

## **IMPORTANT NOTICE**

### **NOT FOR DISTRIBUTION TO ANY U.S. PERSON OR TO ANY PERSON OR ADDRESS IN THE U.S.**

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NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES OR ANY OTHER JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE SECURITIES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, (THE “SECURITIES ACT”), OR THE SECURITIES LAWS OF ANY STATE OF THE U.S. OR OTHER JURISDICTION AND THE SECURITIES MAY NOT BE OFFERED OR SOLD WITHIN THE U.S. OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT), EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE OR LOCAL SECURITIES LAWS.

THE FOLLOWING PROSPECTUS MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER, AND IN PARTICULAR, MAY NOT BE FORWARDED TO ANY U.S. PERSON OR TO ANY U.S. ADDRESS. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF THE SECURITIES ACT OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS.

**Confirmation of the Representation:** In order to be eligible to view this Prospectus or make an investment decision with respect to the securities investors must not be a U.S. Person (within the meaning of Regulation S under the Securities Act). This Prospectus is being sent to you on the basis that by accepting the e-mail and accessing this Prospectus, you shall be deemed to have represented to us that you are not a U.S. Person, the electronic mail address that you have given to us and to which this e-mail has been delivered is not located in the U.S., its territories and possessions (including Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, Wake Island and the Northern Mariana Islands), and that you consent to delivery of such Prospectus by electronic transmission.

You are reminded that this Prospectus has been delivered to you on the basis that you are a person into whose possession this Prospectus may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorised to, deliver this Prospectus to any other person.

The materials relating to the offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction

requires that the offering be made by a licensed broker or dealer and the underwriters or any affiliate of the underwriters is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the underwriters or such affiliate on behalf of the Issuer or the Guarantor in such jurisdiction.

Under no circumstances shall this Prospectus constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful. Recipients of this Prospectus who intend to subscribe for or purchase the Securities are reminded that any subscription or purchase may only be made on the basis of the information contained in the final Prospectus. This Prospectus may only be communicated to persons in the United Kingdom in circumstances where section 21(1) of the Financial Services and Markets Act 2000 does not apply to the Issuer or the Guarantor.

This Prospectus has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of Deutsche Bank AG, London Branch, J.P. Morgan Securities Ltd. and UBS Limited nor any person who controls Deutsche Bank AG, London Branch, J.P. Morgan Securities Ltd. or UBS Limited nor any director, officer, employee or agent of Deutsche Bank AG, London Branch, J.P. Morgan Securities Ltd. or UBS Limited nor any affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the Prospectus distributed to you in electronic format and the hard copy version available to you on request from Deutsche Bank AG, London Branch, J.P. Morgan Securities Ltd. or UBS Limited.

This document is subject to completion and amendment without notice. This document does not constitute an offer to sell or the solicitation of an offer to buy any shares, debentures or securities of the Issuer for the purposes of the United Kingdom Companies Act 1985 or otherwise. It is an advertisement and does not comprise a prospectus for the purposes of EU Directive 2003/71/EC and/or Part VI of the Financial Services and Markets Act 2000 of the United Kingdom. The definitive terms of the transactions described herein will be described in the final version of this document. Investors should not subscribe for any securities referred to herein except on the basis of information contained in the final form of the Prospectus. When available, the final Prospectus will be made available to the public in accordance with EU Directive 2003/71/EC and/or Part VI of the Financial Services and Markets Act 2000 and investors may obtain a copy from the website of the London Stock Exchange.



**HBOS Capital Funding No. 3 L.P.**  
**€750,000,000 Fixed-to-Floating Rate Non-voting**  
**Non-cumulative Perpetual Preferred Securities**

having the benefit of a subordinated guarantee of

**HBOS plc**

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

**Issue price: 100%**

The €750,000,000 Fixed-to-Floating Rate Non-voting Non-cumulative Perpetual Preferred Securities (the "Preferred Securities") each with a liquidation preference of 100 per cent. of the nominal value of the denomination in which it is issued (the "Liquidation Preference"), comprising limited partnership interests in HBOS Capital Funding No. 3 L.P. (the "Issuer"), are proposed to be issued on 23 May 2006 (the "Closing Date"). The Preferred Securities will entitle investors, subject to certain conditions described herein, to receive non-cumulative distributions ("Distributions") annually in arrear on 23 May in each year until 23 May 2016 and thereafter quarterly in arrear on 23 August, 23 November, 23 February and 23 May in each year (each, a "Distribution Payment Date"). Distributions shall accrue from (and including) the Closing Date to (but excluding) 23 May 2016 (the "First Optional Redemption Date"), at a fixed rate per annum of 4.939% and from (and including) 23 May 2016, at a floating rate per annum equal to the sum of 1.73% and the three-month EURIBOR for the relevant Distribution Period. The first Distribution will, if payable, be paid on 23 May 2007. In respect of each Distribution Payment Date falling on or prior to the First Optional Redemption Date, the amount of each Distribution payable in respect of each €50,000 of Preferred Securities held shall be €2,469.50. See "Description of the Preferred Securities – Distributions".

The Issuer, as a Jersey limited partnership, is not a legal entity separate from its partners. All obligations of the Issuer to make payments in respect of the Preferred Securities will be guaranteed on a limited and subordinated basis by HBOS plc ("HBOS" or the "Guarantor") pursuant to a subordinated guarantee dated 23 May 2006 (the "Guarantee"), all as more fully described herein under "Subordinated Guarantee".

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

The Preferred Securities may, at the option of the General Partner, at any time be substituted by Qualifying Tier 1 Securities issued, directly or indirectly, by HBOS. In addition, upon the occurrence of a Substitution Event, the General Partner shall take all reasonable steps to cause the Preferred Securities to be substituted by Substitute Preference Shares issued by HBOS. See "Description of the Preferred Securities" and "Investment Considerations".

In the event of the dissolution of the Issuer, Holders of Preferred Securities will be entitled to receive a liquidation distribution in an amount equal to the distributions that those Holders would have received in a dissolution of HBOS at that time, if they had held, instead of the Preferred Securities, non-cumulative preference shares issued directly by HBOS, having the same liquidation preference and stated distribution rate as the Preferred Securities held by them, subject as described herein under "Description of the Preferred Securities".

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

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

Application has been made to the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "FSMA") (the "UK Listing Authority") for the Preferred Securities to be admitted to the official list of the UK Listing Authority (the "Official List") and to the London Stock Exchange plc (the "London Stock Exchange") for the Preferred Securities to be admitted to trading on the London Stock Exchange's Gilt-Edged and Fixed Interest Market (the "Market"). References in this Prospectus to Preferred Securities being "listed" (and all related references) shall mean that such Preferred Securities have been admitted to trading on the Market and have been admitted to the Official List. The Market is a regulated market for the purposes of the Investment Services Directive 93/22/EC.

The Preferred Securities will be represented by a single global certificate in registered form (the "Global Certificate") and issued in the denomination of €50,000 per Preferred Security and integral multiples of €1,000 there above, subject in each case to investors holding a minimum interest of €50,000. The Preferred Securities will be registered in the name of a nominee of, and deposited with, a common depository for Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear") and Clearstream Banking, société anonyme, Luxembourg ("Clearstream, Luxembourg"). Preferred Securities issued in definitive certificated form will only be available in certain limited circumstances. See "Summary of Provisions relating to the Preferred Securities in Global Form".

**Deutsche Bank**

**JPMorgan Cazenove**

**UBS Investment Bank**

Dated: 19 May 2006

This Prospectus comprises a prospectus for the purposes of Article 5.4 of Directive 2003/71/EC (the “Prospectus Directive”) and for the purpose of giving information with regard to HBOS Capital Funding No. 3 L.P., and HBOS plc which, according to the particular nature of the Issuer, HBOS and the Preferred Securities, is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Issuer or HBOS.

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

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

Neither the General Partner, the Issuer nor HBOS has authorised the making or provision of any representation or information regarding it or the Preferred Securities other than as contained or incorporated by reference in the Prospectus or in the Subscription Agreement or as approved for such purpose by the General Partner, the Issuer or HBOS or as is publicly available. Any such representation or information should not be relied upon as having been authorised by the Issuer, HBOS or the Lead Managers.

No representation or warranty is made or implied by the Lead Managers or any of their respective affiliates, and neither the Lead Managers nor any of their respective affiliates make any representation or warranty or accept any responsibility, as to the accuracy or completeness of the information contained in the Prospectus. Unless expressly stated otherwise, neither the delivery of the Prospectus nor the offering or delivery of any Preferred Security shall, in any circumstances, create any implication that there has been no adverse change in the financial situation of the Responsible Persons since the date hereof.

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

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

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

The Jersey Financial Services Commission (the “Commission”) has given and has not withdrawn its consent under Article 10 of the Control of Borrowing (Jersey) Order 1958 to the creation by the Issuer of the Preferred Securities. The Commission is protected by the Control of Borrowing (Jersey) Law 1947, as amended, against liability arising from the discharge of its functions under that Law.

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

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

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**IN CONNECTION WITH THE ISSUE OF THE PREFERRED SECURITIES, DEUTSCHE BANK AG, LONDON BRANCH (THE “STABILISING MANAGER”) (OR ANY PERSON ACTING ON BEHALF OF THE STABILISING MANAGER) MAY OVER-ALLOT PREFERRED SECURITIES (PROVIDED THAT THE AGGREGATE PRINCIPAL AMOUNT OF PREFERRED SECURITIES ALLOTTED DOES NOT EXCEED 105% OF THE AGGREGATE PRINCIPAL AMOUNT OF THE PREFERRED SECURITIES) OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE PREFERRED SECURITIES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE PREFERRED SECURITIES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE PREFERRED SECURITIES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE PREFERRED SECURITIES.**

## **Documents Incorporated by Reference**

This Prospectus should be read and construed in conjunction with the audited consolidated annual financial statements of HBOS for the financial years ended 31 December 2004 and 31 December 2005 together in each case with the audit report thereon. These documents shall be deemed to be incorporated in, and form part of this Prospectus, save that any statement contained in a document which is deemed to be incorporated by reference herein shall be deemed to be modified or superseded for the purpose of this Prospectus to the extent that a statement contained herein modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

Copies of documents incorporated by reference in this Prospectus may be obtained at the offices of Shepherd+Wedderburn, Level 2, Saltire Court, 20 Castle Terrace, Edinburgh EH1 2ET, and are, in addition, available free of charge on or through HBOS' internet website at [www.hbosplc.com](http://www.hbosplc.com) and on or through the website of the Regulatory News Service operated by the London Stock Exchange at [www.londonstockexchange.com/en-gb/pricesnews/marketnews.htm](http://www.londonstockexchange.com/en-gb/pricesnews/marketnews.htm).

## Summary of the Offering

*This summary must be read as an introduction to this Prospectus. Any decision to invest in the Preferred Securities should be based on a consideration of this Prospectus as a whole, including the documents incorporated by reference, by any investor. Following the implementation of the relevant provisions of the Prospectus Directive in each Member State of the European Economic Area (an “EEA State”), the responsible persons may have civil liability in respect of this summary, if it is misleading, inaccurate or inconsistent when read together with the other parts of this Prospectus. Where a claim relating to information contained in this Prospectus is brought before a court in an EEA State, the plaintiff may, under the national legislation of the EEA State where the claim is brought, be required to bear the costs of translating the Prospectus before the legal proceedings are initiated.*

<b>HBOS plc:</b> .....	HBOS was incorporated and registered in Scotland on 3 May 2001, as a public limited company under the Companies Act 1985 (the “Companies Act”). HBOS is the holding company of the HBOS Group, comprising HBOS and its subsidiaries and subsidiary undertakings (as defined in the Companies Act, and which include The Governor and Company of the Bank of Scotland and HBOS Treasury Services plc, as wholly-owned subsidiaries of HBOS) (the “HBOS Group”), a diversified financial services group engaged in a range of banking, insurance broking, financial services and finance-related activities for personal and medium and large size corporate customers throughout the UK and internationally. Headquartered in Edinburgh, Scotland, the HBOS Group has a large and diversified customer base.
<b>Issuer:</b> .....	HBOS Capital Funding No. 3 L.P., a limited partnership established for an unlimited duration in Jersey and registered under the Limited Partnerships (Jersey) Law, 1994, as amended (the “Law”). The Issuer is not a legal entity separate from its partners and has no operating history.
<b>General Partner:</b> .....	HBOS Capital Funding (Jersey) Limited, a wholly-owned subsidiary of, and fully controlled by, HBOS, incorporated in Jersey with limited liability, is the sole general partner of the Issuer and, as such, solely administers the Issuer.
<b>Issue:</b> .....	€750,000,000 Fixed-to-Floating Rate Non-voting Non-cumulative Perpetual Preferred Securities, each with a Liquidation Preference of 100 per cent. of the nominal value of the denomination in which it is issued comprising limited partnership interests in the Issuer.
<b>Use of Proceeds:</b> .....	The proceeds of the issue of the Preferred Securities will be used by the General Partner, on behalf of the Issuer, after paying any expenses of the issue, to subscribe for perpetual subordinated notes to be issued by HBOS and will augment HBOS’s regulatory capital base.
<b>Ranking of the Preferred Securities:</b> .....	The Preferred Securities, together with the Guarantee, are intended to provide Holders, as nearly as possible, with rights equivalent to those to which the Holders would be entitled if they held the most senior preference shares of HBOS.

<b>Risk Factors:</b> .....	The Preferred Securities have no fixed maturity date, payment of the Distribution is at the absolute discretion of the General Partner and claims in respect thereof and under the Guarantee are subordinated so as to rank equally with the most senior preference shares of HBOS. Accordingly they involve a degree of investment risk.
<b>Subordinated Guarantee:</b> .....	<p>HBOS will irrevocably guarantee on a subordinated basis and to the extent set out in the Guarantee payments due on the Preferred Securities representing (i) Distributions, (ii) any Liquidation Distributions to which the Holders are entitled, (iii) the relevant Redemption Price and (iv) any Additional Amounts.</p> <p>The Guarantee will rank (a) junior to all liabilities of HBOS including subordinated liabilities (in each case other than any liability of HBOS which constitutes Tier 1 Securities or any liability which is referred to in (b) or (c) and any other liability expressed to rank <i>pari passu</i> with or junior to the Guarantee), (b) <i>pari passu</i> with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking <i>pari passu</i> with the Guarantee and (c) senior to Junior Share Capital.</p>
<b>Distributions:</b> .....	Non-cumulative distributions (the “Distributions”) will accrue on the Liquidation Preference of the Preferred Securities (i) from (and including) the Closing Date to (but excluding) the First Optional Redemption Date at a fixed rate per annum of 4.939% payable annually in arrear, and (ii) from (and including) the First Optional Redemption Date, for each consecutive three-month period thereafter at a floating rate per annum equal to the sum of 1.73% and three-month EURIBOR for such period payable quarterly in arrear.
<b>Distribution Payment Dates:</b> .....	Distributions will, if payable, be paid on 23 May in each year beginning on 23 May 2007 up to and including 23 May 2016 and thereafter, subject as provided herein, on 23 August, 23 November, 23 February and 23 May in each year.
<b>Limitations on payments in respect of Distributions:</b> .....	<p>Distributions on the Preferred Securities will be payable at the sole discretion of the General Partner out of the Issuer’s own legally available resources on each Distribution Payment Date.</p> <p>Notwithstanding the above, on any Distribution Payment Date with respect to which (i) a Capital Disqualification Event has occurred and is continuing and (ii) HBOS is in compliance with its Applicable Regulatory Capital Requirements, the Issuer shall be obliged to pay the Distribution Payment on such Distribution Payment Date and neither the Issuer nor HBOS may exercise its discretion to not pay a Distribution Payment.</p> <p>“Applicable Regulatory Capital Requirements” means any requirements contained in Capital Regulations for the maintenance of capital from time to time applicable to HBOS on a solo and/or consolidated basis, including transitional rules and waivers;</p> <p>“Capital Regulations” means at any time the regulations, requirements, guidelines and policies relating to capital adequacy</p>

then in effect of the FSA or other relevant regulator; and “Capital Disqualification Event” shall be deemed to have occurred if, (a) the Preferred Securities would not be eligible to qualify (save, where such non-qualification is only as a result of any applicable limitation on the amount of such capital) as regulatory capital resources for HBOS under Applicable Regulatory Capital Requirements and (b) the FSA has confirmed to HBOS that the Preferred Securities would not be eligible to qualify as regulatory capital resources for HBOS.

**Distribution and Capital**

**Stopper** .....

If any Distribution is not paid in full, HBOS will not (a) declare or pay any distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any Parity Securities where the dividend is at the discretion of the directors and any Junior Share Capital (except for any Series of preference shares which are issued in satisfaction of an obligation existing on 27 April 2004 (“Excluded Preference Shares”)), or (b) (if permitted) repurchase or redeem Parity Securities or Junior Share Capital (except for Excluded Preference Shares), in each case (a) or (b) until after the next succeeding Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full, in the case of a Distribution Period ending on or before the First Optional Redemption Date, or until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full, in the case of a Distribution Period ending after the First Optional Redemption Date.

**Withholding Tax and**

**Additional Amounts:** .....

Such additional amounts as may be necessary in order that the net payment received by each Holder in respect of the Preferred Securities or the Guarantee, after withholding for any taxes imposed by tax authorities in Jersey or the U.K. will equal the amount which would have been received in the absence of any such withholding taxes, subject to customary exceptions.

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

The Preferred Securities will be perpetual securities and not subject to any mandatory redemption provisions. They will be, however, redeemable on 23 May 2016 (the “First Optional Redemption Date”) or on any Distribution Payment Date thereafter in whole, but not in part, at the option of the General Partner at the Optional Redemption Price (being the Liquidation Preference per Preferred Security together with any due and accrued but unpaid Distributions).

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

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

“Change in Law Tax Event” means that as a result of a change in any law or regulation or in any treaty, on or after the Closing Date, (i) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or the

Notes in Jersey or the U.K. or (ii) HBOS would not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes or payment under the Guarantee;

“Tax Event” means (i) a Withholding Tax Event, (ii) a Change in Law Tax Event or (iii) that, other than as a result of a Withholding Tax Event or a Change in Law Tax Event, (A) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or the Notes in Jersey or the U.K. or (B) HBOS would not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes or payment under the Guarantee;

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

“Withholding Tax Event” means that, as a result of a change in any law or regulation or in any treaty, on or after the Closing Date, (i) payments to Holders would be subject to deduction or to withholding tax or would give rise to any obligation of the Issuer or HBOS to account for any tax in Jersey or the U.K. or (ii) payments by HBOS in respect of the Notes would be subject to deduction or to withholding tax in the U.K.

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

“Make Whole Amount” means (A) at any time prior to the First Optional Redemption Date an amount equal to the sum of (i) the present value of the Liquidation Preference; and (ii) the present value of each remaining scheduled Distribution to and including the First Optional Redemption Date, discounted from the First Optional Redemption Date or the relevant Distribution Payment Date, respectively, in each case to the Tax Event Redemption Date at a rate equal to the sum of (x) 0.30% and (y) the yield on an equivalent European government bond on an annual basis on the third TARGET Business Day (as defined in the Description of the Preferred Securities below) prior to the Tax Event Redemption Date and (B) thereafter, zero.

**Qualifying Tier 1 Securities**

**Substitution:** . . . . .

Subject to the prior consent of the FSA, if then required, the General Partner may at any time cause the substitution of the Preferred Securities in whole, but not in part, with Qualifying Tier 1 Securities without the requirement for approval of the Holders.

**Preference Shares Substitution:** . . .

If either (i) HBOS’s total capital ratio calculated on a consolidated basis in accordance with applicable U.K. bank capital adequacy regulations, has fallen below the then generally applicable minimum ratio (or ratios if then applicable) required by such regulations

(currently 8%); or (ii) HBOS's board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (i) above is expected to occur in the near term; or (iii) on the Involuntary Dissolution of the Issuer (in circumstances when HBOS is not itself insolvent or in liquidation), the General Partner shall take all reasonable steps to cause the substitution of the Preferred Securities by Substitute Preference Shares, being fully-paid preference shares issued directly by HBOS having in all material commercial respects the same economic rights and benefits as are attached to the Preferred Securities and the Guarantee taken together, save that in circumstances where the directors of HBOS are otherwise permitted to declare and pay dividends or distributions on the Substitute Preference Shares, Holders shall only be entitled to receive such dividends or distributions on their Substitute Preference Shares if (and to the extent) such dividends or distributions are declared by the directors of HBOS at their discretion, all as more fully described under "*Description of the Preferred Securities — Substitution by Substitute Preference Shares*".

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

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

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

In the event of an order being made for the liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation or a declaration being made that HBOS is insolvent,

the Issuer shall be dissolved and the amount per Preferred Security to which Holders will be entitled as a Liquidation Distribution will be as described above.

<b>Voting Rights:</b> .....	Holders will not generally be entitled to receive notice of, attend or vote at any meeting of partners of the Issuer or participate in the management of the Issuer. If Distributions have not been paid by the Issuer in full and/or HBOS has not made payments in respect thereof under the Guarantee for one Distribution Period, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for four consecutive Distribution Periods, the Holders are entitled to elect a special representative to enforce their statutory rights.
<b>Yield:</b> .....	4.939%
<b>Governing Law:</b> .....	The Limited Partnership Agreement (as defined under “HBOS Capital Funding No. 3 L.P.”) establishing HBOS Capital Funding No. 3 L.P. and the Preferred Securities are governed by, and construed in accordance with, Jersey law. However, determinations in respect of amounts of Adjusted Distributable Reserves are construed in accordance with Scots Law. The Guarantee will be governed by, and construed in accordance with, English law.
<b>Listing:</b> .....	An application has been made for the Preferred Securities to be listed on the London Stock Exchange.
<b>Ratings:</b> .....	The Preferred Securities are expected to be assigned on issue a rating of “A” by Standard & Poor’s, “A1” by Moody’s and “AA-” by Fitch Ratings Ltd. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the relevant rating organisation.

## **Risk Factors**

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

Prospective investors should note that the risks described below are not the only risks faced by HBOS. HBOS has described only those risks relating to their operations that they consider to be material. There may be additional risks that HBOS currently considers not to be material or of which it is not currently aware, and any of these risks could have the effects set forth above.

### **Risks relating to HBOS and its business**

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

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

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

The most significant market risks it faces are interest rate, foreign exchange and bond, equity and house price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs. Changes in currency rates affect the value of assets and liabilities denominated in foreign currencies and affect earnings reported by its non-UK subsidiaries, and may affect income from foreign exchange dealing. The performance of financial markets may cause changes in the value of its investment and trading portfolios. The HBOS Group has implemented risk management methods to mitigate and control these and other market risks to which it is exposed. However, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on its financial performance and business operations.

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

It is subject to capital adequacy guidelines adopted by the Financial Services Authority for a bank or a bank holding company, which provide for a minimum ratio of total capital to risk-adjusted assets both on a consolidated basis and on a solo-consolidated basis expressed as a percentage. At least half of the total capital must be maintained in the form of Tier 1 capital. HBOS's failure to maintain its ratios may result in administrative actions or sanctions against it which may impact its ability to fulfill its obligations under the Preferred Securities.

In addition, 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 Financial Services Authority's capital adequacy guidelines, have recently been revised and are expected to be implemented in 2006, with more advanced techniques to be implemented at the start of 2007 for retail credit

assets and at the start of 2008 for non-retail credit assets and other risk categories. The principal changes effected by the revised guidelines include the application of risk-weighting (depending upon the credit status of certain customers, using an “internal ratings-based” approach to credit risk, and subject to approval of supervising authorities), allocation of risk assets in relation to operational risk and supervisory review of the process of evaluating risk measurement and capital ratios. At this time, HBOS is unable to predict how the revised guidelines will affect its calculations of capital and the impact of these revisions on other aspects of its operations.

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

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

**Risks Relating to the Preferred Securities**

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

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

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

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

Distributions on the Preferred Securities will only be payable at the sole discretion of the General Partner. Distributions will only be paid when so determined by the General Partner and applicable law so permit, and if sufficient resources exist. If Distributions on the Preferred Securities for any Distribution Period are not paid, the Holders will not be entitled to receive such Distributions (or any payment under the Guarantee in respect of such Distributions) whether or not funds are, or subsequently become, available.

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

HBOS has previously issued Preference Shares and other securities having similar economic rights and benefits as the Preferred Securities and Guarantee taken together. If the Directors do not pay in full dividends on those preference shares or securities, Distributions will not be permitted to be made in respect of the Preferred Securities. Similar restrictions apply in respect of certain other Tier 1 capital instruments issued by HBOS, directly or indirectly. The prohibition on such Distributions arises on non-payment of sums required to be paid on those securities.

***Perpetual Nature of the Preferred Securities***

The Preferred Securities have no fixed final redemption date and Holders have no rights to call for the redemption of the Preferred Securities. Although the Issuer may redeem the Preferred Securities in certain circumstances (including at its option on 23 May 2016 or on any Distribution Payment Date thereafter or following the occurrence of a Tax Event), there are limitations on its ability to do so. Therefore, Holders should be aware that they may be required to bear the financial risks of an investment in the Preferred Securities for an indefinite period of time.

***Subordination***

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

***Preference Shares issued on substitution may have to be issued as Junior Preference Shares***

In certain circumstances relating to HBOS's capital ratios or on an Involuntary Dissolution of the Issuer, the General Partner is required to seek to replace the Preferred Securities with preference shares of HBOS having equivalent rights. However, if (i) the aggregate nominal amount of the substitute preference shares together with the aggregate nominal amount of HBOS's Priority Preference Shares (as defined in the Articles of Association of HBOS) would exceed an amount equal to 25% of HBOS's Adjusted Capital and Reserves (as defined in the Articles of Association of HBOS) or (ii) the average of the profit after taxation and before extraordinary items and dividends on an annualized basis for the most recent three accounting reference periods of HBOS to have ended prior to the date of issue of the substitute preference shares, for each such period does not exceed four and one half times the aggregate annual amount of the dividends (exclusive of any imputed tax credit available to shareholders) payable in the then current accounting reference period on the whole of the issued share capital of HBOS which has priority to or ranks equally with HBOS's Priority Preference Shares (including any such substitute preference shares then being issued), then HBOS may not issue preference shares ranking equally with Parity Securities but instead may issue substitute preference shares ranking immediately below the Parity Securities.

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

## Description of the Preferred Securities

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

### 1 Definitions and Interpretation

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

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

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

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

“Agency Agreement” means the paying and transfer agency agreement dated 23 May 2006 relating to the Preferred Securities between, *inter alios*, the Issuer, HBOS and the Principal Paying and Transfer Agent;

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

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

“Capital Disqualification Event” shall be deemed to have occurred if (a) the Preferred Securities would not be eligible to qualify (save where such non-qualification is only as a result of any applicable limitation on the amount of such capital) as regulatory capital resources for HBOS under Applicable Regulatory Capital Requirements and (b) the FSA has confirmed to HBOS that the Preferred Securities would not be eligible to qualify as regulatory capital resources for HBOS;

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

“Change in Law Tax Event” means that as a result of a change in any law or regulation of the U.K. or Jersey, or in any treaty to which the U.K. or Jersey is a party or in the official interpretation or application of any law, regulation or treaty by any relevant body in the U.K. or Jersey, on or after 23 May 2006, (i) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or the Notes (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) actual profits arising to it as a result of payments received by it from the Issuer or (b) activities (if any) carried on by it other than those permitted or contemplated in the Limited Partnership Agreement in respect of the Notes and the Preferred Securities) in Jersey or the U.K. or (ii) HBOS (or the relevant U.K. tax resident member of the HBOS Group) would not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes or payment under the Guarantee (other than payments representing a repayment of amounts subscribed for Preferred Securities);

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

“Closing Date” means 23 May 2006;

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

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

and, on or after the First Optional Redemption Date, the actual number of days in the relevant Distribution Period divided by 360;

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

“Distribution Determination Date” means, with respect to any Distribution Payment Date, the tenth TARGET Business Day (as defined below) prior to such Distribution Payment Date;

“Distribution Payment Date” means 23 May in each year, commencing on 23 May 2007 and ending on the First Optional Redemption Date and thereafter 23 August, 23 November, 23 February and 23 May in each year provided that where a Distribution Payment Date falling after the First Optional Redemption Date is not a TARGET Business Day, it shall be postponed to the next day which is a TARGET Business Day;

“Distribution Period” means the period from (and including) the Closing Date to (but excluding) 23 May 2007 and each period thereafter from (and including) one Distribution Payment Date to (but excluding) the next following Distribution Payment Date;

“Distribution Rate” means, in respect of the Preferred Securities, (i) for each Distribution Period until the First Optional Redemption Date, 4.939% per annum and (ii) for each Distribution Period thereafter a floating rate per annum equal to the sum of 1.73% and the three-month EURIBOR for such Distribution Period;

“Euro” and “€” means the lawful currency of the Member States of the European Union that have adopted or do adopt the single currency in accordance with the Treaty establishing the European Community as amended from time to time;

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

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

“Existing Parity Securities” means (a) the 300,000,000 9¼% and 100,000,000 9¾% Non-cumulative Irredeemable Preference Shares of £1 each, the 100,000,000 9¾% Non-cumulative Irredeemable Preference Shares of £1 each, the 750,000 6.0884% Non-cumulative Redeemable Preference Shares of £1 each with a liquidation preference of £1,000 each, the 198,065,600 6.475% Non-cumulative Redeemable Preference Shares of £1 each, the 750,000 6.413% Non-cumulative Redeemable Preference Shares of \$1 each with a liquidation preference of \$1,000 each and the 750,000 5.920% Non-cumulative Redeemable Preference Shares of \$1 each with a liquidation preference of \$1,000 each in the capital of HBOS (together, the “Existing Preference Shares”), and (b) the U.S.\$1,000,000,000 6.85% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities issued by HBOS Capital Funding No. 1 L.P. and guaranteed by HBOS, the £600,000,000 6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A issued by HBOS Capital Funding L.P. and guaranteed by HBOS, the US\$750,000,000 6.071% Non-voting Non-cumulative Perpetual Preferred Securities issued by HBOS Capital Funding No. 2 L.P. and guaranteed by HBOS, the £245,000,000 7.881% Guaranteed Non-voting Non-cumulative Preferred Securities issued by HBOS Sterling Finance (Jersey) L.P. and guaranteed by HBOS and the £415,000,000 Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities issued by HBOS Euro Finance (Jersey) L.P. and guaranteed by HBOS in issue at the date hereof and in each case any further securities required to be issued pursuant to the terms of such aforementioned securities;

“First Optional Redemption Date” means 23 May 2016;

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

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

“Guarantee” means the subordinated guarantee in respect of the Preferred Securities executed by HBOS as a deed poll and dated 23 May 2006;

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

“HBOS Group” means HBOS together with the Subsidiaries;

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

“Initial Holder” means Citivic Nominees Limited;

“Initial Preferential Limited Partner” means Ueberior Investment plc;

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

“Issuer” means HBOS Capital Funding No. 3 L.P.;

“Jersey” means the Island of Jersey;

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

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

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

“Limited Partnership Agreement” means an agreement dated 19 May 2006 between the General Partner, the Initial Preferential Limited Partner, HBOS and the Initial Holder establishing the Issuer, as the same may be amended from time to time;

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

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

“Make Whole Amount” in respect of a Preferred Security means, at any time prior to the First Optional Redemption Date, an amount equal to the sum of:

- (i) the present value of its Liquidation Preference; and
- (ii) the present value of each remaining scheduled Distribution to and including the First Optional Redemption Date,

discounted from (i) in relation to the Liquidation Preference, the First Optional Redemption Date, and (ii) in relation to each such remaining scheduled Distribution, the relevant Distribution Payment Date, in each case to the Tax Event Redemption Date, at a rate equal to the sum of (x) 0.30% and (y) the Reference Bond yield on an annual basis in accordance with the Day Count Fraction (rounded to four decimal places) at 11.00 a.m. (Brussels time) on the third TARGET Business Day prior to the date fixed for redemption and after the First Optional Redemption Date, zero;

“Notes” means (i) the €750,000,000 Undated Subordinated Fixed-to-Floating Rate Notes issued by HBOS and subscribed for by the General Partner, on behalf of the Issuer, with the net proceeds of the issue of the Preferred Securities and any further notes of HBOS of the same series issued after the Closing Date and ranking *pari passu* with such Notes or (ii) any Replacement Debt;

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

“Optional Redemption Date” means, in the case of an optional redemption pursuant to paragraph 4.2, 23 May 2016 and each Distribution Payment Date thereafter, as specified in the relevant notice of redemption;

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

“Parity Securities” means any preference shares, preferred securities (other than the Preferred Securities) or other securities either (a) issued directly by HBOS and ranking *pari passu* with HBOS’s obligations under the Guarantee or (b) issued by the Issuer or any other Subsidiary or entity and entitled to the benefit of the Guarantee or any other guarantee or support agreement of HBOS ranking *pari passu* with the Guarantee;

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

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

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

“Preferred Securities” means the €750,000,000 Fixed-to-Floating Rate Non-voting Non-cumulative Perpetual Preferred Securities outstanding, each such security representing an interest of a Holder in the Issuer attributable to the nominal amount of the Preferred Securities held by it, including any further Preferred Securities of the Issuer of the same series issued after the Closing Date and ranking *pari passu* with the Preferred Securities as regards participation in the profits and assets of the Issuer and “Preferred Security” shall be construed accordingly;

“Principal Paying and Transfer Agent” means Citibank, N.A. or such other entities as are appointed by the General Partner on behalf of the Issuer and notified to the Holders as described under paragraph 10;

“Qualifying Tier 1 Securities” means securities whether debt, equity, interests in limited partnerships or otherwise, issued directly or indirectly by HBOS that:

- (a) have terms not materially less favourable to a Holder of the Preferred Securities (as reasonably determined by HBOS, and provided that a certification to such effect of two Directors and an opinion to such effect of an independent investment bank shall have been delivered to HBOS prior to the issue of the relevant securities) provided that they shall (1) include a ranking at least equal to that of the Guarantee, (2) have the same dividend or distribution rate or rate of return and Distribution Payment Dates from time to time applying to the Preferred Securities, (3) have the same redemption dates as the Preferred Securities, (4) be issued in an amount at least equal to the total number of Preferred Securities multiplied by €50,000, (5) comply with the then current requirements of the FSA in relation to Tier 1 Capital and (6) preserve any existing rights under the Preferred Securities and the Guarantee to any accrued dividend which has not been paid in respect of the period from (and including) the Distribution Payment Date last preceding the Substitution Date to (but excluding) the Substitution Date; and
- (b) are listed on the London Stock Exchange, the Luxembourg Stock Exchange or such other stock exchange as is a recognised stock exchange;

“Redemption Conditions” means, with respect to any redemption, (i) that the consent of the FSA to the redemption, if then required, has been obtained and (ii) that HBOS either has (a) Adjusted Distributable Reserves or (b) proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the redemption, in either of cases (ii)(a) or (b) in an amount at least equal to the relevant Redemption Price;

“Redemption Price” means the Optional Redemption Price or the Tax Event Redemption Price;

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

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

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

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

“Relevant Proportion” means, in relation to any partial payment of any Liquidation Distribution on a Preferred Security, the total amount available for all such payments and for making any corresponding payment of a liquidation distribution on any Parity Securities divided by the sum of (i) the full Liquidation Distributions before any reduction or abatement in respect of the Preferred Securities and (ii) the amount of the full liquidation distribution before any reduction or abatement in respect of any Parity Securities, in each case converted where necessary into the same currency in which liquidation payments are made to creditors of HBOS;

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

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

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

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

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

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

“Substitute Preference Shares” means fully-paid preference shares issued directly by HBOS having in all material commercial respects the same economic rights and benefits as are attached to the Preferred Securities and the Guarantee taken together, save that in circumstances where the directors of HBOS are otherwise permitted to declare and pay dividends or distributions on the Substitute Preference Shares, Holders shall only be entitled to receive such dividends or distributions on their Substitute Preference Shares if (and to the extent) such dividends or distributions are declared by the directors of HBOS at their discretion, or, if the restrictions contained in the Articles of Association of HBOS on the issue of Priority Preference Shares apply, “Substitute Preference Shares” shall mean preference shares ranking junior to the Priority Preference Shares, all as more fully described under “*Description of the Preferred Securities — Substitution by Substitute Preference Shares*”;

“Substitution Confirmation” has the meaning ascribed to it in paragraph 5.3;

“Substitution Event” means that either (i) HBOS’s total capital ratio calculated on a consolidated basis in accordance with applicable U.K. bank capital adequacy regulations, has fallen below the then generally applicable minimum ratio (or ratios, if then applicable) required by such regulations (currently 8%); or (ii) HBOS’s board of directors in its sole discretion has notified the FSA and the Issuer that it has determined that (i) above is expected to occur in the near term;

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

“TARGET System” means the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System or any successor thereto;

“Tax Event” means (i) a Withholding Tax Event, (ii) a Change in Law Tax Event or (iii) that, other than as a result of a Withholding Tax Event or a Change in Law Tax Event, (A) the Issuer or the General Partner would be subject to more than a *de minimis* amount of tax in respect of the Preferred Securities or Notes (except, in the case of the General Partner only, for any such tax that would arise as a result of (a) actual profits arising to it as a result of payments received by it from the Issuer or (b) activities (if any) carried on by it other than those permitted or contemplated in the Limited Partnership Agreement in respect of the Preferred Securities) in Jersey or the U.K. or (B) HBOS (or

the relevant U.K. tax resident member of the HBOS Group) would not obtain relief for the purposes of U.K. corporation tax for any payment of interest in respect of the Notes or payment under the Guarantee (other than payments representing a repayment of amounts subscribed for Preferred Securities);

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

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

“three-month EURIBOR”, in respect of any Distribution Period falling after the First Optional Redemption Date, means the offered rate (expressed as a rate per annum) for three-month euro deposits which appears on the display page designated as page 248 of Moneyline Telerate (or such other page or pages as may replace it for the purpose of displaying such information) as of 11:00 a.m., Brussels time, on the second TARGET Business Day prior to the first day of the relevant Distribution Period; *provided that*, if, at such time, no such rate appears or the relevant Moneyline Telerate page is unavailable, it shall mean the rate calculated by the Calculation Agent as the arithmetic mean of at least two offered quotations obtained by the Calculation Agent after requesting the principal Euro-zone office of each of four major reference banks, in the Euro-zone interbank market, to provide the Calculation Agent with its offered quotation for deposits for three months in euro commencing on the first day of the relevant Distribution Period to prime banks in the Euro-zone interbank market at approximately 11:00 a.m., Brussels time, on the second TARGET Business Day prior to the first day of the relevant Distribution Period; provided further that if fewer than two such offered quotations are provided as requested, it shall mean the rate calculated by the Calculation Agent as the arithmetic mean of the euro lending rates which leading banks in the Euro-zone selected by the Calculation Agent are quoting, on the second TARGET Business Day prior to the first day of the relevant Distribution Period, to leading European banks for a period of three months, except that, if the banks so selected by the Calculation Agent are not quoting as mentioned above, the rate shall be the rate in effect for the last preceding Distribution Period;

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

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

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

“Withholding Tax Event” means that, as a result of a change in any law or regulation of the U.K. or Jersey, or in any treaty to which the U.K. or Jersey is a party, or in the official interpretation or application of any law, regulation or treaty by any relevant body in the U.K. or Jersey, on or after 23 May 2006, (i) payments to Holders would be subject to deduction or to withholding tax or would give rise to any obligation of the Issuer or HBOS to account for any tax in Jersey or the U.K. or (ii) payments by HBOS (or the relevant U.K. tax resident member of the HBOS Group) in respect of the Notes would be subject to deduction or to withholding tax in the U.K.

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

## **2 Distributions**

- 2.1 Subject as provided by the Law and in paragraph 2.3, non-cumulative distributions (“Distributions”) on the Preferred Securities shall accrue from the Closing Date (or, in the case of any further Preferred Securities of the same series issued so as to rank *pari passu* with the Preferred Securities as regards participation in the profits and assets of the Issuer, their respective dates of issue or as otherwise provided) and shall be payable in arrear on each Distribution Payment Date.
- 2.2 Subject to the Law, Distributions in respect of any Distribution Period will be payable at the applicable Distribution Rate on the Liquidation Preference of the Preferred Security. In respect of each Distribution Payment Date falling on or prior to the First Optional Redemption Date, the amount of each Distribution payable in respect of each €50,000 of Preferred Securities shall be €2,469.50. In respect of each Distribution Period falling after the First Optional Redemption Date, the Calculation Agent will at or as soon as practicable after each time at which the Distribution Rate is to be determined, determine the Distribution for the relevant Distribution Period. Each such determination will be notified to the Issuer, HBOS, the Registrar, the Holders and the Stock Exchange before the commencement of the Distribution Period in accordance with paragraph 10 hereof.
- 2.3 Distributions on the Preferred Securities will be payable at the sole discretion of the General Partner out of the Issuer’s own legally available resources on each Distribution Payment Date.

Distributions on the Preferred Securities will not be cumulative. If the General Partner decides not to pay Distributions on the Preferred Securities or HBOS does not pay corresponding amounts under the Guarantee, the Holders of the Preferred Securities will have no claim in respect of such non-payment.

Notwithstanding the above, on any Distribution Payment Date with respect to which (i) a Capital Disqualification Event has occurred and is continuing and (ii) HBOS is in compliance with its Applicable Regulatory Capital Requirements, the Issuer shall be obliged to pay the Distribution Payment on such Distribution Payment Date and neither the Issuer nor HBOS may exercise its discretion to not pay a Distribution Payment.

- 2.4 HBOS has undertaken in the Guarantee that, in the event that any Distribution is not paid in full in accordance with the rights attaching to the Preferred Securities under the Limited Partnership Agreement, it will not (a) declare or pay any distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any Parity Securities where the dividend or distribution is at the discretion of the directors and any Junior Share Capital (except for any Excluded Preference Shares) or (b) (if permitted) repurchase or redeem Parity Securities or Junior Share Capital (except for any Excluded Preference Shares), in each case (a) or (b) until after the next succeeding Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount equivalent to the Distributions to be paid in respect of the next following Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), in the case of a Distribution Period ending on or before the First Optional Redemption Date, or

until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount equivalent to the Distributions to be paid in respect of the next four following Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), in the case of a Distribution Period ending after the First Optional Redemption Date.

- 2.5 On each Distribution Determination Date, HBOS will determine whether sufficient Adjusted Distributable Reserves exist to allow a payment of some or all of the relevant Distribution and in any event the General Partner will decide whether or not to make such payment. In the event that any Distribution cannot be or is not to be paid in full, HBOS will notify or procure notification to the Stock Exchange, the Issuer, the Registrar and the Principal Paying and Transfer Agent and to the Holders, in accordance with paragraph 10, of the amount, if any, to be paid in respect of that Distribution.
- 2.6 Save as described above, Holders will have no right to participate in the profits of the Issuer or HBOS and in particular will have no rights to receive from the Issuer amounts paid under the Notes or otherwise amounts in excess of Distributions due and payable under the Preferred Securities. In the event that any amounts received by the Issuer exceed the amount (if any) then due by way of Distribution under the Preferred Securities, the amount of such excess will be paid to the Preferential Limited Partner and Holders will have no rights in respect thereof.
- 2.7 The liability of a Holder to contribute to the debts or obligations of the Issuer (if any) shall (subject to the Law) not exceed the amount of that Holder's capital contribution.

### **3 Liquidation Distributions**

- 3.1 Without prejudice to paragraph 8.6, in the event of the commencement of any dissolution (other than an Involuntary Dissolution) of the Issuer, the Holders will be entitled, subject as set out in paragraph 3.4, to receive the Liquidation Distribution, in respect of each Preferred Security held, out of the assets of the Issuer available for distribution to such Holders under the Law. Such entitlement will arise (a) before any payments due to the holder of the Preferential Right and (b) before any distribution of assets is made to the General Partner.

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

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

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

- 4.1 The Preferred Securities have no fixed final redemption date and Holders have no rights to call for the redemption of the Preferred Securities.
- 4.2 The Preferred Securities are redeemable, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions and the Law, in whole, but not in part, on any Optional Redemption Date upon not less than 30 nor more than 60 days' notice to the Holders specifying the Optional Redemption Date (which notice shall be irrevocable). Upon the expiry of such notice, the Issuer shall be bound to redeem each of the Preferred Securities accordingly by payment of an amount equal to the Optional Redemption Price.
- 4.3 If at any time a Tax Event has occurred and is continuing, the effect of which cannot be avoided by the Issuer or HBOS taking reasonable measures available to it, then the Preferred Securities may be redeemed, in whole but not in part, at the option of the General Partner, subject to the satisfaction of the Redemption Conditions and to the Law, at any time upon not less than 30 nor more than 60 days' notice to the Holders specifying the Tax Event Redemption Date (which notice shall be irrevocable), each Preferred Security being redeemable at the Tax Event Redemption Price. Prior to the publication of any notice of redemption pursuant to the foregoing, the General Partner shall deliver to the Registrar a certificate signed by two

Directors of HBOS stating that the Issuer is entitled to effect such redemption and an opinion of counsel to HBOS experienced in such matters to the effect that a Tax Event has occurred (and specifying which of clauses (i) to (iii) as set out in the definition of “Tax Event” is applicable and in the case of a Withholding Tax Event or a Change in Law Tax Event further specifying which of clauses (i) or (ii) in the definition of “Withholding Tax Event” or “Change in Law Tax Event”, as the case may be, is applicable, and, in the case of an event within clause (iii) in the definition of “Tax Event”, further specifying which of clauses (A) and (B) is applicable). Upon the expiry of such notice, the Issuer shall be bound to redeem each of the Preferred Securities accordingly in accordance with and subject to the Law.

- 4.4 Under existing FSA requirements, the Issuer may not redeem, and neither the Issuer nor HBOS may purchase, any Preferred Securities unless the FSA gives its prior written consent. The FSA may impose conditions on any redemption or purchase.
- 4.5 For so long as the Preferred Securities are admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange’s Gilt-Edged and Fixed Interest Market, the General Partner shall cause notice of any redemption to be given to the London Stock Exchange.

## **5 Substitution by Qualifying Tier 1 Securities or Substitute Preference Shares**

- 5.1 Subject to the prior consent of the FSA, if then required, the General Partner may, at any time, by giving not less than 30 nor more than 60 days notice to Holders in accordance with paragraph 10, elect that the Preferred Securities be substituted in whole by an equivalent notional amount of Qualifying Tier 1 Securities or Substitute Preference Shares.
- 5.2 As soon as reasonably practicable following the occurrence of a Substitution Event or the Involuntary Dissolution of the Issuer (in circumstances where HBOS is itself not insolvent or in liquidation), the General Partner shall cause notice thereof to be given in accordance with paragraph 10 and take all reasonable steps to cause the substitution of the Preferred Securities by Substitute Preference Shares. In the event that at the time of any such substitution HBOS is unable, by reason of the operation of Article 4.7 of its Articles of Association (or any provision in its Articles of Association from time to time corresponding thereto) but not otherwise, to issue Substitute Preference Shares, the Substitute Preference Shares shall comprise preference shares of HBOS which provide the Holders in all material commercial respects with the same economic rights and benefits as aforesaid save that they shall rank junior to (i) the Parity Securities issued from time to time by HBOS and (ii) the Guarantee and any other guarantee or support agreement ranking *pari passu* with the Guarantee, but senior to all Junior Share Capital in issue from time to time.

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

- 5.3 Following the creation of such Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares, and the obtaining of all corporate authorisations and any applicable regulatory approvals required for the allotment and issue thereof, HBOS has undertaken that it will, or it will procure the relevant person to allot, issue and deliver Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares in satisfaction of the rights of the Holders in the circumstances and subject to the conditions described herein. HBOS has undertaken that it will take all reasonable steps to procure that such Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares, will at the relevant time be listed on a recognised stock exchange. HBOS has undertaken that as soon as practicable after a Substitution Event or the Involuntary Dissolution of the Issuer in circumstances where HBOS is itself not insolvent or in liquidation or following an election by the General Partner to substitute Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares it will give written notice to the Holders enclosing a substitution confirmation (the “Substitution Confirmation”) which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of the Principal Paying and Transfer Agent. To receive Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares in respect of some or all of its holding of Preferred Securities, each Holder must deliver to the Principal Paying and Transfer Agent a Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. If at the time of any substitution of the Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares pursuant to the foregoing, the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depositary for Euroclear or Clearstream, Luxembourg, the Holder may provide a list of each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or any other clearing systems as a person with an entitlement in respect of the Preferred Securities and, in the case of the Qualifying Tier 1 Securities, or as the case may be, Substitute Preference Shares which are in registered form, in whose name (or the name of the nominee for such person) the Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares should be registered or, in the case of Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares in bearer form, to whom such Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares should be delivered, subject to any such person submitting a duly completed Substitution Confirmation and appropriate references to “Holders” in this paragraph 5 shall be construed accordingly.

HBOS has undertaken in the Guarantee that following such substitution, each Qualifying Tier 1 Security or, as the case may be, Substitute Preference Share, allotted will rank for any distribution from the immediately preceding Distribution Payment Date or, if none, the Closing Date and will have no entitlement to any accrued Distributions or any other payment on the Preferred Securities.

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

- 5.4 If (i) Substitute Preference Shares are issued upon a Substitution Event or Involuntary Dissolution of the Issuer, HBOS will confer upon Holders the option (A) to receive such

Substitute Preference Shares in certificated form or (B) subject to such Holders agreeing to pay any U.K. stamp duty or stamp duty reserve tax (“SDRT”) arising on the issue of the Substitute Preference Shares and, to the extent permitted by applicable law, providing appropriate indemnities satisfactory to HBOS against any such stamp duty or SDRT, to require HBOS to issue such Substitute Preference Shares, to convert such Substitute Preference Shares into warrant to bearer form and to deliver them to a depositary (or a nominee or agent for such depositary) of a clearing system or if (ii) Substitute Preference Shares are issued other than upon a Substitution Event or Involuntary Dissolution of the Issuer, HBOS will (A) issue such Substitute Preference Shares, convert such Substitute Preference Shares into warrant to bearer form and deliver them to a depositary (or a nominee or agent for such depositary) of a clearing system and (B) pay any U.K. stamp duty or SDRT arising on the issue of the Substitute Preference Shares. HBOS will pay or procure that the issuer of the relevant Qualifying Tier 1 Securities (other than Substitute Preference Shares) will pay any U.K. stamp duty or SDRT arising on issue of such Qualifying Tier 1 Securities.

- 5.5 The General Partner will use all reasonable endeavors to procure that certificates (if any) for Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares issued on substitution will be dispatched by mail free of charge (but uninsured and at the risk of the person entitled thereto) within one month after receipt of a duly completed Substitution Confirmation. Upon an Involuntary Dissolution of the Issuer occurring after a Substitution Event but prior to the relevant substitution being effected, Holders will have no further rights, title or interest in or to Preferred Securities except the right to have their respective Preferred Securities substituted in the manner described above. Notwithstanding the foregoing, if Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares are required to be issued, Holders will continue to be entitled to receive Distributions and/or a Liquidation Distribution in respect of the Preferred Securities until such time as notice is given by HBOS in accordance with paragraph 10 that the Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares are available for issue upon substitution and thereafter Holders will have no further rights, title or interest in or to their Preferred Securities except to have them substituted in the manner described above.

## **6 Additional Amounts**

All payments in respect of the Preferred Securities by the Issuer will be made without withholding or deduction for, or on account of, any Jersey Tax, unless the withholding or deduction of such Jersey Tax is required by law. In the event of such withholding or deduction, each Holder will be entitled to receive, as further distributions, such additional amounts (“Additional Amounts”) as may be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable in respect of the Preferred Securities in the absence of such withholding or deduction; except that no such Additional Amounts will be payable to a Holder (or to a third party on his behalf) with respect to any Preferred Security (i) to the extent that such Jersey Tax is imposed or levied by virtue of such Holder (or the beneficial owner) of such Preferred Security having some connection with Jersey, other than merely being a Holder (or beneficial owner) of such Preferred Security or (ii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive, and except that the Issuer’s obligations to make

any such payments are subject to the Law and to the limitations provided in paragraphs 2.3, 3.1 and 3.2.

## **7 Payments**

7.1 Distributions will be payable on the relevant Distribution Payment Date (or where any Distribution Payment Date is not a TARGET Business Day on the next TARGET Business Day (without interest in respect of such delay)) to the Holders of record as they appear on the Register on the relevant record date, which will be five TARGET Business Days prior to the relevant Distribution Payment Date.

If the General Partner gives a notice of redemption in respect of the Preferred Securities pursuant to (i) paragraph 4.2 or 4.3, then, by 11:00 a.m. (Brussels time) on the Optional Redemption Date or the Tax Event Redemption Date, as the case may be, the General Partner shall procure that the Optional Redemption Price or Tax Event Redemption Price, as the case may be, will be paid by the Registrar or by the Principal Paying and Transfer Agent on behalf of the Issuer to the Holders. Upon such payment, all rights of Holders to participate in the assets of the Issuer or to be returned any amount in respect of the Preferred Securities (including capital contribution (or any part thereof) made by or on behalf of the Holders) will be extinguished and the Holder shall thereupon cease to be a limited partner of the Issuer provided its holding of Preferred Securities is redeemed in accordance with the foregoing, and capital contribution will, on payment of the Optional Redemption Price or the Tax Event Redemption Price, as the case may be, be deemed repaid.

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

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

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

provided, however, that a Holder may receive such payment by direct transfer if appropriate direct transfer instructions have been received by the Registrar in sufficient time prior to the relevant date of payment. Holders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a TARGET Business Day, if the Holder is late in surrendering certificates (if required to do so) or if a cheque mailed in accordance with this paragraph arrives after the due date for payment.

In the event that payment of the Optional Redemption Price or the Tax Event Redemption Price in respect of any Preferred Security is improperly withheld or refused and not paid by the Issuer, Distributions on such Preferred Security, subject as described in paragraph 2.3, will continue to accrue, according to the Day Count Fraction, from the Optional Redemption Date or the Tax Event Redemption Date, as the case may be, to the date of actual payment of such Optional Redemption Price.

- 7.3 The Issuer will not, and HBOS has undertaken in the Guarantee that it will not and it will procure that no member of the HBOS Group will, make any payment to Holders, or procure such a payment in respect of the Preferred Securities, that could not lawfully have been made if Holders had held the most senior preference shares of HBOS (if any and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.
- 7.4 The General Partner will, and HBOS has undertaken in the Guarantee that it will procure that the General Partner will, maintain at all times whilst the Preferred Securities are outstanding (a) whilst the Preferred Securities are admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange's Gilt-Edged and Fixed Interest Market, a Principal Paying and Transfer Agent in London, and (b) a Registrar having its office outside the U.K.

## **8 Voting Rights**

- 8.1 Except as described below and provided for in the Law, Holders will not be entitled to receive notice of or attend or vote at any meeting of partners in the Issuer or participate in the management of the Issuer.
- 8.2 If for a Distribution Period, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for any four consecutive Distribution Periods:
  - 8.2.1 Distributions and any Additional Amounts in respect of such Distributions have not been paid in full on the Preferred Securities by the Issuer; and/or
  - 8.2.2 HBOS breaches any of its payment obligations under the Guarantee in respect of such Distributions or any such Additional Amounts thereon,

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

Not later than 30 days after such entitlement arises, if the written notice of the Holders of outstanding Preferred Securities in the circumstances described in the preceding paragraph has not been given as provided for in the preceding paragraph, the General

Partner will convene a separate general meeting for the above purpose. If the General Partner fails to convene such meeting within such 30 day period, the Holders of 10% by Liquidation Preference of the Preferred Securities will be entitled to convene such meeting for the above purpose. The Limited Partnership Agreement contains provisions concerning the convening and conduct of meetings of Holders. Any Special Representative so appointed shall vacate office, if for one Distribution Period, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for any four consecutive Distribution Periods, Distributions and any Additional Amounts in respect of such Distributions have resumed with payment in full on the Preferred Securities by the Issuer and/or HBOS has made payment of all amounts in respect of such Distributions and any Additional Amounts in respect thereof (or an amount equivalent to the Distributions to be paid in respect of such Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders).

- 8.3 The consent in writing of the Holders of at least a simple majority in Liquidation Preference of the outstanding Preferred Securities or the sanction of a resolution, passed by Holders of at least a simple majority in Liquidation Preference of the Preferred Securities present or represented at a separate meeting at which the quorum shall be Holders present or represented holding at least one-third in Liquidation Preference of the outstanding Preferred Securities, shall be required in order to give effect to any variation or abrogation of the rights, preferences and privileges of the Preferred Securities by way of amendment of the Limited Partnership Agreement or otherwise (including, without limitation, the authorisation or creation of any securities or ownership interests of the Issuer ranking, as to participation in the profits or assets of the Issuer, senior to the Preferred Securities or the approval of the exchange or substitution of the Preferred Securities and/or the Preferred Securities for obligations or securities of another entity) (unless otherwise required by applicable law). Notwithstanding the foregoing, the General Partner may, without such consent in writing or such sanction amend the Limited Partnership Agreement (including the rights, preferences and privileges of the Preferred Securities) if, as determined by the General Partner, the proposed amendment is solely of a formal, minor or technical nature or is to correct an error or cure an ambiguity, provided that the proposed amendment does not reduce the amounts payable to Holders, impose any obligation on the Holders or adversely affect their voting rights or any modification of the terms of the Preferred Securities pursuant to paragraph 8.4.
- 8.4 Notwithstanding the foregoing, provided that the most recent Distribution, in the case of Distributions to be paid in respect of Distribution Periods ending on or before the First Optional Redemption Date, or the four most recent Distributions to be paid in respect of Distribution Periods thereafter, have been paid in full by the Issuer (or HBOS pursuant to the Guarantee) (or an amount equivalent to the Distributions to be paid in respect of the next Distribution Period, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for the next four Distribution Periods, has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), the General Partner may, without the consent or sanction of the Holders, take such action as is required in order to amend the Limited Partnership Agreement to allow an increase in the level of capital contributions and the corresponding number of Preferred Securities.

Thereafter the Issuer may, provided that the most recent Distribution, in the case of Distributions to be paid in respect of Distribution Periods ending on or before the First

Optional Redemption Date, or the four most recent Distributions to be paid in respect of Distribution Periods thereafter, have been paid in full by the Issuer (or HBOS pursuant to the Guarantee) (or an amount equivalent to the Distributions to be paid in respect of the next Distribution Period, in the case of Distribution Periods ending on or before the First Optional Redemption Date, or thereafter for the next four Distribution Periods, has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), without the consent of the Holders issue any such further securities having the same terms and conditions as the Preferred Securities in all respects (or in all respects except for the first payment of Distributions on them) and so that such further issue shall be consolidated and form a single series with the Preferred Securities. References herein to the Preferred Securities include (unless the context requires otherwise) any other securities issued pursuant to this paragraph and forming a single series with the Preferred Securities.

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

## **9 Covenants of the General Partner**

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

## **10 Notices**

All notices to the Holders will be mailed to the Holder of record and, so long as the Preferred Securities are admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange's Gilt-Edged and Fixed Interest Market and the rules of the London Stock Exchange so require, published in a leading London daily newspaper which is expected to be the *Financial Times*. Any mailed notice shall be deemed to have been given one clear day after the date on which it was posted and any notice published in a newspaper shall be deemed to have been given on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

## **11 Transfers and Form**

11.1 The Preferred Securities will be in registered form each in an amount equal to the Liquidation Preference.

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

## **12 Replacement of Certificates**

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

## **13 Prescription**

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

#### **14 Governing Law**

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

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

## **Summary of Provisions Relating to the Preferred Securities in Global form**

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

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

### **Accountholders**

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

### **Exchange**

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

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

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

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

### **Payments**

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

### **Transfers of Interests**

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

### **Settlement**

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

## Subordinated Guarantee

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

THIS DEED OF GUARANTEE (the “Guarantee”), dated 23 May 2006, is executed and delivered by HBOS plc (“HBOS”) for the benefit of the Holders (as defined below).

WHEREAS:

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

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

### 1 Definitions

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

“Guaranteed Payments” means (without duplication) collectively (i) all Distributions due on the Preferred Securities, (ii) any Liquidation Distribution to which Holders are entitled, (iii) the Optional Redemption Price; (iv) the Tax Event Redemption Price; and (v) any relevant Additional Amounts;

“Guarantor Additional Amounts” has the meaning ascribed to it in clause 2.4;

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

“Issuer” means HBOS Capital Funding No. 3 L.P.;

“Limited Partnership Agreement” means the Limited Partnership Agreement dated 19 May 2006 establishing the Issuer as amended from time to time;

“Preferred Securities” means the €750,000,000 Fixed-to-Floating Non-voting Non-cumulative Perpetual Preferred Securities outstanding of the Issuer, including any further Preferred Securities of the same series, whether or not in issue on the date of this Guarantee, the Holders of which are entitled to the benefits of this Guarantee as evidenced by the execution of this Guarantee; and

“Senior Creditors” has the meaning ascribed to it in clause 2.3.

## **2 Guarantee**

- 2.1 Subject to the exceptions and limitations contained in the following provisions of this clause 2, HBOS irrevocably agrees to pay in full to the Holders the Guaranteed Payments, as and when due, to the extent that such payments have not been paid when due and payable by the Issuer regardless of any defence, right of set-off or counterclaim which the Issuer may have or assert. This Guarantee is continuing, irrevocable and absolute. The rights and claims of the Holders against HBOS under this Guarantee are subordinated to the claims of the Senior Creditors (as defined in clause 2.3) in that payment of the Guaranteed Payments is conditional upon satisfaction of the conditions set out in the following provisions of this clause 2.
- 2.2 Notwithstanding clause 2.1, HBOS will not be obliged to make any Guaranteed Payment if the General Partner has exercised its discretion, on behalf of the Issuer, not to pay a Distribution on the Preferred Securities.
- 2.3 Notwithstanding clause 2.1, if, at the time that the Liquidation Distribution is to be paid by HBOS under this Guarantee in respect of any Preferred Securities, proceedings have been commenced for the voluntary or involuntary liquidation, dissolution or winding-up of HBOS other than pursuant to a Permitted Reorganisation, payment under this Guarantee of such Liquidation Distribution shall not exceed the amount per security that would have been paid as a liquidation distribution out of the assets of HBOS had the Preferred Securities and all Parity Securities been the most senior class of preference shares in HBOS with equivalent rights of participation in the capital of HBOS (whether or not HBOS could in fact have issued such securities at such time) and ranked:
- (a) junior to all liabilities of HBOS including subordinated liabilities (in each case other than any liability of HBOS which constitutes Tier 1 Securities or any liability which is referred to in (b) or (c) and any other liability expressed to rank *pari passu* with or junior to this Guarantee) (“Senior Creditors”);
  - (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with this Guarantee; and
  - (c) senior to Junior Share Capital.
- 2.4 All Guaranteed Payments made hereunder will be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed or levied by or on behalf of the U.K. or any political sub-division thereof or by any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In that event, HBOS will, if permitted by the FSA (to the extent such approval is required), pay such additional amounts (“Guarantor Additional Amounts”) as may be necessary in order that the

net amounts received by the Holders after such withholding or deduction shall equal the amounts which would have been receivable under this Guarantee in the absence of such withholding or deduction; except that no such Guarantor Additional Amounts will be payable to a Holder of a Preferred Security (or a third party on his behalf) (i) to the extent that such taxes, duties, assessments or governmental charges are imposed or levied by virtue of such Holder (or the beneficial owner) of such Preferred Security having some connection with the U.K., other than merely being a Holder (or beneficial owner) of such Preferred Security or (ii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive or (iii) which would not have been payable or due but for the failure to comply with any statutory requirements or make, or procure that any third party makes, a declaration of non-residence or similar claim for exemption from such withholding or deduction or (iv) where the relevant Preferred Security is presented for payment more than 30 days after the Relevant Date, except to the extent that the Holder thereof would have been entitled to such Guarantor Additional Amounts on presenting the same for payment on the last day of such period of 30 days, and except that HBOS's obligation to pay any Guarantor Additional Amounts is subject to the exceptions relating to Guaranteed Payments set out in clauses 2.2 and 2.3.

In this Clause 2.4, "Relevant Date" means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received by the Principal Paying and Transfer Agent on or prior to such due date, the date on which, the full amount having been so received, notice to that effect shall have been given to the Holders. Any reference in this Guarantee to any Guaranteed Payment shall be deemed to include any additional amounts which may be payable by the Guarantor under this clause 2.4, or under any undertaking given by the Guarantor in addition to or substitution for this clause 2.4;

- 2.5 HBOS hereby waives notice of acceptance of this Guarantee and of any liability to which it applies or may apply, presentment, demand for payment, protest, notice of non-payment, notice of dishonour, notice of redemption and all other notices and demands.
- 2.6 The obligations, covenants, agreements and duties of HBOS under this Guarantee shall in no way be affected or impaired by reason of the happening from time to time of any of the following:
  - (a) the release or waiver, by operation of law or otherwise, of the performance or observance by the Issuer of any express or implied agreement, covenant, term or condition relating to the Preferred Securities to be performed or observed by or on behalf of the Issuer;
  - (b) the extension of time for the payment by or on behalf of the Issuer of all or any portion of any Distribution, the Optional Redemption Price, the Tax Event Redemption Price, the Liquidation Distribution or any other sums payable under the terms of the Preferred Securities or the extension of time for the performance of any other obligation under, arising out of, or in connection with, the Preferred Securities;

- (c) any failure, omission, delay or lack of diligence on the part of Holders to enforce, assert or exercise any right, privilege, power or remedy conferred on the Holders pursuant to the terms of the Preferred Securities, or any action on the part of the Issuer granting indulgence or extension of any kind;
- (d) the voluntary or involuntary winding-up, dissolution, amalgamation, reconstruction, sale of any collateral, receivership, insolvency, bankruptcy, assignment for the benefit of creditors, reorganisation, arrangement, composition or readjustment of debt of, or other similar proceedings affecting, the Issuer or any of the assets of the Issuer;
- (e) any invalidity of, or defect or deficiency in, the Preferred Securities; or
- (f) the settlement or compromise of any obligation guaranteed hereby or hereby incurred.

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

- 2.7 This Guarantee shall be deposited with and held by the Registrar until all the obligations of HBOS have been discharged in full. HBOS hereby acknowledges the right of every Holder to the production of, and the right of every Holder to obtain a copy of, this Guarantee from the Registrar.
- 2.8 A Holder may enforce this Guarantee directly against HBOS, and HBOS waives any right or remedy to require that any action be brought against the Issuer or any other person or entity before proceeding against HBOS. Subject to clause 2.9, all waivers contained in this Guarantee shall be without prejudice to the right to proceed against the assets of the Issuer and the General Partner as permitted by the terms of the Preferred Securities. HBOS agrees that this Guarantee shall not be discharged except by complete performance of all obligations of HBOS under this Guarantee.
- 2.9 HBOS shall be subrogated to any and all rights of the Holders against the assets of the Issuer in respect of any amounts paid to the Holders by HBOS under this Guarantee. HBOS shall not (except to the extent required by mandatory provisions of law) exercise any rights which it may acquire by way of subrogation or any indemnity, reimbursement or other agreement, in all cases as a result of a payment under this Guarantee, if, at the time of any such payment, any amounts are due and unpaid under this Guarantee. If HBOS shall receive or be paid any amount with respect to the Preferred Securities in violation of the preceding sentence, HBOS agrees to pay over such amount to the Holders.
- 2.10 HBOS acknowledges that its obligations hereunder are several and independent of the obligations of the Issuer with respect to the Preferred Securities and that HBOS shall be liable as principal and sole obligor hereunder to make Guaranteed Payments pursuant to the terms of this Guarantee, notwithstanding the occurrence of any event referred to in clause 2.6.
- 2.11 Subject to applicable law, HBOS agrees that its obligations hereunder constitute unsecured obligations of HBOS and the Holders will at all times rank (a) junior to all Senior Creditors, (b) *pari passu* with Parity Securities, if any, issued by HBOS and any guarantee or support agreement of HBOS ranking *pari passu* with this Guarantee and (c) senior to Junior Share Capital.

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

### **3 Undertakings**

- 3.1 HBOS undertakes that it will not issue any preferred securities or preference shares or other Tier 1 Securities ranking senior to its obligations under this Guarantee or enter into any support agreement or give any guarantee in respect of any Preferred Securities or preference shares or other Tier 1 Securities issued by any Subsidiary or other entity if such support agreement or guarantee would rank senior to this Guarantee (including, without limitation, any guarantee that would provide a priority of payment with respect to Adjusted Distributable Reserves) unless, in each case, (a) this Guarantee is changed to give the Holders such rights and entitlements as are contained in or attached to such Preferred Securities or preference shares or other securities or such other support agreement or guarantee so that this Guarantee ranks *pari passu* with, and contains substantially equivalent rights of priority as to payment on, any such preferred securities, preference shares, Tier 1 Securities or such other support agreement or guarantee and (b) payments of Distributions on the Preferred Securities in respect of the most recent Distribution Period, if on or before the First Optional Redemption Date, or payments of Distributions on the Preferred Securities in respect of the four most recent Distribution Periods, if after the First Optional Redemption Date, have been made in full either by the Issuer or by HBOS pursuant to this Guarantee.
- 3.2 HBOS undertakes that, in the event that any Distribution is not paid in full to Holders in accordance with the rights attaching to the Preferred Securities in accordance with the Limited Partnership Agreement, HBOS will not (a) declare or pay any distribution or dividend and, where applicable, will procure that no distribution or dividend is declared or paid on any Parity Securities where the dividend is at the discretion of the directors and any Junior Share Capital (except for any series of preference shares which are issued in satisfaction of an obligation

existing on 27 April 2004 (“Excluded Preference Shares”)), or (b) (if permitted) repurchase or redeem Parity Securities or Junior Share Capital (except for Excluded Preference Shares), in each case (a) or (b) until after the next succeeding Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount equivalent to the distributions to be paid in respect of the next following Distribution Period has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), in the case of a Distribution Period ending on or before the First Optional Redemption Date, or until after the fourth consecutive following Distribution Payment Date on which Distributions in respect of the Preferred Securities are paid in full (or an amount equivalent to the distributions to be paid in respect of the next four following Distribution Periods has been paid or irrevocably set aside in a separately designated trust account for payment to the Holders), in the case of a Distribution Period ending after the First Optional Redemption Date.

- 3.3 HBOS undertakes that, so long as any of the Preferred Securities is outstanding (a) unless HBOS is itself being wound up, it will not permit, or take any action that would or might cause, the liquidation, dissolution or winding-up of the General Partner or the Issuer otherwise than (i) with the prior approval of the FSA (if then required) and (ii) if either (A) HBOS has sufficient Adjusted Distributable Reserves or (B) HBOS has proceeds available from an issue of Replacement Capital that has been made for the purpose of funding the Liquidation Distribution (in either of cases (ii)(A) or (B) in an amount at least equal to the aggregate Liquidation Distribution) and (b) the General Partner will at all times be a directly or indirectly wholly owned subsidiary of HBOS, unless in the case of (a) or (b), otherwise approved by a simple majority of the Holders by vote or in writing.
- 3.4 HBOS undertakes that it will not and it will procure that no member of the HBOS Group will, make any payment to Holders, or procure such a payment in respect of the Preferred Securities, that could not lawfully have been made if Holders had held the most senior preference shares of HBOS (if any, and whether or not HBOS could issue such preference shares at such time) instead of the Preferred Securities.
- 3.5 HBOS undertakes to take all reasonable steps to ensure that it (a) will at all times have a sufficient number of authorised but unissued Substitute Preference Shares to permit the substitution thereof for all outstanding Preferred Securities and (b) undertakes to take all reasonable steps to ensure that all corporate authorisations will have been taken for the allotment and issue of the same free from preemptive rights. Following the creation of such Substitute Preference Shares and obtaining such corporate authorisations as aforesaid, HBOS further undertakes that (a) it will allot, issue and deliver Substitute Preference Shares in satisfaction of the rights of the Holders in the circumstances and subject to the conditions described in the Limited Partnership Agreement, and (b) it will take all reasonable steps to procure that such Substitute Preference Shares will at the relevant time be listed on a recognised stock exchange and (c) if (i) Substitute Preference Shares are issued upon a Substitution Event or an Involuntary Dissolution of the Issuer, HBOS will confer upon Holders the option (A) to receive such Substitute Preference Shares in certificated form or (B) subject to such Holders agreeing to pay any U.K. stamp duty or SDRT arising on the issue of the Substitute Preference Shares and, to the extent permitted by applicable law, providing appropriate indemnities against any such stamp duty or SDRT, to require HBOS to issue such Substitute Preference Shares, to convert such Substitute Preference Shares into warrant to bearer form and to deliver them to a depositary (or a nominee or agent for such depositary) of a clearing system; or if (ii) Substitute Preference Shares are issued other than upon a

Substitution Event or Involuntary Dissolution of the Issuer, HBOS will (A) issue such Substitute Preference Shares, convert such Substitute Preference Shares into warrant to bearer form and deliver them to a depositary (or a nominee or agent of such depositary) of a clearing system and (B) pay any U.K. stamp duty or SDRT arising on the issue of the Substitute Preference Shares. HBOS undertakes that as soon as practicable after a Substitution Event or the Involuntary Dissolution of the Issuer (in circumstances where HBOS is itself not insolvent or in liquidation) or following an election by the General Partner in its absolute discretion on behalf of the Issuer to substitute Substitute Preference Shares as contemplated in the Limited Partnership Agreement it will give written notice in accordance with the Limited Partnership Agreement to the Holders enclosing a Substitution Confirmation which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of the Principal Paying and Transfer Agent. To receive Substitute Preference Shares in respect of some or all of its holding of Preferred Securities, each Holder must deliver to the Principal Paying and Transfer Agent a Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. If at the time of any substitution of the Substitute Preference Shares pursuant to the foregoing, the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depositary for Euroclear or Clearstream, Luxembourg, the Holder may provide a list of each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or any other clearing systems as a person with an entitlement in respect of the Preferred Securities. HBOS undertakes that following such substitution, each Substitute Preference Share allotted will rank for any dividend from the immediately preceding Distribution Payment Date or, if none, the Closing Date and will have no entitlement to any accrued Distributions or any other payment on the Preferred Securities.

- 3.6 Where the Preferred Securities are being exchanged for Qualifying Tier 1 Securities not being Substitute Preference Shares, HBOS undertakes that it will or will procure that the relevant issuer will allot, issue and deliver Qualifying Tier 1 Securities not being Substitute Preference Shares in satisfaction of the rights of the Holders in the circumstances and subject to the conditions described herein. HBOS undertakes that it will take all reasonable steps to procure that such Qualifying Tier 1 Securities not being Substitute Preference Shares, will at the relevant time be listed on a recognised stock exchange. HBOS undertakes that as soon as practicable following an election by the General Partner to substitute Qualifying Tier 1 Securities it will give written notice to the Holders enclosing a substitution confirmation (the "Substitution Confirmation") which each Holder will be required to complete. The form of such Substitution Confirmation shall also be made available at the offices of the Principal Paying and Transfer Agent. To receive Qualifying Tier 1 Securities not being Substitute Preference Shares in respect of some or all of its holding of Preferred Securities, each Holder must deliver to the Principal Paying and Transfer Agent a Substitution Confirmation together with the certificate representing its holding of Preferred Securities or other evidence of entitlement satisfactory to the General Partner. Any such substitution shall be effected subject in each case to any applicable fiscal laws or other laws or regulations. If at the time of any substitution of the Qualifying Tier 1 Securities not being Substitute Preference Shares pursuant to the foregoing, the Preferred Securities are represented by a single certificate registered in the name of a nominee of a common depositary for Euroclear or Clearstream, Luxembourg, the Holder may provide a list of each of the persons shown in the records of Euroclear or Clearstream, Luxembourg or any other clearing systems as a person with an

entitlement in respect of the Preferred Securities and, in the case of the Qualifying Tier 1 Securities not being Substitute Preference Shares which are in registered form, in whose name (or the name of the nominee for such person) the Qualifying Tier 1 Securities should be registered or, in the case of Qualifying Tier 1 Securities not being Substitute Preference Shares in bearer form, to whom such Qualifying Tier 1 Securities or, as the case may be, Substitute Preference Shares should be delivered, subject to any such person submitting a duly completed Substitution Confirmation and appropriate references to “Holders” in this paragraph 5 shall be construed accordingly. HBOS undertakes that following such substitution, each Qualifying Tier 1 Security not being a Substitute Preference Share will rank for any distribution from the immediately preceding Distribution Payment Date or, if none, the Closing Date, and will have no entitlement to any accrued Distributions or any other payment on the Preferred Securities.

HBOS will pay or procure that the issuer of the relevant Qualifying Tier 1 Securities other than Substitute Preference Shares will pay any U.K. stamp duty or SDRT arising on issue of such Qualifying Tier 1 Securities.

Prior to the publication of any notice of substitution pursuant to the foregoing provisions, HBOS must first deliver to the Registrar a certificate, signed by two Directors, certifying that the securities to be offered in substitution for the Preferred Securities are, and an independent investment bank appointed by HBOS for the purpose of making such an assessment agrees that they are, Qualifying Tier 1 Securities not being Substitute Preference Shares.

- 3.7 HBOS will procure that the General Partner will maintain at all times whilst the Preferred Securities are outstanding (a) whilst the Preferred Securities are admitted to the Official List of the FSA in its capacity as competent authority under the Financial Services and Markets Act 2000 and admitted to trading on the London Stock Exchange’s Gilt-Edged and Fixed Interest Market, a Principal Paying and Transfer Agent in London and (b) a Registrar having its office outside the U.K.

#### **4 Termination**

With respect to the Preferred Securities, this Guarantee shall terminate and be of no further force and effect upon (i) payment of the Optional Redemption Price or the Tax Event Redemption Price, as the case may be, on all Preferred Securities, (ii) purchase and cancellation of all Preferred Securities, (iii) full payment of the Liquidation Distribution or (iv) upon the issue and allotment of the Qualifying Tier 1 Securities, as the case may be, provided however that this Guarantee will continue to be effective or will be reinstated, as the case may be, if at any time payment of any sums paid in respect of the Preferred Securities or under this Guarantee must be restored by a Holder for any reason whatsoever or if the Qualifying Tier 1 Securities have not been validly issued and allotted.

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

- 5.1 Subject to operation of law, all guarantees and agreements contained in this Guarantee shall bind the successors, assigns, receivers, trustees and representatives of HBOS and shall inure to the benefit of the Holders. HBOS shall not transfer its obligations hereunder without the prior approval of the Holders of not less than a simple majority in Liquidation Preference of the outstanding Preferred Securities (excluding any Preferred Securities held by HBOS or any entity of which HBOS, either directly or indirectly, owns 20% or more of the voting shares or

similar ownership interests), which approval shall be obtained in accordance with procedures contained in Schedule 3 to the Limited Partnership Agreement and applicable law of Jersey.

- 5.2 Except for those changes (a) required by clause 3.1 hereof; or (b) which do not adversely affect the rights of Holders (in any of which cases no agreement will be required), this Guarantee shall be changed only by agreement in writing signed by HBOS with the prior approval of the Holders of not less than a simple majority in Liquidation Preference of the outstanding Preferred Securities (excluding any Preferred Securities held by HBOS or any entity of which HBOS, either directly or indirectly, owns 20% or more of the voting shares or other similar ownership interests), which approval shall be obtained in accordance with the procedures contained in Schedule 3 to the Limited Partnership Agreement and applicable law of Jersey.
- 5.3 Any notice, request or other communication required or permitted to be given hereunder to HBOS shall be given in writing by delivering the same against receipt therefor or be addressed to HBOS, as follows, to:

HBOS plc  
The Mound  
Edinburgh  
EH1 1YZ  
Attention: Company Secretary  
Telephone: +44 (0) 131 442 7777  
Facsimile: +44 (0) 131 243 5516

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

Any notice, request or other communication required or permitted to be given hereunder to the Holders shall be given by HBOS in the same manner as notices sent on behalf of HBOS Capital Funding No. 3 L.P. to Holders.

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

## **6 Governing Law**

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

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

## **Use of Proceeds**

The net proceeds from the issuance of the Preferred Securities, less commissions and expenses payable by the Issuer, are estimated to be approximately €744,375,000 and will be used to strengthen the capital base of the HBOS Group and to support the continuing growth of its business.

## **HBOS Capital Funding No. 3 L.P.**

### **Introduction**

HBOS Capital Funding No. 3 L.P. (the “Issuer”) was registered in Jersey on 12 May 2006 under the Law for an unlimited duration, with registered number LP 758 with HBOS Capital Funding (Jersey) Limited as the general partner (the “General Partner”), Citivic Nominees Limited as the initial limited partner (the “Initial Holder”) and Uberior Investments plc, as the initial preferential limited partner (the “Initial Preferential Limited Partner” and, together with the Initial Holder, the “Limited Partners”) holding the Preferential Right (as defined under “description of the preferred securities”). The General Partner, the Limited Partners and HBOS have entered into a limited partnership agreement dated 19 May 2006 (the “Limited Partnership Agreement”) for the purpose of establishing the Issuer. The Issuer is not a legal entity separate from its partners and as such has no subsidiaries. The Limited Partnership Agreement does not create a trust relationship between any of the partners. Although a party to the Limited Partnership Agreement, HBOS is not a partner in the Issuer.

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

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

The General Partner and the Initial Preferential Limited Partner also hold partnership interests in HBOS Capital Funding L.P., HBOS Capital Funding No. 1 L.P. and HBOS Capital Funding No. 2 L.P., which are separately established partnerships whose assets are segregated from those of the Issuer.

### **Sole Activity**

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

### **Administration**

HBOS Capital Funding No. 3 L.P. will be operated by the General Partner. The registered office of the Issuer and the General Partner is 22 Grenville Street, St Helier, Jersey JE4 8PX, telephone number +44 (0) 1534 609 000. No Holder may participate in the administration of the Issuer. The Directors of the General Partner are Julia Chapman; Helen Grant; Gareth Essex-Cater; Daniel Le Blancq and David Balai whose business address is that set out for the General Partner, excluding David Balai whose business address is 33 Old Broad Street, London, EC2N 1HZ, United Kingdom.

The General Partner has agreed to contribute capital from time to time to the extent required for the Issuer to meet any operating expenses that it may have. The General Partner has also agreed that it will at all

times maintain sole ownership of its general partner interest in the Issuer, subject to the terms of the Limited Partnership Agreement. The Limited Partnership Agreement provides that all of the Issuer's business and affairs will be conducted by the General Partner and the General Partner will have unlimited liability for the debts and obligations of the Issuer to the extent that these cannot be satisfied out of partnership assets.

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

### **Indebtedness**

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

### **Conflicts of Interest**

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

# HBOS

## Introduction

HBOS plc is the holding company of the HBOS Group. HBOS has four principal subsidiaries: Halifax plc, the Bank of Scotland, HBOS Insurance & Investment Group Limited and Halifax Share Dealing Limited. HBOS was incorporated and registered in Scotland in the register of companies on 3 May 2001, with registered number SC 218813 as a public limited company under the Companies Act 1985 (the “*Companies Act*”). The principal legislation under which HBOS operates is the Companies Act. The registered office and head office of HBOS in the United Kingdom is at The Mound, Edinburgh EH1 1YZ, telephone no. 0870 600 500. HBOS together with its subsidiaries and subsidiary undertakings (as defined in the Companies Act) are collectively referred to as the “**HBOS Group**”.

Clause 4 of the memorandum of association of HBOS provides that its objects include the carrying on of all or any part of the businesses of a holding company, the carrying on of business as an investment holding company and the carrying on of the business of banking and the provision of financial services in each case in all their forms. The memorandum of association of HBOS also grants HBOS a range of corporate capabilities to effect these objects.

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.

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

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

## ***Retail***

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

As at 31 December 2005, the HBOS Group was the largest retail mortgage provider in the UK, with a market share of residential mortgages of 21 per cent., with balances of approximately £201 billion and held savings and banking balances of over £132 billion. <sup>1</sup>Mortgages in the UK are provided by Retail under five mortgage brands: Halifax, the Bank of Scotland, Intelligent Finance, Birmingham Midshires and The Mortgage Business.

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<sup>1</sup> Based on a comparison of HBOS Group’s U.K. residential mortgage book as against market size information taken from Bank of England statistics.

### ***Corporate***

Corporate provides a range of banking services to the corporate and business sector. Its principal market is medium-sized and large-sized UK based businesses (typically those with an annual turnover in excess of £1 million). The division comprises a number of relationship banking and specialist lending teams with responsibilities including working capital finance, term loans, asset finance, motor finance, multi-currency loans and deposits, project and specialist finance, acquisition finance and syndicated lending. The key objective of these teams is to expand and strengthen the HBOS Group's corporate market share by pursuing a relationship and partnership driven approach and delivering specialist services to existing and new customers.

As at 31 December 2005, the HBOS Group employed over 7,500 staff in the Corporate Division across the UK.

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

The Insurance and Investment Division comprises two different operating businesses: HBOS Financial Services (which conducts its business predominantly through Halifax Life and Clerical Medical Investment Group Ltd.) and HBOS General Insurance. The businesses of St James's Place Capital, esure and First Alternative also come within the division's ambit. These are not wholly-owned subsidiaries of the HBOS Group, but are run on an autonomous basis and subject to joint venture or relationship agreements. Products offered by the Insurance and Investment Division include savings, investments and pensions, life, household, creditor, travel and motor insurance. Products are distributed through a number of different channels, including branches, independent financial advisers, a dedicated high net worth salesforce and telephone and internet sales.

### ***Strategy & International***

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

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

Treasury is the centralised treasury for the HBOS Group. It provides and manages prudential and regulatory liquidity and wholesale multi-currency funding for the HBOS Group. It arranges the HBOS Group's debt capital issuance and asset securitization programmes and offers a range of treasury services to HBOS Group customers.

Asset Management, comprised of Insight Investment Management Limited and its subsidiary companies, is the investment management business within the HBOS Group. It provides investment management services, investment advisory sources and is also a retailer of open-ended investment companies and other investment vehicles.

### *Principal HBOS Group Subsidiaries*

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

<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly or indirectly) by HBOS</b>	<b>Country of incorporation or registration</b>	<b>Registered office/ head office</b>
The Governor & Company of Bank of Scotland . . . . .	Banking, financial and related services	100	Scotland	The Mound Edinburgh EH1 1YZ
HBOS Treasury Services plc . . . .	Banking	100	England and Wales	33 Old Broad Street London EC2N 1HZ
Bank of Scotland (Ireland) Limited . . . . .	Banking	100	Ireland	Bank of Scotland House 124-127 St. Stephen's Green Dublin 2 Ireland
Capital Bank plc . . . . .	Banking and personal finance	100	England and Wales	Capital House Queens Park Road Handbridge Chester CH88 3AN
HBOS Australia Pty Limited . . .	Banking	100	Australia	Bankwest Tower 108 St Georges Terrace Perth Australia WA 6000
Bank of Western Australia Limited . . . . .	Banking	100	Australia	Bankwest Tower 108 St Georges Terrace Perth Australia WA 6000
Halifax plc . . . . .	Banking	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG

<i>(continued)</i>				
<b>Company</b>	<b>Activity</b>	<b>Total % of ordinary share capital held (directly or indirectly) by HBOS</b>	<b>Country of incorporation or registration</b>	<b>Registered office/ head office</b>
Halifax Share Dealing Limited . . . . .	Execution only stockbroking	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
HBOS Insurance & Investment Group Limited . . . . .	Investment holding	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
Halifax General Insurance Services Limited . . . . .	General insurance brokerage	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
St Andrews Insurance plc . . . . .	General insurance	100	England and Wales	St Andrews House Portsmouth Road Esher Surrey KT10 9SA
Clerical Medical Investment Group Limited . . . . .	Life assurance	100	England and Wales	33 Old Broad Street London EC2N 1HZ
Halifax Life Limited . . . . .	Life assurance	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
Halifax Investment Fund Managers Limited . . . . .	OEIC management	100	England and Wales	Trinity Road Halifax West Yorkshire HX1 2RG
Insight Investment Management Limited . . . . .	Investment management	100	England and Wales	33 Old Broad Street London EC2N 1HZ
St James's Place Capital PLC . . .	Financial services	60	England and Wales	St James's Place House Dollar Street Cirencester GL7 2AQ

## Management of the Company

### *Board of Directors of the Company*

<b>Name</b>	<b>Position in the Company</b>	<b>Principal outside activity (if any) of significance to the Company</b>
Lord Stevenson of Coddendam	Chairman	
Sir Ronald Garrick	Non-executive Director	
	Deputy Chairman	
	Non-executive Director	—
James Crosby	Chief Executive	—
Andrew Hornby	Chief Executive Designate	—
Phil Hodgkinson	Group Finance Director	—
Peter Cummings	Chief Executive Corporate Division	—
Jo Dawson	Chief Executive - Insurance and Investment Division	—
Benny Higgins	Chief Executive - Retail Division	—
Colin Matthew	Chief Executive Strategy & International Operations	—
Charles Dunstone	Non-executive Director	Carphone Warehouse Group plc
Anthony Hobson	Non-executive Director	—
Brian Ivory	Non-executive Director	—
Karen Jones	Non-executive Director	—
Coline McConville	Non-executive Director	Clear Channel International Limited
Kate Nealon	Non-executive Director	—
David Shearer	Non-executive Director	—

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

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

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

### ***Audit Committee***

The members of the audit committee of the Company are Anthony Hobson (Chairman), David Shearer, Coline McConville, Kate Nealon and John Ormerod. This committee also acts as the audit committee for the HBOS Group, and as the audit committee for regulated entities that are not wholly within a single division of the HBOS Group, such as Bank of Scotland, and is supported by five risk control committees.

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

The Audit Committee, which meets at least quarterly, *inter alia* reviews management's procedures for:

- identifying business risks and controlling their financial impact;
- preventing and detecting fraud;
- ensuring compliance with regulatory and legal requirements; and
- monitoring the operational effectiveness of policies and systems.

The Audit Committee, which summarizes its findings to the Board of Directors of the Company, obtains assurance about the internal control and risk management environment through regular reports from Group Financial and Operational Risk, Group Regulatory Risk and Group Internal Audit. The Group Risk Director, the Chief Financial and Operational Risk Officer, the Head(s) of Group Regulatory Risk and the Head of Group Internal Audit all have right of direct access to the Chairman of the Audit Committee and the Chief Executive.

The Audit Committee also considers external auditors' reports and reviews the minutes and work of divisional Risk Control Committees.

All business divisions have divisional Risk Control Committees which generally comprise at least two independent Non-executive Directors and an Executive, independent of that division. They review, on behalf of the Audit Committee, the adequacy of the business divisions' systems of internal control (including financial, regulatory and operational risk management). These committees meet regularly to review the significant risks facing their division's business and the techniques used to identify, assess and manage them.

The divisional Risk Control Committees and, where appropriate, subsidiary companies' Audit Committees operate under delegated authority from the Audit Committee and the planning and co-ordination of their activities is reviewed by the Audit Committee.

Group Internal Audit supports the Audit Committee, divisional Risk Control Committees and senior management by reviewing independently and objectively the effectiveness of the control and risk environment.

During 2004 the Committee met eight times. In those meetings, as well as in separate meetings with Executive Directors and management, and privately with both the external and internal auditors, the Committee reviewed:

- and advised the Board of directors of the Company on the Group's interim and annual financial statements, its accounting policies and on the control of its financial and business risks, the nature and scope of the work to be performed by the external and internal auditors, and the results of this audit work and of the response of management;
- the activities, resources, organizational structure and operational effectiveness of the internal audit function;
- the effectiveness of the HBOS Group's system of internal control (including financial, operational, compliance and risk management), as well as the appropriateness and effectiveness of "whistle blowing" procedures;

- and made recommendations on the appointment and remuneration of the external auditors and monitored the performance of the auditors; and
- the non-audit services provided to the HBOS Group by the external auditors and monitored the independence of the auditors.

HBOS complies with all of the provisions of the U.K. Combined Code Principles of Good Governance and Code of Best Practice (the “**Combined Code**”), save for the requirement in Combined Code Provision D.1.1 that the Senior Independent Director should attend meetings with a range of shareholders. The Senior Independent Director attended briefings and other meetings with analysts and other representatives of institutional investors during 2004, but did not undertake a program of meetings with individual shareholders, as this was not considered necessary.

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

The financial information set forth on the following pages at the end of and for each of the two years ended 31 December 2005 and 2004 has been extracted without material adjustment from the audited consolidated financial statements and notes thereto of the HBOS Group for those years. The statutory consolidated financial statements and notes thereto have been placed on display at the specified office of the Principal Paying and Transfer Agent and at the offices of Shepherd+Wedderburn, Level 2, Saltire Court, 20 Castle Terrace, Edinburgh EH1 2ET for the life of the issue. The consolidated financial statements and notes thereto have been audited by KPMG Audit Plc, independent auditors.

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

### **2005 financial information**

The 2005 financial information has been prepared on the basis of the recognition and measurement requirements of IFRS that are endorsed by the EU and effective at 31 December 2005. The accounting policies that the Directors have applied to the preparation of the first annual IFRS financial statements for the year ending 31 December 2005 are set out on pages 96 to 100 of the HBOS plc Annual Report and Accounts 2005 containing the Consolidated Financial Statements. Those accounting policies included amendments to IAS 19 “Employee Benefits” and IAS 39 “Financial Instruments Recognition and Measurement” issued by the International Accounting Standards Board which at that date had not yet been endorsed by the EU. These amendments were subsequently endorsed by the EU in November 2005.

### **2004 statutory comparative financial information**

The 2004 statutory comparative financial information is prepared under the reporting basis for statutory comparatives under IFRS for the 2004 financial year. This basis reflects all standards, with the exception of IAS 32, IAS 39 and IFRS 4. These standards only became effective from 1 January 2005 and transitional concessions granted by the International Accounting Standards Board permit the Group to report the comparatives for areas covered by these standards on a UK GAAP basis for 2004 only. The transitional concessions include accounting policies for loans and advances, debt securities, equities, derivatives and insurance. In preparing the 2004 comparative information the Group has adjusted amounts previously reported in financial statements under UK GAAP.

### **2004 pro forma financial information**

The 2004 financial information labelled as pro forma has been prepared on a comparable basis to the 2005 financial information which includes the impact of IAS 32, IAS 39 and IFRS 4, which only became effective from 1 January 2005. The 2004 pro forma income statement does not reflect the impact of derivative hedge accounting owing to the necessary documentation not being in place given the late finalisation of the IFRS standard. This information is unaudited. For the avoidance of doubt, the 2004 information labelled ‘pro forma’ does not constitute pro forma financial information for the purposes of Article 5 of Regulation (EC) No. 809/2004.

## Summary Annual Consolidated Profit and Loss Account of HBOS

	Year ended 31 December ,		
	2005	2004	2004 pro forma (unaudited)
	(in £ millions, except per share)		
Net interest income . . . . .	6,829	5,885	6,278
Non-interest income . . . . .	16,788	16,610	10,285
Net Operating Income (all from continuing operations)	23,617	22,495	16,563
Operating expenses . . . . .	(17,244)	(16,811)	(11,304)
Impairment losses on loans and advances . . . . .	(1,599)	(1,201)	(1,255)
Impairment on investment securities . . . . .	(51)	(21)	(22)
Operating profit (all from continuing operations) . . . . .	4,723	4,462	3,982
Share of profits of jointly controlled entities . . . . .	29	55	41
Share of operating profits of associated undertakings . . . . .	10	69	66
Non-operating income . . . . .	46	23	23
Profit before taxation . . . . .	4,808	4,609	4,112
Tax on profit . . . . .	(1,546)	(1,272)	(1,203)
Profit after taxation . . . . .	3,262	3,337	2,909
Attributable to:			
Parent company shareholders (including certain non-equity interests in 2004) . . . . .	3,230	3,118	2,898
Minority Interests (equity) . . . . .	32	45	11
(non-equity) . . . . .		174	
	3,262	3,337	2,909
Pence per share . . . . .	—		—
Basic earnings per share . . . . .	82.2p	79.7p	74.9p
Diluted earnings per share . . . . .	81.3p	79.2p	74.5p

## Summary Annual Consolidated Balance Sheet of HBOS

	Year ended 31 December ,		
	2005	2004	2004 pro forma (unaudited)
	(in £ millions, except per share)		
Shareholder's Equity			
Issued share capital .....	1,884	1,381	981
Reserves .....	16,381	15,881	15,541
Shareholders' equity (excluding minority interests) (includes certain non-equity interests in 2004) .....	18,265	17,262	16,522
Minority interests (equity) .....	191	295	159
Shareholders' equity (including minority interests) (includes certain non-equity interests in 2004) .....	18,456	17,557	16,681
Minority and other interests (non-equity) .....		2,617	
Total shareholders' equity .....	18,456	20,174	16,681
Other borrowed funds .....	20,254	14,633	18,257
Deposits by banks, customer accounts and debt securities in issue ...	390,950	338,799	352,978
Loans and advances to banks and customers .....	361,124	306,669	331,752
Impairment losses on loans and advances .....	2,938	2,494	2,536
Total assets .....	540,873	448,165	47,674
Net assets per share .....	452p	440p	421p

## Other Annual Financial Data of HBOS (unaudited)

	Year ended 31 December		
	2005	2004	2004 pro forma (unaudited)
	(in £ millions, except per share)		
Group Post-tax return on mean equity <sup>(1)</sup> . . . . .	19.6%	N/A	19.6%
Net interest margin . . . . .	1.80%	N/A	1.79%
Cost: income ratio <sup>(2)</sup> . . . . .	42.2%	N/A	44.7%
Capital Adequacy			
Tier 1 capital . . . . .	8.1%	N/A	7.9%
Total capital . . . . .	12.4%	N/A	12.3%
Total impairment provisions as a percentage of closing advances . .	0.85%	N/A	0.81%

(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 basis as follows:

	Year ended 31 December 2005	Year ended 31 December 2004 pro forma (unaudited)
	(in £ millions)	
Operating expenses . . . . .	17,244	11,304
Retail rationalisation costs . . . . .	(84)	
Merger integration costs . . . . .		(48)
Mortgage endowment compensation . . . . .	(260)	(130)
Goodwill impairment . . . . .		(6)
	16,900	11,120
Operating lease depreciation . . . . .	(561)	(428)
Change in investment contract liabilities . . . . .	(5,089)	(1,753)
Net claims paid on insurance contracts . . . . .	(2,019)	(2,388)
Net change in insurance contract liabilities . . . . .	(4,220)	(2,190)
Change in unallocated surplus . . . . .	(369)	
<b>Underlying operating expenses . . . . .</b>	<b>4,642</b>	<b>4,361</b>
Net operating income . . . . .	23,617	16,563
Gross up for policyholder tax . . . . .	(200)	
Short term fluctuations . . . . .	(110)	(17)
	23,307	16,546
Impairment on investment securities . . . . .	(51)	(22)
Operating lease depreciation . . . . .	(561)	(428)
Change in investment contract liabilities . . . . .	(5,089)	(1,753)
Net claims incurred on insurance contracts . . . . .	(2,019)	(2,388)
Net change in insurance contract liabilities . . . . .	(4,220)	(2,190)
Change in unallocated surplus . . . . .	(369)	
<b>Underlying operating income . . . . .</b>	<b>10,998</b>	<b>9,765</b>

## Capitalisation and Indebtedness of HBOS

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

	As at 31 December 2005 <u>(£ millions)</u>
<b>Authorised capital</b>	
6.0884% Non-cumulative Preference Shares (of £1 each) . . . . .	1
6.475% Non-cumulative Preference Shares (of £1 each) . . . . .	198
6.125% Non-Cumulative Redeemable Preference Shares (of £1 each) . . . . .	200
Sterling Preference Shares (of £1 each) . . . . .	2,597
8.117% Non-Cumulative Perpetual Preference Shares Class A (of £10 each) . . . . .	3
7.754% Non-Cumulative Perpetual Preference Shares Class B (of £10 each) . . . . .	1
Ordinary Shares (of 25p each) . . . . .	1,185
	<u><u>4,185</u></u>
	As at 31 December 2005 <u>(£ millions)</u>
Euro Preference Shares (of €1 each) . . . . .	3,000
	<u><u>3,000</u></u>
	As at 31 December 2005 <u>(£ millions)</u>
US\$ Preference Shares (of US\$1 each) . . . . .	4,498
6.413% preference shares series "A" (of US\$1 each) . . . . .	1
5.92% preference shares series "B" (of US\$1 each) . . . . .	1
	<u><u>4,500</u></u>

	As at 31 December 2005 (£ millions)
<b>Issued Share Capital</b>	
6.0884% Non-cumulative Preference Shares . . . . .	728
6.475% Non-cumulative Preference Shares . . . . .	197
Ordinary Shares (of 25p each, fully paid) . . . . .	959
	<hr/>
Allotted, called up and fully paid share capital . . . . .	1,884
Reserves . . . . .	16,381
	<hr/>
Shareholders' Equity (excluding minority interests) . . . . .	18,265
Minority Interests (Equity) . . . . .	191
	<hr/>
<b>Total Shareholders' Equity . . . . .</b>	<b>18,456</b>
	<hr/> <hr/>

	As at 31 December 2005 (£ millions)
<b>Other Indebtedness</b>	
Deposits by banks . . . . .	32,041
Customer accounts . . . . .	200,948
Debt securities in issue . . . . .	157,961
Subordinated liabilities . . . . .	16,441
Other borrowings <sup>(1)</sup> . . . . .	3,813
	<hr/>
<b>Total Indebtedness . . . . .</b>	<b>411,204</b>
	<hr/> <hr/>
<b>Total Capitalisation and Indebtedness . . . . .</b>	<b>429,660</b>
	<hr/> <hr/>

(1) Other borrowings includes those preference shares and preferred securities which are defined as liabilities. Other borrowings therefore include £300 million of 9 1/4% Non-cumulative Irredeemable Preference Shares and £100 million of 9 3/4% Non-cumulative Irredeemable Preference Shares.

Save for £13,221 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 £54,792 million of the HBOS Group's debt securities in issue which are unguaranteed but secured on asset backed securities of the HBOS Group, none of the other borrowings, at 31 December 2005, are secured or guaranteed. As at 31 December 2005, the HBOS Group had contingent liabilities (including guarantees) of £5,116 million. No account has been taken of intra group guarantees.

There have been no material changes in the capitalisation, indebtedness and contingent liabilities (including guarantees) of HBOS Group since 31 December 2005.

## **Taxation**

### **General**

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

### **Jersey Taxation**

The Issuer is not itself assessable to Jersey Tax. Holders of Preferred Securities (other than residents of Jersey) are not subject to any tax in Jersey in respect of the holding, exchange, sale or other disposal of the Preferred Securities. The Comptroller of Income Tax in Jersey has confirmed in writing that, for such time as the General Partner holds “exempt company” status, there will be no withholding or similar tax required to be deducted from income or capital distributions to the Holders.

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

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

On 3 June 2003, the European Union Council of Economics and Finance Ministers reached political agreement on certain issue relating to its Code of Conduct on Business Taxation (the “Code”). Jersey is not a member of the EU and is not subject to EU fiscal legislation but is a dependent territory of the United Kingdom. The Policy and Resources Committee of the States of Jersey has announced that, in keeping with Jersey’s policy of constructive international engagement, it intends to propose legislation to replace the Jersey exempt company regime by the end of 2008 with a general zero rate of corporate tax.

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

As part of an agreement reached in connection with the EU directive on the taxation of savings income in the form of interest payments, and in line with steps taken by other relevant third countries, Jersey introduced with effect from 1 July 2005 a retention tax system in respect of payments of interest, or other similar income, made to an individual beneficial owner resident in an EU Member State by a paying agent established in Jersey. The retention tax system applies for a transitional period prior to the implementation of a system of automatic communication to EU Member States of information regarding such payments. During this transitional period, such an individual beneficial owner resident in an EU Member State will be entitled to request a paying agent not to retain tax from such payments but instead to apply a system by

which the details of such payments are communicated to the tax authorities of the EU Member State in which the beneficial owner is resident.

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

## **U.K. Taxation**

In this section, the term “U.K. Investors” means Holders who are persons resident (or, in the case of individuals, ordinarily resident) in the United Kingdom for tax purposes.

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

#### *Classification of the Issuer*

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

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

#### *Corporate U.K. Investors*

On the basis that the Issuer is treated for U.K. tax purposes as a partnership, corporate U.K. Investors should be treated, for the purposes of the “loan relationship rules” in the Finance Act 1996 and/or the “derivative contract rules” in the Finance Act 2002, as being entitled to an appropriate share of the total debits and credits (including those in respect of foreign exchange gains and losses) arising in respect of the Issuer’s ownership of the Notes. Such U.K. Investors would also be liable to tax as income under the same rules on profits arising to them on transfer or redemption of their Preferred Securities.

In determining the debits and credits to be brought into account as described above, corporate U.K. Investors will be required to apply a generally accepted accounting practice with respect to either international accounting standards or U.K. GAAP.

#### *Individual U.K. Investors*

The Preferred Securities are not qualifying corporate bonds and, accordingly, a disposal of Preferred Securities by an individual U.K. Investor or an individual Holder who is not resident or ordinarily resident in the United Kingdom for tax purposes but who carries on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Preferred Security is attributable may give rise to a chargeable gain or allowable loss for the purposes of taxation of capital gains. In calculating any gain or loss on disposal of a Preferred Security, sterling values are compared at acquisition and transfer. A transfer or redemption of a Preferred Security by an individual U.K. Investor could also give rise to a charge under the “accrued income scheme”.

If the Issuer's holding of the Notes issued by HBOS is replaced with Replacement Debt, it is possible that a chargeable gain or an allowable loss may arise for individual U.K. Investors on such replacement for the purposes of the taxation of capital gains, although the position will depend on the circumstances of such replacement.

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

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

***(c) U.K. Withholding Tax on Interest on the Notes***

The Notes will constitute "quoted Eurobonds" within the meaning of section 349 of the Income and Corporation Taxes Act 1988 (the "Act") so long as they are and continue to be listed on a "recognised stock exchange" within the meaning of section 841 of the Act. This condition will be satisfied if the Notes are admitted to listing on the Official List of the U.K. Listing Authority and to trading on the London Stock Exchange (which is a "recognised stock exchange" for these purposes). Accordingly, payments of interest on the Notes may be made without withholding or deduction for or on account of U.K. income tax provided the Notes are so listed at the time of payment.

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

It is possible that if HBOS makes any payments in respect of interest on the Preferred Securities (or other amounts due under the Preferred Securities other than amounts subscribed for the Preferred Securities) under the Guarantee, such payments may be subject to U.K. withholding tax at a maximum rate of currently 22 per cent. HBOS has undertaken in such circumstances, subject to certain exceptions, to pay additional amounts in respect of such payments under the Guarantee.

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

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

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

***Substitute Preference Shares***

The following comments relate to Substitute Preference Shares in registered form and (because they will be expressed in euro) to Substitute Preference Shares in bearer form.

No liability to stamp duty will arise on issue of the Substitute Preference Shares. Under current HMRC practice, if the Substitute Preference Shares are issued either:

- (i) to a provider of clearance services (or to a nominee for such a person) and the provider of the clearance services has not made an election under section 97A of the Finance Act 1986; or
- (ii) to a depositary receipt issuer (or to a nominee or agent for such a person) who has issued or is to issue depositary receipts for the Substitute Preference Shares,

then there should be an SDRT charge at the rate of 1.5% of their price when issued unless such Substitute Preference Shares are in bearer form (and expressed in euro). There can be no guarantee, however, that HMRC practice will not change between the date hereof and the issue of any Substitute Preference Shares.

If the Substitute Preference Shares are issued to a provider of clearance services which has not made an election under section 97A of the Finance Act 1986 (or to a nominee for such a person), there will be no SDRT on any subsequent agreement to transfer the Substitute Preference Shares. There should also be no stamp duty on any subsequent transfer of interests in the Substitute Preference Shares within the clearing system.

If the Substitute Preference Shares are issued to a provider of clearance services which has made an election under section 97A of the Finance Act 1986 (or to a nominee for such a person), there will be no stamp duty or SDRT on the issue to the clearance service provider, but there will be an SDRT charge at the rate of 0.5% of the amount or value of the consideration on any subsequent agreement to transfer interests in the Substitute Preference Shares within the clearing system unless such Substitute Preference Shares are in bearer form (and expressed in euro) and are listed on a recognised stock exchange and not issued in connection with any takeover.

If the Substitute Preference Shares are held by a provider of clearance services which has made a section 97A election (or a nominee for such a person) and that election is subsequently terminated (whether at the instigation of such person or HMRC or otherwise) an SDRT charge of 1.5% will arise as if, immediately after such termination, the Substitute Preference Shares had been transferred to a provider of clearance services that had not made a section 97A election.

If the Substitute Preference Shares are issued to a depositary receipt issuer (or to its nominee or agent), there will be no SDRT on any subsequent agreement to transfer the depositary receipts representing interests in the Substitute Preference Shares and there should also be no stamp duty on any subsequent transfer of the depositary receipts provided that any instrument of transfer or written agreement to transfer the depositary receipts is executed outside the U.K. and remains at all times outside the U.K.

If the Substitute Preference Shares are not issued to a provider of clearance services (or to a nominee for such a person) or to a depositary receipt issuer (or to a nominee or agent for such a person) then no liability to SDRT will arise on the issue of Substitute Preference Shares but (since in accordance with the terms of the Preferred Securities such Substitute Preference Shares will be in certificated form) there will be an SDRT charge at the rate of 0.5% on any subsequent agreement to transfer such Substitute Preference Shares.

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

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

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

## **Subscription and Sale**

Pursuant to a Subscription Agreement (the “Subscription Agreement”) dated 19 May 2006, Deutsche Bank AG, London Branch, J.P. Morgan Securities Ltd. and UBS Limited (the “Lead Managers”) have jointly and severally agreed to subscribe for the Preferred Securities at a price of 100 per cent. of their principal amount less a combined management and underwriting commission. In addition, the Lead Managers shall be reimbursed for certain of their expenses in connection with the issue of the Preferred Securities. The Lead Managers are entitled to terminate the Subscription Agreement in certain circumstances before the issue of the Preferred Securities.

### **United States of America**

Each Lead Manager understands that the Preferred Securities have not been and will not be registered under the United States Securities Act of 1933, as amended (the “Securities Act”) and may not be offered or sold within the United States or to or for the account or benefit of U.S. persons except in accordance with Regulation S under the Securities Act or pursuant to an exemption from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Each Lead Manager has agreed that, except as permitted by the Subscription Agreement, (a) it will not offer, sell or deliver Preferred Securities (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the closing date, within the United States or to, or for the account or benefit of, US persons, (b) neither it, its affiliates nor any persons acting on its or their behalf will engage in any directed selling efforts with respect to the Preferred Securities and (c) it will have sent to each distributor, manager or person to which it sells Preferred Securities during the distribution compliance period a confirmation or other notice setting forth the restrictions on offer and sales of the Preferred Securities within the United States or to, or for the account or benefit of, US persons. Terms used in this paragraph have the respective meanings given to them by Regulation S under the Securities Act.

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

### **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”), each Lead Manager has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “Relevant Implementation Date”) it has not made and will not make an offer of Preferred Securities to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of Preferred Securities to the public in that Relevant Member State:

- (a) following the publication of a prospectus in relation to those Preferred Securities which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive;
- (b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;

- (c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than ? 43,000,000 and (3) an annual net turnover of more than ? 50,000,000, as shown in its last annual or consolidated accounts; or
- (d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Preferred Securities to the public” in relation to any Preferred Securities in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Preferred Securities to be offered so as to enable an investor to decide to purchase or subscribe the Preferred Securities, 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.

## **UK**

Each Lead Manager represents to and agrees with the Issuer and HBOS that:

### **1 *Financial promotion***

It has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Preferred Securities in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or HBOS; and

### **2 *General compliance***

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

## **Jersey**

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

## **General**

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

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

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

## General Information

1. The Prospectus which comprises a prospectus for the purposes of the Prospectus Directive was published on or about 19 May 2006, and the listing of the Preferred Securities is expected to be effective on or around 24 May 2006.

2. None of the Issuer, HBOS nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) during the 12 months preceding the date of this Prospectus, which may have or have had in the recent past, a significant effect on the financial position or profitability of the Issuer or of HBOS and its subsidiary undertakings.

3. There has been no significant change in the financial or trading position of the Issuer nor any material adverse change in the prospects of the Issuer since its establishment.

4. There has been no significant change in the financial or trading position of HBOS or its subsidiaries nor any material adverse change in the prospects of HBOS or its subsidiaries since 31 December 2005.

5. The Issuer expects to publish its first financial statements in respect of the year ending 31 December 2006. The auditors are KPMG, chartered accountants, registered auditors and independent auditors (authorised and regulated by the Financial Services Authority for designated investment business) whose address is 5 St Andrew's Place, Charing Cross, St Helier, Jersey JE4 8WQ.

6. The financial statements of HBOS for the two years ended 31 December 2004 and 31 December 2005, have been audited without qualification by KPMG Audit Plc, chartered accountants, registered auditors and independent auditors, (authorised and regulated by the Financial Services Authority for designated investment business) whose address is Saltire Court, 20 Castle Terrace, Edinburgh EH1 2EG. The reports of KPMG Audit plc ("KPMG") dated 1 March 2005 and 28 February 2006, in respect of HBOS for the years ended 31 December 2004 and 31 December 2005, respectively, stated that the reports were made solely to HBOS' members, as a body, in accordance with section 235 of the Companies Act 1985. The reports further stated that KPMG's audit work had been undertaken so that KPMG might state to HBOS' members those matters KPMG were required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, KPMG did not accept or assume responsibility to anyone other than HBOS and HBOS' members as a body, for their audit work, for their reports, or for the opinions KPMG formed.

7. For so long as the Preferred Securities may be issued pursuant to this Prospectus, copies of the following documents may be inspected during normal business hours at the specified office of the Principal Paying and Transfer Agent and, in respect of HBOS, at the offices of Shepherd+Wedderburn, Level 2, Saltire Court, 20 Castle Terrace, Edinburgh EH1 2ET, namely:

- the memorandum and articles of association of HBOS;
- the Limited Partnership Agreement;
- the Paying and Transfer Agency Agreement;
- the Prospectus; and
- the audited financial statements of HBOS for the financial years ended 31 December 2004 and 31 December 2005.

8. The execution of the Limited Partnership Agreement to establish HBOS Capital Funding No. 3 L.P. has been duly authorised by a resolution of the Board of Directors of the General Partner passed on 18 May 2006.

The entering into of the Limited Partnership Agreement and the Guarantee by HBOS was authorised by a resolution of a duly authorised committee of the Board of Directors of HBOS passed on 10 May 2006 and the issue of the Notes by HBOS was authorised by a resolution of the Board of Directors of HBOS passed on 10 May 2006.

9. The Preferred Securities will be accepted for clearance through Euroclear and Clearstream, Luxembourg or any other relevant clearing system (which will be the entities in charge of keeping the records with a Common Code of 025524276). The International Securities Identification Number (ISIN) for the Preferred Securities is XS0255242769.

10. The address of Euroclear is 1 Boulevard du Roi Albert 11, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is 42 Avenue JF Kennedy L-1855 Luxembourg.

11. The Articles of Association of HBOS restrict the circumstances in which HBOS can issue preference shares (“Additional Preference Shares”) which rank *pari passu* with the Existing Preference Shares (as defined herein in the “Description of the Preferred Securities”) and other Priority Preference Shares (as defined herein in the Articles of Association of HBOS) (see also “Investment Considerations – Substitution”). Article 4.7 provides that no such Additional Preference Shares may be issued unless (i) at the time of such proposed issue the Auditors (as defined therein) have reported that immediately following such issue the aggregate nominal amount of the Additional Preference Shares to be issued, when added to the aggregate nominal amount of the Priority Preference Shares for the time being in issue, will not exceed an amount equal to 25 per cent. of the Adjusted Capital and Reserves; and (ii) the average of the profit after taxation and before extraordinary items and dividends on an annualised basis for the most recent three accounting reference periods of HBOS to have ended prior to the date of such issue for each such period exceeds four and one half times the aggregate annual amount of the dividends (exclusive of any imputed tax credit available to shareholders) payable in the then current accounting reference period on the whole of the issued share capital of HBOS which has priority to or ranks equally with the Priority Preference Shares (including any such share capital then being issued). For these purposes, the “Adjusted Capital and Reserves” means the aggregate from time to time of the amount paid up or credited as paid up on the issued share capital of HBOS and the amount standing to the credit of reserve accounts, including any share premium account and revaluation reserve and any credit balance on the profit and loss account all as shown in the balance sheet from the then latest accounts but after: (i) deducting from the aggregate any debit balance on the profit and loss account subsisting at the date of the accounts; (ii) deducting any amount referable to goodwill (arising other than on consolidation) or any other intangible asset; (iii) deducting an amount equal to any distribution (other than distributions to any member of the HBOS Group) out of the profits accrued prior to the date of the accounts; (iv) excluding any sums set aside for future taxation; (v) excluding any amounts attributable to outside interests in subsidiaries; (vi) making such adjustments as may be appropriate to reflect any variation in the amount of the paid up share capital or share premium account since the date of the accounts; and (vii) making such adjustments as may be appropriate to reflect the issue of the Additional Preference Shares then to be issued.

The Articles of Association of HBOS also restrict the circumstances in which HBOS can redeem or declare dividends on shares. Article 5.17 provides that HBOS cannot redeem or declare, or set aside any sum for the payment of, any dividends on any series of preference shares or any other shares which rank *pari passu* with, or junior to, such series of preference shares in circumstances where, in respect of all other series

of preference shares and any other shares which rank equally with the preference shares and have the benefit of Article 5.17, such preference shares are shares in respect of which the directors of HBOS are required (save where to do so would result in a breach of U.K. banking capital adequacy requirements) to declare dividends if there are profits available to do so and (i) all dividends on cumulative preference shares (including dividend arrears) have not been fully paid or a sum has not been set aside for full payment or (ii) dividends on non-cumulative preference shares have not been fully paid or a sum has not been set aside for full payment or, if the Holders of such non-cumulative preference shares are entitled to additional non-cumulative preference shares in lieu of a dividend, such additional shares have not been allotted and issued, in each such case (i) and (ii) on the relevant dividend date(s) or in respect of the relevant dividend period(s).

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

## Registered Office of the Issuer

22 Grenville Street  
St Helier  
Jersey JE4 8PX  
Channel Islands

## REGISTERED OFFICE OF HBOS

**HBOS plc**  
The Mound  
Edinburgh EH1 1YZ

## LEAD MANAGERS

**Deutsche Bank AG, London  
Branch**  
Winchester House  
1 Great Winchester Street  
London EC2N 2DB

**J.P. Morgan Securities Ltd.**  
125 London Wall  
London EC2Y 5AJ

**UBS Limited**  
1 Finsbury Avenue  
London EC2M 2PP

## PRINCIPAL PAYING AND TRANSFER AGENT

**Citibank, N.A.**  
Citigroup Centre  
Canada Square  
Canary Wharf  
London E14 5LB

**REGISTRAR**  
**Citigroup Global Markets**  
**Deutschland AG & Co. KGaA**  
Reuterweg 16  
60323 Frankfurt  
Germany

## LEGAL ADVISERS

*To the Issuer as to the laws of  
Jersey*  
**Ogier**  
Whiteley Chambers  
Don Street  
St Helier  
Jersey JE4 9WG

*To HBOS as to the laws of  
Scotland*  
**Shepherd+Wedderburn**  
Saltire Court  
20 Castle Terrace  
Edinburgh EH1 2ET

*To HBOS as to  
the laws of England*  
**Linklaters**  
One Silk Street  
London EC2Y 8HQ

*To the Lead Managers as to  
English law*  
**Clifford Chance**  
**Limited Liability Partnership**  
10 Upper Bank Street  
London E14 5JJ

## AUDITORS

*To the Issuer*  
**KPMG**  
5 St. Andrew's Place  
Charing Cross  
St. Helier  
Jersey JE4 8WQ  
Channel Islands

*To HBOS*  
**KPMG Audit Plc**  
Saltire Court  
20 Castle Terrace  
Edinburgh EH1 2EG