <b>HBOS Shareholders</b> ”	the registered holders of HBOS Shares and “ <b>HBOS Shareholder</b> ” means any of such holders;
“ <b>HBOS Shares</b> ”	the issued ordinary shares of 25 pence each in the capital of HBOS and “ <b>HBOS Share</b> ” means any one of them;
“ <b>HBOS Share Schemes</b> ”	the HBOS plc Sharesave Plan 2001, the HBOS plc International Sharesave Plan 2001, the HBOS plc Inland Revenue Approved Employee Share Option Plan 2002, the Bank of Scotland 1995 Executive Stock Option Scheme, the Bank of Scotland 1996 Executive Stock Option Scheme, the HBOS plc International Free Shares Plan, the HBOS plc Long Term Executive Bonus Plan, the HBOS plc Australian Free Shares Plan, the HBOS plc Annual Bonus Plan, the HBOS plc Share Incentive Plan, the HBOS plc Approved Profit Sharing Scheme and the ICC Bank Employee Share Ownership Trust, the ICC Bank Approved Profit Share Scheme and the Insight Investment Management Share Option Plan and “ <b>HBOS Share Scheme</b> ” means any one of them;
“ <b>Hearing Record Time</b> ”	6.00 p.m. on the Business Day immediately preceding the date of the Reduction Court Hearing;
“ <b>HMRC</b> ”	HM Revenue and Customs;
“ <b>HM Treasury</b> ”	the Commissioners of Her Majesty’s Treasury (or, where HM Treasury has nominated a nominee to acquire any shares which HM Treasury would otherwise be obliged to acquire, such nominee);
“ <b>IAS</b> ”	International Accounting Standards;
“ <b>IFRS</b> ”	International Financial Reporting Standards;
“ <b>Implementation Agreement</b> ”	the implementation agreement dated 18 September 2008 between HBOS and Lloyds TSB in relation to the Acquisition and as amended and restated on 13 October 2008;
“ <b>ISIN</b> ”	International Securities Identifying Number;
“ <b>Issue Price</b> ”	113.6 pence per Open Offer Share;
“ <b>Jersey NewCo</b> ”	HBOS JPS Limited, a Jersey-incorporated subsidiary of HBOS, established in connection with the Placing and Open Offer mechanics;
“ <b>Joint Sponsors</b> ”	Morgan Stanley & Co. International plc and Dresdner Kleinwort Limited;
“ <b>Listing Rules</b> ”	the Listing Rules of the UK Listing Authority;
“ <b>Lloyds TSB</b> ”	Lloyds TSB Group plc, registered in Edinburgh (no. SC95000);
“ <b>Lloyds TSB ADSs</b> ”	the American Depositary Shares of Lloyds TSB, each representing four Lloyds TSB Shares and “ <b>Lloyds TSB ADS</b> ” means any one of them;
“ <b>Lloyds TSB Board</b> ”	the board of directors of Lloyds TSB;
“ <b>Lloyds TSB Circular</b> ”	the circular to Lloyds TSB Shareholders dated 3 November 2008 in connection with, <i>inter alia</i> , the Acquisition and the Lloyds TSB Placing and Open Offer;
“ <b>Lloyds TSB Directors</b> ”	the directors of Lloyds TSB as at the date of this document, and “ <b>Lloyds TSB Director</b> ” means any one of them;
“ <b>Lloyds TSB General Meeting</b> ”	the general meeting of Lloyds TSB to be held at 11.00 a.m. on 19 November 2008, or any adjournment thereof, to consider and, if thought fit, to approve, among other things, the Acquisition;

<b>“Lloyds TSB Group”</b>	Lloyds TSB and its subsidiary undertakings from time to time, notice of which is set out on the Lloyds TSB Report on Form 6-K dated 4 November 2008 which is incorporated by reference into this document;
<b>“Lloyds TSB Interim Results”</b>	the condensed consolidated Half Year unaudited financial statements of the Lloyds TSB Group prepared in accordance with the Disclosure and Transparency Rules and with IAS 34 “Interim Financial Reporting” as adopted by the European Union;
<b>“Lloyds TSB Preference Shares”</b>	means preference shares of 25 pence each in the capital of Lloyds TSB, and <b>“Lloyds Preference Share”</b> means any one of them;
<b>“Lloyds TSB Preference Share Subscription Agreement”</b>	the preference share subscription agreement to be entered into by Lloyds TSB and HM Treasury in connection with the New Lloyds TSB Preference Share Issue
<b>“Lloyds TSB Open Offer”</b>	the offer by Lloyds TSB to Lloyds TSB Shareholders constituting an offer to apply for the Lloyds TSB Open Offer Shares;
<b>“Lloyds TSB Open Offer Shares”</b>	the new Lloyds TSB Shares to be issued prior to the Effective Date by Lloyds TSB pursuant to the Lloyds TSB Placing and Open Offer;
<b>“Lloyds TSB Placing”</b>	the conditional placing by Lloyds TSB of the Lloyds TSB Open Offer Shares with HM Treasury, a copy of the announcement of which is set out on the Lloyds TSB Report on Form 6-K dated 19 September 2008 which is incorporated by reference into this document;
<b>“Lloyds TSB Placing and Open Offer”</b>	the Lloyds TSB Placing and the Lloyds TSB Open Offer;
<b>“Lloyds TSB Placing and Open Offer Agreement”</b>	the agreement relating to the Lloyds TSB Placing and Open Offer entered into with effect from 13 October 2008 between, <i>inter alia</i> , Lloyds TSB and HM Treasury;
<b>“Lloyds TSB Prospectus”</b>	the Lloyds TSB prospectus to be issued by Lloyds TSB in connection with the new Lloyds TSB Shares to be issued pursuant to the Acquisition and the Lloyds TSB Placing and Open Offer;
<b>“Lloyds TSB Resolutions”</b>	the resolutions set out in the notice convening the Lloyds TSB General Meeting at the end of the Lloyds TSB Circular;
<b>“Lloyds TSB Shareholders”</b>	registered holders of Lloyds TSB Shares and <b>“Lloyds TSB Shareholder”</b> means any one of them;
<b>“Lloyds TSB Shares”</b>	ordinary shares of 25 pence each in the capital of Lloyds TSB and <b>“Lloyds TSB Share”</b> means any one of them;
<b>“London Stock Exchange”</b>	London Stock Exchange plc or its successor;
<b>“Long Term Repo”</b>	a repurchase agreement or contract in which the seller of securities agrees to buy them back at a specified time (usually after 3 months of the date of that contract) and price;
<b>“Merrill Lynch”</b>	Merrill Lynch International;
<b>“Money Laundering Regulations”</b>	the Money Laundering Regulations 1993 (SI 1993 No. 1933), as amended, and the Money Laundering Regulations 2003 (SI 2003 No. 3075);
<b>“Morgan Stanley”</b>	Morgan Stanley & Co. International plc;
<b>“New HBOS Preference Shares”</b>	means the £3,000,000,000 Fixed to Floating Callable Non-Cumulative Preference Shares to be issued by HBOS to HM Treasury pursuant to the HBOS Preference Share Subscription Agreement;



<b>“New HBOS Preference Share Issue”</b>	the issue of New HBOS Preference Shares by HBOS pursuant to the HBOS Preference Share Subscription Agreement;
<b>“New HBOS Shares”</b>	the new ordinary shares of 25 pence each in the capital of HBOS to be issued in accordance with Clause 2b of the Scheme and <b>“New HBOS Share”</b> means any one of them;
<b>“New Lloyds TSB Preference Shares”</b>	the £1,000,000,000 Fixed to Floating Callable Non-Cumulative Preference Shares to be issued by Lloyds TSB to HM Treasury pursuant to the Lloyds TSB Preference Share Subscription Agreement;
<b>“New Lloyds TSB Preference Share Issue”</b>	the issue of the New Lloyds TSB Preference Shares by Lloyds TSB pursuant to the Lloyds TSB Preference Share Subscription Agreement;
<b>“New Lloyds TSB Shares”</b>	the Lloyds TSB Shares proposed to be issued (or delivered in full or in part from treasury stock) and credited as fully paid pursuant to the Acquisition and <b>“New Lloyds TSB Share”</b> means any one of them;
<b>“NYSE”</b>	the New York Stock Exchange, Inc;
<b>“Offer”</b>	should Lloyds TSB elect to make the Acquisition by way of a contractual offer, that contractual offer for the shares in HBOS made by Lloyds TSB, and where the context admits, any subsequent revision or variation of such offer which represents no diminution in the value of such offer;
<b>“Office of Fair Trading” or “OFT”</b>	the UK Office of Fair Trading;
<b>“Official List”</b>	the official list of the UK Listing Authority;
<b>“Open Offer”</b>	the offer by HBOS to Qualifying Shareholders constituting an invitation to apply for the Open Offer Shares on the terms and subject to the conditions set out in this document and, in the case of Qualifying Non-CREST Shareholders, in the Application Form;
<b>“Open Offer Entitlement”</b>	the entitlement of a Qualifying Shareholder to apply for 1.3839 Open Offer Shares for every one Existing HBOS Share held on the Open Offer Record Date;
<b>“Open Offer Record Date”</b>	close of business on 5 December 2008;
<b>“Open Offer Shares”</b>	the 7,482,394,366 HBOS Shares to be offered to Qualifying Shareholders under the Open Offer and for which HM Treasury has agreed to acquire pursuant to the Placing and Open Offer Agreement, subject to clawback in respect of valid applications by Qualifying Shareholders and <b>“Open Offer Share”</b> means any one of them;
<b>“Overseas Shareholders”</b>	HBOS Shareholders who have registered addresses outside the United Kingdom, and, in the context of the Open Offer, are also Qualifying Shareholders and <b>“Overseas Shareholder”</b> means any one of them;
<b>“Panel”</b>	The Panel on Takeovers and Mergers;
<b>“Placing”</b>	the placing of the Open Offer Shares with placees as described in this document;
<b>“Placing Agents”</b>	Morgan Stanley & Co. International plc and Dresdner Bank AG, London Branch;
<b>“Placing and Open Offer”</b>	the Placing and the Open Offer;
<b>“Placing and Open Offer Agreement”</b>	the agreement relating to the Placing and Open Offer entered into with effect from 13 October 2008 between, <i>inter alia</i> , HBOS and HM Treasury (as amended);
<b>“Pounds, pence, £ and p”</b>	the lawful currency of the United Kingdom;

<b>“PPI”</b>	payment protection insurance;
<b>“Proposed Government Funding”</b>	the proposed funding by the UK Government as part of a co-ordinated package of capital and funding measures for the UK banking sector as announced on 8 October 2008;
<b>“Prospectus Directive”</b>	the Directive 2003/71/EC and includes any relevant implementing measures in each Member State of the European Economic Area that has implemented the Directive 2003/71/EC;
<b>“Prospectus Rules”</b>	the prospectus rules made by the FSA pursuant to Part VI of FSMA;
<b>“Qualified Institutional Buyer” or “QIB”</b>	has the meaning given in Rule 144A under the Securities Act;
<b>“Qualifying CREST Shareholders”</b>	Qualifying Shareholders whose HBOS Shares on the register of members of HBOS at the Open Offer Record Date are in uncertificated form and held through CREST;
<b>“Qualifying Non-CREST Shareholders”</b>	Qualifying Shareholders whose HBOS Shares on the register of members of HBOS at the Open Offer Record Date are in certificated form;
<b>“Qualifying Shareholders”</b>	HBOS Shareholders on the register of members of HBOS at the Open Offer Record Date with the exclusion (subject to certain exceptions) of HBOS Shareholders with a registered address in the United States or a Restricted Jurisdiction;
<b>“Receiving Agent” or “Registrar”</b>	Computershare Investor Services PLC;
<b>“Reduction Court Hearing”</b>	the hearing at which the Court’s confirmation of the reduction of capital provided for by the Scheme will be sought under section 137 of the Companies Act 1985;
<b>“Reduction Court Order”</b>	the order of the Court confirming under section 137 of the Companies Act 1985 the reduction of capital provided for by the Scheme;
<b>“Reduction Court Order”</b>	the order of the Court confirming the Capital Reduction under section 137 of the Companies Act 1985 (as amended or re-enacted);
<b>“Registrar” or “Receiving Agent”</b>	Computershare Investor Services PLC;
<b>“Registrar of Companies”</b>	the Registrar of Companies in Scotland;
<b>“Regulatory Information Service”</b>	any of the services authorised from time to time by the FSA for the purposes of disseminating regulatory announcements;
<b>“Replacement Lloyds TSB Preference Shares”</b>	the preference shares in the capital of Lloyds TSB to be issued to HBOS Preference Shareholders in accordance with the HBOS Preference Share Scheme;
<b>“Restricted Entities”</b>	<ul style="list-style-type: none"> <li>(i) any body or bodies corporate which would be prohibited under section 23 of the Companies Act 1985 from being a shareholder of Lloyds TSB upon the Scheme becoming effective provided that any such body or bodies corporate will only be a Restricted Entity to the extent of such prohibition; or</li> <li>(ii) who, being a member of the Lloyds TSB Group, holds HBOS Shares beneficially or any other person who holds HBOS Shares on behalf of such member of the Lloyds TSB Group, provided that any such body corporate will only be a Restricted Entity in respect of such holding,</li> </ul> <p>and <b>“Restricted Entity”</b> means any one of them;</p>

<b>“Restricted Jurisdiction”</b>	Hong Kong, Japan, Singapore, South Africa, the UAE and certain other overseas jurisdictions;
<b>“Reorganisation Record Time”</b>	the time at which a certified copy of the Scheme Court Order is delivered to the Registrar of Companies;
<b>“Rights Issue”</b>	the Company’s 2 for 5 rights issue of 1,499,662,328 HBOS Shares, which completed in July 2008;
<b>“Rule 9 Waiver”</b>	the waiver agreed to be granted by the Panel, subject to the passing by the HBOS Shareholders (other than HM Treasury, if applicable) of resolution 1 set out in the notice convening the HBOS General Meeting, set out in paragraph 3.8 of Part XXII (“Additional Information”), of the obligation to make a general offer to HBOS Shareholders under Rule 9 of the City Code that might otherwise arise on HM Treasury;
<b>“Scheme” or “Scheme of Arrangement”</b>	the proposed scheme of arrangement under sections 895 to 899 of the Companies Act between HBOS and the Scheme Shareholders, with or subject to any modification thereof or in addition thereto or condition agreed by HBOS and Lloyds TSB and which the Court may think fit to approve or impose;
<b>“Scheme Court Hearing”</b>	the hearing at which the Court’s sanction of the Scheme will be sought under sections 895 to 899 of the Companies Act;
<b>“Scheme Court Order”</b>	the order of the Court sanctioning the Scheme under sections 895 to 899 of the Companies Act;
<b>“Scheme Document”</b>	the document dated 14 November 2008 containing, <i>inter alia</i> , the Scheme and the notice of the Court Meeting and the HBOS General Meeting;
<b>“Scheme Record Time”</b>	means 6.00 p.m. (London time) on the Business Day immediately prior to the Reduction Court Hearing;
<b>“Scheme Shareholders”</b>	the holders of Scheme Shares and <b>“Scheme Shareholder”</b> means any one of them;
<b>“Scheme Shares”</b>	means the HBOS Shares: <ul style="list-style-type: none"> <li>(i) in issue at the date of this document;</li> <li>(ii) issued after the date of this document and prior to the Voting Record Time; and</li> <li>(iii) issued at or after the Voting Record Time but before the Scheme Record Time either on terms that the original or any subsequent holder thereof shall be bound by the Scheme or, in the case of any such shares issued prior to the adoption of the amendment to the HBOS Articles to be adopted at the HBOS General Meeting, in respect of which the original or any subsequent holder thereof is, or shall have agreed in writing to be, bound by the Scheme,</li> </ul> and for the avoidance of doubt, the Open Offer Shares and, where the context requires, the A Ordinary Shares and (if any) the B Ordinary Shares, but excluding the Deferred Share and <b>“Scheme Share”</b> means any one of them;
<b>“Scheme Special Resolution”</b>	resolution 2 to be proposed at the HBOS General Meeting in connection with the implementation of the Scheme;
<b>“SDRT”</b>	stamp duty reserve tax;
<b>“Securities Act”</b>	the United States Securities Act of 1933, (as amended);
<b>“Shareholder Guide”</b>	the guide accompanying the Application Form containing instructions as to the completion of the Application Form;
<b>“SME”</b>	small and medium-sized entities;
<b>“Tier 1”</b>	has the meaning given to the term from time to time by the FSA;

<b>“Tier 2”</b>	has the meaning given to the term from time to time by the FSA;
<b>“UAE”</b>	United Arab Emirates;
<b>“UK Listing Authority”</b>	the FSA in its capacity as the competent authority under FSMA;
<b>“United Kingdom” or “UK”</b>	the United Kingdom of Great Britain and Northern Ireland and its dependent territories;
<b>“United States” or “US”</b>	the United States of America, its possessions and territories, any state or political sub-division of the United States of America and the District of Columbia;
<b>“USE”</b>	shall have the meaning given in the CREST Manual issued by Euroclear; and
<b>“Voting Record Time”</b>	6.00 p.m. on the day which is two days before the date of the Court Meeting and the HBOS General Meeting or, if the Court Meeting and/or the HBOS General Meeting is adjourned, 6:00 p.m. on the day which is two days before the date of such adjourned meeting.

For the purposes of this document, “subsidiary”, “subsidiary undertaking”, “undertaking” and “associated undertaking” have the meanings given by the Companies Act.

Unless otherwise stated, all times referred to in this document are references to London time.

All references to legislation in this document are to the legislation of England and Wales unless the contrary is indicated. Any reference to any provision of any legislation shall include any amendment, modification, re-enactment or extension thereof.

For the purpose of this document, “subsidiary”, “subsidiary undertaking”, “undertaking” and “associated undertaking” have the meanings given by the Companies Act.

Words importing the singular shall include the plural and vice versa, and words importing the masculine gender shall include the feminine or neutral gender.

## PART XXIV

### INFORMATION INCORPORATED BY REFERENCE

As further described in this document, the Placing and Open Offer is inter-conditional with the Acquisition. Therefore, any Open Offer Shares acquired under the Placing and Open Offer will be acquired by Lloyds TSB pursuant to the Acquisition, and holders of HBOS Shares (including those acquired by HBOS Shareholders or other investors under the Placing and Open Offer) will receive Lloyds TSB Shares in accordance with the terms of the Acquisition.

Lloyds TSB has today, 18 November 2008, published the Lloyds TSB Prospectus, which is the document that Lloyds TSB is required by the FSA to publish in order that all Lloyds TSB Shares issued pursuant to the Lloyds TSB Placing and Open Offer and the Acquisition can be admitted to listing on the Official List and to trading on the London Stock Exchange's main market for listed securities.

Given the inter-conditionality of the Placing and Open Offer and the Acquisition referred to above, HBOS considers that certain information published by Lloyds TSB in the Lloyds TSB Prospectus concerning the Lloyds TSB Group and the Enlarged Group including, among other things, the future strategy for the Enlarged Group, is information which is necessary to enable HBOS Shareholders and others to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the Company and of the rights attaching to the Open Offer Shares.

Accordingly, HBOS has incorporated by reference into this document certain information published by Lloyds TSB in the Lloyds TSB Prospectus and the Lloyds TSB Circular. Both these documents are available on the Lloyds TSB website at [www.investorrelations.lloydstsb.com/ir/homepage.asp](http://www.investorrelations.lloydstsb.com/ir/homepage.asp).

Due to the timing of publication of the Lloyds TSB Circular relative to the Lloyds TSB Prospectus, certain information in the Lloyds TSB Prospectus has itself been incorporated by reference from the Lloyds TSB Circular that was published on 3 November 2008. In accordance with the requirements of the UK Listing Authority, HBOS is consequently obliged to incorporate information direct from the Lloyds TSB Circular.

The following information, available free of charge from HBOS's registered office at The Mound, Edinburgh EH1 1YZ, United Kingdom, is incorporated by reference in this Prospectus so as to provide the information required pursuant to the Prospectus Rules and to ensure that HBOS Shareholders and others are aware of all information which, according to the particular nature of the Company and the Open Offer Shares, is necessary to enable HBOS Shareholders and others to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Company and of the rights attaching to the Open Offer Shares:

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
HBOS Annual Report and Accounts 2007	Independent Auditors' Report	152	Part XVII ("Historical Information Relating to HBOS") – Part A ("Audited Financial Information")
HBOS Annual Report and Accounts 2007	Consolidated Income Statement	153	Part XVII ("Historical Information Relating to HBOS") – Part A ("Audited Financial Information")
HBOS Annual Report and Accounts 2007	Consolidated Balance Sheet	154-155	Part XVII ("Historical Information Relating to HBOS") – Part A ("Audited Financial Information")
HBOS Annual Report and Accounts 2007	Consolidated Statement of Recognised Income and Expense	156	Part XVII ("Historical Information Relating to HBOS") – Part A ("Audited Financial Information")
HBOS Annual Report and Accounts 2007	Consolidated Cash Flow Statement	156-157	Part XVII ("Historical Information Relating to HBOS")

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
HBOS Annual Report and Accounts 2007	Notes to the Financial Statements	160-223(1)	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2007	Note 47 (“Related Party Transactions”) and 48 (“Transactions with Key Management Personnel”)	221-223	Part XXII (“Additional Information”) – paragraph 10.6 (“Related party transactions”)
HBOS Annual Report and Accounts 2006	Independent Auditors’ Report	123	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2006	Consolidated Income Statement	124	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2006	Consolidated Balance Sheet	125-126	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2006	Consolidated Statement of Recognised Income and Expense	127	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2006	Consolidated Cash Flow Statement	127-128	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2006	Notes to the Accounts	131-191 <sup>(1)</sup>	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2006	Note 47 (“Related Party Transactions”) and 48 (“Transactions with Key Management Personnel”)	187-188	Part XXII (“Additional Information”) – paragraph 10.6 (“Related party transactions”)
HBOS Annual Report and Accounts 2005	Independent Auditors’ Report	95	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2005	Consolidated Income Statement	101	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2005	Consolidated Balance Sheet	102-103	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2005	Consolidated Statement of Recognised Income and Expense	105	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2005	Consolidated Cash Flow Statement	106-107	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2005	Notes to the Accounts	109-179 <sup>(1)</sup>	Part XVII (“Historical Information Relating to HBOS) – Part A (“Audited Financial Information”)
HBOS Annual Report and Accounts 2005	Note 50 (“Related Party Transactions”) and 51 (“Transactions with Key Management Personnel”)	165-166	Part XXII (“Additional Information”) – paragraph 10.6 (“Related party transactions”)
HBOS Interim Results for six months ended 30 June 2008	Condensed Financial Statements	74-75	Part III (“Other Important Information”)
HBOS Interim Results for six months ended 30 June 2008	Consolidated Income Statement (unaudited)	76	Part XVII (“Historical Information Relating to HBOS) – Part B (“Unaudited Financial Information”)
HBOS Interim Results for six months ended 30 June 2008	Consolidated Balance Sheet (unaudited)	77	Part XVII (“Historical Information Relating to HBOS) – Part B (“Unaudited Financial Information”)
HBOS Interim Results for six months ended 30 June 2008	Consolidated Statement of Recognised Income and Expense (unaudited)	78	Part XVII (“Historical Information Relating to HBOS) – Part B (“Unaudited Financial Information”)

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
HBOS Interim Results for six months ended 30 June 2008	Consolidated Cash Flow Statement (unaudited)	79-80	Part XVII ("Historical Information Relating to HBOS) – Part B ("Unaudited Financial Information")
HBOS Interim Results for six months ended 30 June 2008	Notes to the Condensed Financial Statements	81	Part XVII ("Historical Information Relating to HBOS) – Part B ("Unaudited Financial Information")
HBOS Interim Results for six months ended 30 June 2008	Independent review report	95	Part XVII ("Historical Information Relating to HBOS) – Part B ("Unaudited Financial Information")
HBOS Rights Issue Prospectus	Part XIV ("Operating and Financial Review of HBOS")	73-116	Part XIII ("Operating and Financial Review relating to HBOS")
HBOS Rights Issue Prospectus	Part XV ("Selected Statistical and Other Information")	117-121	Part XIII ("Operating and Financial Review relating to HBOS") Part XVII ("Historical Financial Information relating to HBOS") – Part B ("Unaudited Interim Information")
HBOS Rights Issue Prospectus	Part XVIII ("Additional Information") section 18 ("Litigation")	185-186	Part XXII ("Additional Information") – paragraph 10.7 ("Litigation")
Scheme Document	Part I ("Letter from the Chairman of HBOS plc") – sections 6, 10 and 11	19-20, 23-24	Part VII ("Terms and Conditions of the Placing and Open Offer") and Part XII ("Additional Information") – paragraph 12 ("Employees")
Scheme Document	Part 2 ("Explanatory Statement in connection with the Scheme") – section 19 ("Taxation")	42-45	Part XXI ("Taxation Considerations") – Part A ("United Kingdom Taxation Considerations") and Part B ("United States Taxation Considerations")
Scheme Document	Part 6 ("Conditions relating to the Proposed Government Funding")	59-61	Part XXII ("Additional Information") – paragraph 17.1 ("HBOS Material Contracts")
Scheme Document	Part 3 ("Conditions to the Implementation of the Scheme and the Acquisition")	47-48	Part VII ("Terms and Conditions of the Placing and Open Offer")
Lloyds TSB Annual Report and Accounts 2007	Consolidated Income Statement	77	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")
Lloyds TSB Annual Report and Accounts 2007	Consolidated Balance Sheet	78-79	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")
Lloyds TSB Annual Report and Accounts 2007	Consolidated Statement of Changes in Equity	80	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")
Lloyds TSB Annual Report and Accounts 2007	Consolidated Cash Flow Statement	81	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")
Lloyds TSB Annual Report and Accounts 2007	Notes to the Accounts	82-147 <sup>(1)</sup>	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")
Lloyds TSB Annual Report and Accounts 2007	Note 45 ("Related Party Transactions")	131-132	Part XXII ("Additional Information") – paragraph 10.7 ("Related party transactions")
Lloyds TSB Annual Report and Accounts 2007	Independent Auditors' Report	76	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")
Lloyds TSB Annual Report and Accounts 2007	Directors' Remuneration Report	64-75	Part XXII ("Additional Information") – paragraph 11.6
Lloyds TSB Annual Report and Accounts 2006	Consolidated Income Statement	63	Part XVIII ("Historical Information Relating to Lloyds TSB") – Part A ("Audited Financial Information")

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
Lloyds TSB Annual Report and Accounts 2006	Consolidated Balance Sheet	64-65	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2006	Consolidated Statement of Changes in Equity	66	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2006	Consolidated Cash Flow Statement	67	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2006	Notes to the Accounts	68-120 <sup>(1)</sup>	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2006	Note 45 (“Related Party Transactions”)	111	Part XXII (“Additional Information”) – paragraph 10.7 (“Related party transactions”)
Lloyds TSB Annual Report and Accounts 2006	Independent Auditors’ Report	62	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2005	Consolidated Income Statement	59	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2005	Consolidated Balance Sheet	60-61	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2005	Consolidated Statement of Changes in Equity	62	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2005	Consolidated Cash Flow Statement	63	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2005	Notes to the Accounts	64-120 <sup>(1)</sup>	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report and Accounts 2005	Note 49 (“Related Party Transactions”)	104-105	Part XXII (“Additional Information”) – paragraph 10.7 (“Related party transactions”)
Lloyds TSB Annual Report and Accounts 2005	Independent Auditors’ Report	58	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Consolidated Income Statement	F-3	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Consolidated Balance Sheet	F-4-F-5	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Consolidated Statement of Changes in Equity	F-6	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Consolidated Cash Flow Statement	F-7	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Notes to the Financial Statements	F-8-F-77	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Independent Auditors’ Report	F-2	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Operating and Financial Review and Prospects	3-4, 15-74	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)



<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Compensation Report	83-93	Part XVIII (“Historical Financial Information relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Business Review Report	6-11	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Annual Report on Form 20-F, for the year ending 31 December 2007	Financial Soundness	62-74	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB Interim Results for the half year ended 30 June 2008 (also furnished on page 35 of Form 6-K, report dated 30 July 2008)	Consolidated Income Statement (unaudited)	30	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part B (“Unaudited Financial Information”)
Lloyds TSB Interim Results for the half year ended 30 June 2008 (also furnished on page 36 of Form 6-K, report dated 30 July 2008)	Consolidated Balance Sheet (unaudited)	31	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part B (“Unaudited Financial Information”)
Lloyds TSB Interim Results for the half year ended 30 June 2008 (also furnished on pages 36 to 37 of Form 6-K, report dated 30 July 2008)	Consolidated Statement of Changes in Equity	32-33	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part B (“Unaudited Financial Information”)
Lloyds TSB Interim Results for the half year ended 30 June 2008 (also furnished on page 38 of Form 6-K, report dated 30 July 2008)	Consolidated Cash Flow Statement (unaudited)	34	Part XVIII (“Historical Information Relating to Lloyds TSB”) – Part B (“Unaudited Financial Information”)
Lloyds TSB Interim Results for the half year ended 30 June 2008 (also furnished on pages 39 to 49 of Form 6-K, report dated 30 July 2008)	Notes to the Condensed Interim Financial Statements	35-45	Part III (“Other Important Information”)
Lloyds TSB Interim Results for the half year ended 30 June 2008 (also furnished on page 51 of Form 6-K, report dated 30 July 2008)	Independent Review Report	47	Part XXIII (“Historical Information Relating to Lloyds TSB”) – Part B (“Unaudited Financial Information”)
Lloyds TSB Circular	Part III (“Principal Terms of the Acquisition”)	47-52	Part VIII (“Information on the Acquisition”)
Lloyds TSB Circular	Part V (“Conditions Relating to the Proposed Government Funding”)	57-58	Part VII (“Terms and Conditions of the Placing and Open Offer”) and Part XXII (“Additional Information”) paragraph 17.1 (“HBOS Material Contracts”)
Lloyds TSB Circular	Part VI (“Principal Terms of the Capitalisation Issue”)	59-60	Part VII (“Terms and Conditions of the Placing and Open Offer”)
Lloyds TSB Circular	Part VII (“Information on the Lloyds TSB Group”) including the Lloyds TSB Interim Management Statement (issued on 3 November 2008) and also furnished on Form 6-K report stated 3 November 2008	61-71	Part XI (“Information on the Lloyds TSB Group”)
Lloyds TSB Circular	Part X (“Reconciliation of Accounting Policies”)	235-237	Part XIX (“Reconciliation of Accounting Policies”)

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
Lloyds TSB Circular	Part XII (“Additional Information”), section 9.1 (“Lloyds TSB Material Contracts”)	254-258	Part XXII (“Additional Information”) – paragraph 17.2 (Lloyds TSB Material Contracts”)
Lloyds TSB Circular	Part XII (“Additional Information”), section 10 (“Related Party Transactions”)	262-263	Part XXII (“Additional Information”) – paragraph 10.7 (“Related party transactions”)
Lloyds TSB Circular	Part XII (“Additional Information”), section 11 (“Litigation”)	263-265	Part XXII (“Additional Information”) – paragraph 18.2 (“Litigation relating to Lloyds TSB”)
Lloyds TSB Report on Form 6-K dated 19 September 2008	Announcement of Placing	whole document	Part XXIII (“Definitions”)
Lloyds TSB Report on Form 6-K dated 11 July 2008	Segmental Analysis Restatement	whole document	Part XVIII (“Historical Financial Information Relating to Lloyds TSB”) – Part A (“Audited Financial Information”)
Lloyds TSB’s Memorandum and Articles of Association	Whole document	whole document	Part XII (“Additional Information”) paragraph 4.3
Lloyds TSB Prospectus	Part II (“Risk Factors”) – Risks relating to Lloyds TSB Group	9-21	Part II (“Risk Factors”)
Lloyds TSB Prospectus	Part II (“Risk Factors”) – Risks relating to the Acquisition – paragraphs 2.2-2.7	21-24	Part II (“Risk Factors”)
Lloyds TSB Prospectus	Part II (“Risk Factors”) – Risks relating to the Placing and Open Offer and to investment in Lloyds TSB Shares – paragraphs 3.1, 3.2 and 3.4-3.6	24-26	Part II (“Risk Factors”)
Lloyds TSB Prospectus	Part VI, Part B (“Information on the Acquisition – Further Information on the Acquisition”)	62-69	Part VIII (“Information on the Acquisition”)
Lloyds TSB Prospectus	Part XI (“Regulation and Supervision in the United Kingdom”)	105-112	Part XII (“Regulation and Supervision”)
Lloyds TSB Prospectus	Part XIII (“Operating and Financial Review Relating to Lloyds TSB”)	116-133	Part XIV (“Operating and Financial Review Relating to Lloyds TSB”)
Lloyds TSB Prospectus	Part XIV (“Capital Resources – Part A: Lloyds TSB Group”)	134-139	Part XV (“Capital Resources”) – paragraph 2 (“Capitalisation and Indebtedness”)
Lloyds TSB Prospectus	Part XIV (“Capital Resources Part B: Enlarged Group”)	140	Part XV (“Capital Resources”) – paragraph 5 (“Enlarged Group Capital Resources”)
Lloyds TSB Prospectus	Part XVIII (“Unaudited Pro Forma Net Assets Statement of the Enlarged Group as at 30 June 2008”)	145-151	Part XX (“Unaudited Pro Forma Net Assets Statement of the Enlarged Group as at 30 June 2008”)
Lloyds TSB Prospectus	Part XIX (“Taxation Considerations”) (Part B: United States Taxation Considerations)	155-157	Part XXI (“Taxation Considerations”)
Lloyds TSB Prospectus	Part XX (“Directors, Corporate Governance and Employees”) – sections 2, 3, 5 and 6	158-162, 166-168	Part XXII (“Additional Information”) – paragraph 7.5 (“Lloyds TSB Directors, Corporate Governance and Employees”)

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 1 (“The Company”)	173	Part VII (“Terms and Conditions of the Placing and Open Offer”); Part XXII (“Additional Information”)
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 2 (“Share Capital”)	173-177	Part XXII (“Additional Information”) – paragraph 3.11
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 3 (“Dividends, Capitalisation and other Distributions”)	177-178	Part XXII (“Additional Information”) – paragraph 3.11
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 4 (“Memorandum and Articles of Association”)	178-185	Part XXII (“Additional Information”) – paragraph 4.3
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 5 (“Major Shareholders of Lloyds TSB”)	186-187	Part XXII (“Additional Information”) – paragraph 10.8
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 6 (“Lloyds TSB Employee Share Plans”)	187-193	Part XXII (“Additional Information”) – paragraph 7.5
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 7.1 (“Related Transactions of the Lloyds TSB Group and HBOS Group – Lloyds TSB Group”)	192	Part XXII (“Additional Information”) – paragraph 10.7
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 8.1 (“Material Contracts – Subscription and Transfer Agreement”)	194-195	Part XXII (“Additional Information”) – paragraph 17.2
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 8.2 (“Material Contracts – Lloyds TSB Contracts Incorporated by Reference”)	195	Part XXII (“Additional Information”) – paragraph 17.2
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 9 (“Significant Subsidiaries”)	198-200	Part XXII (“Additional Information”) – paragraph 15.3
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 10 (“Lloyds TSB Shares held by Lloyds TSB Group”)	200	Part XXII (“Additional Information”) – paragraph 10.8
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 11 (“Capital Resources and Liquidity”)	200-202	Part XXII (“Additional Information”) – paragraph 19
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 12 (“Litigation”)	202-204	Part XXII (“Additional Information”) – paragraph 18.2
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 13 (“Pension Schemes”)	205	Part XXII (“Additional Information”) – paragraph 14.2
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 14 (“Costs of the Acquisition and Placing and Open Offer”)	205	Part XXII (“Additional Information”) – paragraph 22.2

<i>Document</i>	<i>Section in such document</i>	<i>Page number(s) in such document</i>	<i>Cross-referenced section in this Prospectus</i>
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 15 (“Sources and Bases of Selected Financial Information”)	205-206	Part XXII (“Additional Information”) – paragraph 22.8
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 16.1 (“Significant Change – Lloyds TSB Group”)	206	Part XXII (“Additional Information”) – paragraph 21
Lloyds TSB Prospectus	Part XXI (“Additional Information”) – section 18 (“Property and Environmental”)	206-207	Part XXII (“Additional Information”) – paragraph 16

(1) Including such other information in the relevant Annual Report and Accounts as is cross-referenced therein.

Information that is itself incorporated by reference in the above documents is not incorporated by reference into this Prospectus. It should be noted that, except as set forth above, no other portion of the above documents are incorporated by reference into this Prospectus.

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