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Materials

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FISCAL YEAR

12-31-01

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Halifax Group PLC

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The New Force



INTELLIGENT FINANCE™
a division of STIHLER plc



CLERICAL MEDICAL
the choice of the employers



St Andrew's
GROUP



CAPITAL BANK
COOPERATIVE BANK GROUP



THE MORTGAGE BUSINESS

Group Contribution

- £1.403m profit (2000 £1.567m)
- 47% contribution
- £131bn customer lending
- 32,000 colleagues

Strategic Objectives

- Market leadership in mortgages and savings
- Fastest growing banking and consumer credit brands
- The UK's most successful bancassurance operation

Brands

- Halifax
- Bank of Scotland
- Intelligent Finance
- Birmingham Midshires
- Halifax Estate Agents
- The Mortgage Business

Group Contribution

- £772m profit (2000 £593m)
- 26% contribution
- £70bn funds under management
- 8,000 colleagues

Strategic Objectives

- Offer customers a wide choice of brands with multi-channel access
- Growth in asset management business
- Single low cost scale platform for growth

Brands

- Halifax
- Clerical Medical
- St. James's Place Capital
- esure
- St Andrew's
- Halifax Equitable
- Bank of Scotland Investors Club

Group Contribution

- £308m profit (2000 £290m)
- 10% contribution
- £19bn customer lending
- 6,000 colleagues

Strategic Objectives

- Break the mould in business banking
- Creative solutions for customer value
- Major market presence in England and Wales

Brands

- Bank of Scotland
- Capital Bank
- Lex Vehicle Leasing/Godfrey Davis
- Hill Hire
- Bank of Scotland Ireland/ICC Bank
- Capital Finance Australia

Group Contribution

- £515m profit (2000 £376m)
- 17% contribution
- £35bn customer lending
- 1000 colleagues

Strategic Objectives

- Growth from the enlarged balance sheet
- Franchise extension in UK, Europe and North America
- Quality earnings growth based on sound credit quality
- To be the standard by which others are judged

Brands

- Bank of Scotland

Group Contribution

- £169m profit (2000 £210m)
- 6% contribution
- £11.8bn assets - eightbn assets
- 5000 colleagues

Strategic Objectives

- First choice provider of Treasury Solutions to HBOS customers
- Sustained quality earnings profile
- Pre-eminent sector centre within

Brands

- HBOS Treasury Services

Profit £3.0bn
 Assets £312bn
 Customers 20m
 Colleagues 60,000
 Shareholders 2.8m

*Before tax, excluding items and minority interests

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Shareholder Information

Financial Calendar

27 February 2002	Annual Results announcement
13 March 2002	HBOS plc Ordinary Shares ex-dividend date
15 March 2002	HBOS plc Ordinary Shares record date
8 May 2002	HBOS plc Preference Shares ex-dividend date
10 May 2002	HBOS plc Preference Shares record date
15 May 2002	Annual General Meeting
31 May 2002	Payment of final ordinary dividend for 2001
31 May 2002	Payment of HBOS plc Preference Shares dividend
25 July 2002	Interim Results for 2002 announced
14 August 2002	HBOS plc Ordinary Share ex-dividend date
16 August 2002	HBOS plc Ordinary Share record date
25 October 2002	Payment of interim ordinary dividend for 2002
6 November 2002	HBOS plc Preference Shares ex-dividend date
8 November 2002	HBOS plc Preference Shares record date
2 December 2002	Payment of HBOS plc Preference Shares dividend

Useful Contacts

For general enquiries about your shares, call our Registrars on 0870 702 0102 or write to Computershare Investor Services PLC, PO Box 1909, The Pavillions, Bridgwater Road, Bristol BS99 7DS.

Share Price

For the current share price call the Halifax Share Dealing Price Line on 0901 4700 007. Calls are charged at 60p per minute at all times and should last no longer than one minute.

Halifax Share Dealing Limited (HSDL)

To buy or sell HBOS plc shares call HSDL on 08705 711 117. If you wish to open a self select mini or maxi stocks and shares ISA with HSDL please call 0870 24 33 444. Halifax Share Dealing Limited is regulated by the Financial Services Authority, a member of the London Stock Exchange and an Inland Revenue approved ISA Manager.

Internet

Visit our home page at www.HBOSplc.com

Registered Office

HBOS plc, The Mound, Edinburgh, EH1 1YZ

Registered Number

SC218813

Share Register Analysis at 31 December 2001

Size of shareholding	Number of shareholders	%	Number of ordinary shares	%
1 – 200	1,192,780	42.46	208,856,236	5.86
201 – 1,000	1,473,403	52.44	577,193,664	16.18
1,001 – 5,000	132,667	4.72	180,531,931	5.06
5,001 – 10,000	5,063	0.18	36,080,695	1.01
10,001 – 50,000	3,950	0.14	77,935,339	2.19
50,001 – 100,000	460	0.02	32,528,036	0.91
over 100,000	1,152	0.04	2,453,441,190	68.79
Total	2,809,475	100	3,566,567,091	100

The New Force

The new agenda:

1. Greatest customer advocacy
2. Most motivated colleagues
3. Highest sector rating

Chairman's Statement

HBOS – a new scale of earnings power

The merger gives us scale where it was needed, support where growth would have been inhibited, and earnings power driven by superb products and services.

Highlights:

- shared values, shared vision, and an ambition to seek out new opportunities
- the right conditions for the 'new force in banking' to make great strides in 2002
- the best people from an exceptional pool of talent

A merger of equals

This is the first Annual Report of HBOS plc, a new company created from the merger between the Bank of Scotland and the Halifax. I will spare the reader a standard Chairman's comment on the numbers as if the merger had not happened. They are what they are – the starting point for life as HBOS.

A quote from the Bank of Scotland's last Annual Report by Sir John Shaw, the Governor of Bank of Scotland at the time of the merger, gives a good insight into why Halifax and Bank of Scotland grasped the opportunity to create additional value for shareholders, despite our scepticism of consolidation in general.

"The Group has exhibited two characteristically fundamental strengths – an ability to stretch itself to grasp large-scale opportunities and a willingness to learn the right lessons from the marketplace".

Penned from a Bank with a 305-year history, the acceptance of change in markets and the way in which value should be delivered to customers and shareholders alike resonated loudly with the operating philosophy at Halifax. Even an organisation as cautious about consolidation as the Halifax could see that here was an organisation with shared values and an ambition to seek out new opportunities to move forward.

Merger discussions were concluded quickly following the first meeting between the

two teams. The speed of the merger demonstrated the shared vision of where the growth opportunities would lie and an excitement at the thought that the position as the new force in banking was ours for the taking. This was a merger of equals, where relative size was always secondary to the shareholder value that teams with a shared vision can create.

A new scale of earnings power across the business

As this Annual Report is being put together, it is difficult to assess the scale and impact of the economic slowdown. However, as I write this Chairman's report in early 2002, I can report that all our businesses had an excellent year and are continuing to perform well.

The scale of the new earnings power is evident with strong sales and clear growth.

In Retail the focus on simple products and real value for both new and existing customers has been rewarded with exceptional performances in mortgage lending, savings inflows, current account and credit card sales. We all feel a real buzz in the branches with the knowledge that we are developing long-term profitable relationships with our customers. And when I see what Intelligent Finance has achieved in its first year, I congratulate my colleagues. They ignored the short-term siren calls to scale down investment in anything to do with new channel development.



Dennis Stevenson

My main business activities are as Chairman of Pearson plc and HBOS plc, having been Chairman of Halifax Group plc. I am also a Non-Executive Director of Manpower Inc.

In the Insurance & Investment businesses sales were equally impressive with particularly strong contributions from Clerical Medical and the Bancassurance operations increasingly benefiting from sales generated by the newly acquired former Equitable salesforce. I am glad to report that esure is off to a good start leveraging the benefits of banking customer data and the lower cost of new channel based operations. This year's launch of the Asset Management business as a standalone, separately branded investment house will capitalise on the outstanding investment performance of Clerical Medical and provide a new platform for growth in the investment market.

Rarely have two great brands and two great organisations combined to offer so much potential for extraordinary growth.

In Corporate Banking the growth rate of over 30% – continued this year – gives good grounds for confidence in the team's ability to grow quality assets, at a time when fair weather lenders leave the scene pleading prudence as an excuse for capping their provisions growth. We make no apology for growing this business, based as it is on a sound philosophy of long-term customer partnerships. This will see provisions grow, as they have this year, reflecting not only strong asset growth but also the reality of the current economic conditions. Sticking with customers through the difficult times and working through problems with them is just as much a part of the deal as the initial loan terms themselves – something our customers can rely on as they make long-term decisions about their businesses and their partners.

Business Banking with around a 20% underlying growth rate in 2001 will make

a big noise in 2002 as that business competes head on in a market where value to the customer is limited and the conditions exist for the new force to establish a clear alternative.

Treasury, where perhaps the most obvious merger of similar operations is now under way, will pursue a clear but primarily customer focused strategy. This reflects the reality that the quality of earnings for this part of our business is best served by focusing on customer flows both internal and external together with low risk securities investment, rather than more volatile proprietary trading activities.

BankWest, in which HBOS's shareholding at 31 December 2001 was 56.3%, not only implemented a major organisational restructure, but also increased profits by 16% as it increased its share of the national market.

The merger combination gives scale where it was needed, balance sheet and funding support where growth would have been inhibited and a new scale of earnings power driven by product and service propositions that attack the entrenched competition. Rarely can two great brands and two great organisations have combined with so much potential for extraordinary growth.

A 'fudge free' management team The new line-up sees an array of exceptional talent leading the operating divisions drawn from Bank of Scotland and Halifax. We haven't messed about with some uneasy peace derived from 'one for you and one for me'. Instead we put the best people in the right jobs irrespective

of their previous home. Cutting through the usual merger distractions in this way meant that on day one of the merger, we hit the ground running with all the senior appointments agreed. Within three months all the supporting team decisions were made and management concentrated on business performance with integration very much part of the business-as-usual task list.

We welcome to the Board Phil Hodgkinson (from Zurich Financial Services) to head up the Insurance & Investment Division. With over twenty years experience in that industry and a belief that there is always something better than the status quo, Phil has already found himself very much at home in HBOS.

I thank the Directors from both Bank of Scotland and Halifax who stood down this year as part of the merger. Their contribution over many years to both organisations was self-evident in the strength of both Boards and the selfless nature of those who have stood aside to see a new Board created for HBOS. I also want to thank the 60,000 colleagues who are now embarked on the new venture that will see the reality of 'the new force in banking'. They have achieved tremendous results in 2001 at a time when for many they have had to grapple with the inevitable personal uncertainties of a merger.

2001 was an exhilarating year for me as your Chairman, firstly as Chairman of Halifax and now as Chairman of HBOS. I am acutely aware of the proud heritage of both Bank of Scotland and Halifax and my colleagues and I are determined that our efforts will reflect and live up to this heritage. HBOS is focused on delivering value for its shareholders. I have great confidence in our ability to make great strides in this in 2002.

Dennis Stevenson
Chairman

Deputy Chairman's Statement

Banks have delivered poor value for customers and transient value for shareholders – we intend to change that

Our two businesses have a common philosophy and little overlap.

Highlights:

- two complementary businesses
- early clarity on management roles and responsibilities
- we will deliver £690m of synergies

The announcement in May of the merger between Bank of Scotland and Halifax was greeted with remarkable enthusiasm. I use the word 'remarkable' because it is rare that the market greet a no-premium, all-paper merger with any enthusiasm at all. And in our case there were no slash-and-burn type cost savings. So the well-nigh universal acceptance was as pleasant a surprise as it was a sensible reaction. It is a very good transaction for our shareholders, for our staff and our customers – and one which our competitors will come to hate!

The real problems in a merger come from ensuring that people work together and that the corporate cultures fit. That is why takeovers are usually easier to manage: there is no dubiety, nor argument as to which culture is going to dominate. But here we were extremely fortunate. Bank of Scotland and Halifax have worked closely together over many years – for example Bank of Scotland processed Halifax's initial credit card portfolio and it also seconded a team of people to help in the aftermath of the property crisis at the start of the Nineties. So there were people in both organisations who had known each other over a long period. That helps. It also helped that our two businesses were largely complementary. There was very little overlap.

Effective integration starts with clarity in management roles and responsibilities. At the Divisional Chief Executive level, it was very obvious who should do what, driven by the relative pre-merger strengths of



Peter Burt

Having worked in the computer industry, I joined Bank of Scotland in 1975. In 1979, I became Assistant General Manager responsible for the Oil and Energy Department and then Head of the International Division in 1985. I was appointed Treasurer and Chief General Manager of Bank of Scotland in 1988 and Group Chief Executive in 1996.

Upon the successful completion of the merger of Halifax and Bank of Scotland I became Deputy Chairman of HBOS plc.

complementary businesses. Hence George Mitchell and Colin Matthew from Bank of Scotland head up Corporate and Business Banking respectively with Andy Hornby from Halifax heading up Retail for the Group. As Dennis has mentioned we welcomed Phil Hodgkinson just after the merger. In Treasury, where arguably the one real merger has had to occur, Gordon McQueen from Bank of Scotland now leads the new team.

On Day One of the merger, the top 50 senior appointments were in place and within three months the top teams comprising some 450 people in total were in place and driving their businesses forward.

Clarity of management and complementarity of businesses were important. Even in

projects which are split pretty much pro rata across the various businesses.

All that is important. But most important of all is the fact that both banks shared a common philosophy. Each had an objective of aggressive growth by providing a first-class service to our customers. Today we will provide the added value which will enable the combined business to grow strongly and profitably.

Having this shared philosophy – that providing better value and a better service to customers is the only way to create long-term growth in shareholder value, that profit is an outcome of running the business well for customers not an objective in its own right – made the

A bank's reach should exceed its grasp.

Information Technology where Bank of Scotland and Halifax might have appeared to have quite different philosophies, one seemingly biased towards outsourcing and the other in-sourced, in reality there was not much philosophical difference. Each business division is now in control of its own decentralised IT software with the centre in charge of the provision of infrastructure. Large-scale outsourcing arrangements are being reviewed in tandem with alternatives and the best solutions for HBOS will be applied.

Synergies are firmly embedded in the Divisional Profit Plans. Mike Ellis and I are charged with monitoring delivery and we are certainly making very good progress. We expect that the merger will deliver £690m of synergies over the next three years, an increase on our first assessment of £620m announced at the time of the merger. In total they come from no less than 70 major initiatives and some 240

decision to merge easy. It also is critical in the implementation of that decision.

Effective integration apart, the essential element in delivering performance is, as always, management. Here the merger has given HBOS an exceptionally strong management team. James Crosby and my colleagues, old and new, are extremely bright, extremely able and extremely well motivated. To (mis)quote Browning: "Ah, but a bank's reach should exceed its grasp, or what's a heaven for?" With such able colleagues, I am confident that we can both reach and grasp!

Peter Burt
Deputy Chairman

Chief Executive's Statement

A strategy to beat customer, colleague and shareholder expectations

It's a rare business indeed that delivers outstanding outcomes for all three stakeholder groups.

Highlights:

- our customers must be our greatest advocates
- our colleagues are central to our ambitions – they must be the most highly motivated in our industry
- our shareholders deserve growth – we will make sure it is quality growth

The creation of HBOS is all about growth, delivered through a pro-competition strategy which genuinely aspires to deliver outstanding outcomes for each of our three stakeholder groups: customers, colleagues and investors.

Customers' growth

The battle for customers' hearts and minds, whether they're individuals, companies or intermediaries, has never been nearly so important as it is today.

In so many areas our industry still evidences a failure of competition. But in due course those who manage their business in the belief that the customer won't vote with his feet or whose pricing maxim is to charge as much as they can get away with today, will fail.

HBOS accepts without question that to grow our relationships with customers, we have to deliver value, absolute transparency and quality service. And translating that into a customer stakeholder goal – quite simply our customers have to rate HBOS as the best since in the financial services market of the 21st century the real power is theirs.

An army of advocates

Every time our customers make contact with any HBOS business, at a branch, over the phone or via the web, they will instinctively compare us to the competition and make a judgement about us. Colleagues right across HBOS have a massive say in that judgement.



James Crosby

My seventeen years in Scotland with Scottish Amicable included ten years as a fund manager followed by senior positions in IT, marketing, finance and corporate development. In the latter role I led the establishment of the joint venture with J Rothschild Assurance (1991) of which I was a director until 1994.

In 1994 I joined Halifax Building Society to set up a new bancassurance business and in 1996 then led the acquisition of Clerical Medical. On 1 January 1999 I was appointed Chief Executive of Halifax Group plc and became Chief Executive of HBOS plc upon successful completion of the merger.

We are hungry for growth and everywhere we set each other tough targets then work together to make them happen. Demanding performance absolutely needs a really top class team to make it happen but even more importantly it calls for 60,000 colleagues who are passionate about each and every one of HBOS's products and services; in short, an army of advocates.

A superior rating

The HBOS strategy is distinctive and challenging. And in our 60,000 colleagues, we believe we have the team to deliver it exceptionally well. But investors are both our judge and jury.

Through our delivery we must persuade them to rate our earnings higher than

offerings for customers extending from sophisticated complete advice provided by the St. James's Place partnership and the recently acquired former Equitable salesforce and the tailored support Clerical Medical gives independent advisers through to the in-branch Halifax consumer champion strategy we apply to mainstream investment products.

In Retail, this year's results demonstrate very clearly how a consumer champion strategy can produce exceptional growth. We have two imperatives; realistic pricing reflected in products that deliver real value to consumers and simple transparent charging so they know precisely what they are paying and why. Coupled with aggressive pro-consumer PR work and

then acting on their feedback is very much part of how we ensure the two-way flow that builds commitment to our company and its goals.

When we announced our merger we enjoyed extraordinary support from our colleagues across HBOS. We have to be sure to preserve and enhance that support in the months ahead. Nowhere is that more important than amongst our 4,000 IT professionals who will take the lead in the crucial area of IT integration over the next three years.

Great products and services, and the buzz created by combative marketing and advertising actually starring HBOS colleagues have encouraged some extraordinary improvements in product advocacy, where it matters most – in the front line, in front of the customer.

Everywhere, advocacy is reinforced by local share and cash based incentive schemes, which link rewards to local performance. These are measured by sales and retention, cost control and a host of other local factors. The bottom line is that good performance is rewarded, poor performance is not and exceptional achievements are rewarded exceptionally.

Growth but not at the expense of quality

To get the best rating for our earnings we must deliver growth but also earnings that are predictable and sustainable and therefore of the highest quality.

The newly created HBOS draws great strength both from its position as a low cost player in each of its core businesses and the sheer diversity of those businesses. The exceptional growth in sales so evident in these results, particularly in Retail and Insurance & Investment, shows just how fast productivity is improving; underlining the opportunity we have to make ourselves the lowest cost provider in each and every one of our businesses. And whilst all our

We will capitalise on the qualities which brought us together; in all our markets we aim to offer customers value, transparency and service.

anyone else's in the sector; and that is our core shareholder value goal.

Customers call the shots

Everywhere we seek to revolutionise the way our customers feel about us, always seeking to deliver something different and recognising that everyday we must earn the right to retain customers.

In Corporate, our competitive advantage is very heavily driven by our ability to innovate and respond quickly to our customers' requirements; key aspects of the Bank of Scotland pedigree. But we also pride ourselves on having the flexibility, whenever realistic, to see customers through the bad times as well as the good. After all a bank that pulls back at the first whiff of trouble does not deserve the partnership we seek with each of our corporate customers.

Last year our Investment businesses showed their real potential. We have a unique range

populist advertising for our core retail brands, Halifax and Bank of Scotland, these are the key ingredients of a truly mould-breaking consumer champion strategy. Intelligent Finance's futuristic banking concept is creating a whole new market and on the clear evidence of its first year's results its unique offering has enormous appeal to customers.

And in extending Bank of Scotland's SME banking services right across Halifax's distribution network in England and Wales, value, simplicity and aggressive marketing will also be at the centre of an ambition to create enduring growth for our shareholders by once again championing the interests of customers; this time in SMEs.

Colleagues make it happen

Earning the advocacy of all 60,000 HBOS colleagues is a tall order. Listening to colleagues' views through regular monthly polling and detailed annual surveys and

Chief Executive's Statement continued

divisions will deliver growth the inherent balance of our business will be preserved; in the medium term we are targeting earnings contributions of 50% Retail, 25% Insurance & Investment with 25% accounted for by Corporate, Business and Treasury.

In the midst of the economic slowdown we will see this year the importance of asset quality is not in doubt. And for HBOS this too is a source of comparative advantage. A well diversified balance sheet centres around residential mortgages which account for about two thirds of customer lending. And whilst we are achieving substantial growth in our consumer finance businesses, it is clear that this has not and will not be at the expense of credit quality.

In corporate and business lending we have a long established determination not to follow fashions. Diversification of our assets, their 'old economy' characteristics and our track record of working through tough situations with our customers are the hallmarks of a loan portfolio which will perform comparatively well; even in difficult times.

Finally, the HBOS merger brings together two of the most conservative Treasury operations in the City; perhaps best illustrated by the fact that 99% of the investment portfolio assets of the merged entity have credit ratings of A or higher. 86% are AAA credits.

Such cost advantages, diversity of business mix and asset quality, all emphasise the sheer quality of HBOS's earnings power. But more than anything else, it was Halifax and Bank of Scotland's shared vision of how best to exploit this quality which brought us together as HBOS; in all our markets we

aim to have customer propositions which offer value, transparency and service.

We will always be realistic on pricing and seek to achieve sustainable margins; the foundation of quality growth. Last year just such a strategy applied in the mortgage market paid huge dividends for HBOS with net lending market share soaring to 31%. At the same time our strategy of exposing exploitative pricing practices in current accounts has led to a revolution in banking; one that is operating very obviously in HBOS's favour.

Demanding goals, superior performance

Our new business has set itself the most demanding of goals – for customers, colleagues and shareholders alike. In doing so we have laid out the most distinctive strategy in our marketplace. These results show very clearly how this strategy is already delivering extraordinary growth in sales and balances; in Retail, Insurance & Investment, Business and in Corporate Banking. Delivering the merger synergies will boost earnings, but right from the start we believe we will be able to demonstrate underlying growth in each of our divisions; the real inspiration behind the creation of HBOS.

James Crosby
Chief Executive

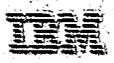
HBOS intends to deliver
outstanding outcomes for all its
stakeholders. We will..



have the most
motivated
colleagues...

Lynne Ferguson, a Customer Service Consultant at IF's Contact Centre in Livingston enjoys a little light relief at the end of another busy day.





BANK OF SCOTLAND
Online

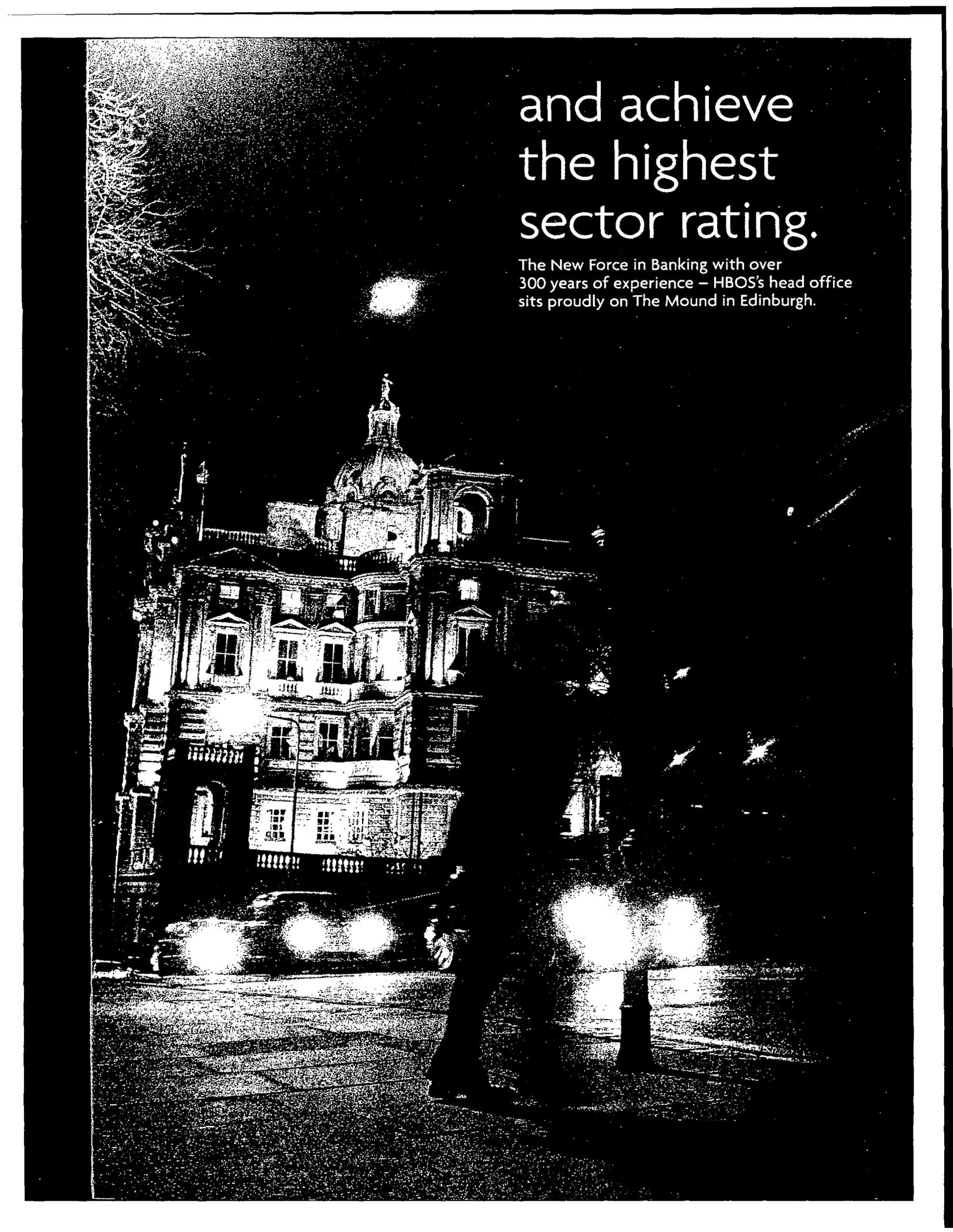
Customer Services

- Current Accounts
- Savings and Investments
- Loans & Mortgages
- Credit, Charge & Debit Cards
- Insurance & Travel

YOUR HOME IS AT RISK IF YOU DO NOT KEEP UP REPAYMENTS ON A MORTGAGE OR OTHER LOAN SECURED ON IT.

HALIFAX FINANCIAL SERVICES MARKETING

Close Exit



and achieve
the highest
sector rating.

The New Force in Banking with over
300 years of experience – HBOS's head office
sits proudly on The Mound in Edinburgh.

HALIFAX



win the
greatest
customer
advocacy...

20m customers, over a quarter
of mums, dads, kids...

The New Force in Retail Banking



Andy Hornby

At ASDA, I worked closely on the strategic development of the business. As Retail Managing Director I had responsibility for 36 stores and 14,000 employees, and was most recently Managing Director of George ASDA.

In November 1999 I joined Halifax as Chief Executive, Halifax Retail and was appointed to the Board. I am responsible for all the retail banking activities of Halifax and Bank of Scotland, which extend to some 1,500 retail banking and estate agency outlets.

Great value products coupled with transparent and honest communication delivered by the friendliest colleagues in the industry will create the most consumer-friendly bank in the UK.

Andy Hornby, Chief Executive, Retail Banking

Strategic aims

- market leadership in Mortgages and Savings
- to be the fastest growing Banking and Consumer Credit Brand in the UK
- to build the UK's most successful bancassurance operation

Revolutionising the customer experience

Angela Anderson from Queen's Street Branch, Glasgow, features in Bank of Scotland's advertising for current accounts.

The New Force in Retail Banking continued

Extraordinary distribution strength

The HBOS Retail Bank has the largest customer base and broadest distribution reach of any UK financial institution. Operating through five consumer brands serving an incredible 20 million personal customers. Each brand is positioned to compete in a specific market segment. Halifax and Bank of Scotland have a long tradition of serving mainstream consumers and are two of the strongest brands in the UK offering the complete range of financial services to this market. Intelligent Finance serves a generally younger and financially sophisticated consumer, with Birmingham Midshires and The Mortgage Business specialist brands meeting specific customers' borrowing needs.

Over a quarter of the British population have a relationship with at least one brand of the HBOS Retail Bank. No other UK financial institution comes close to such a large customer base. We operate across the entire range of financial services distribution channels (retail branches, agencies, estate agencies, telephone, Internet and via intermediaries).

With the Halifax and Bank of Scotland brands operating throughout the UK we have 1,100 bank branches. We are represented in every single major town in the UK, with many branches in prime retail sites. We are determined to be in the best locations for our customers.

We also operate 700 Halifax agencies (typically based within estate agents or solicitors) where customers can carry out basic banking transactions. These agencies have helped provide our customers in rural communities with banking services.

Through a chain of estate agency outlets we are the second largest estate agency in the country under the brand of Halifax Estate Agents providing home buying

services and also another distribution outlet through which we supply mortgages.

Through Intelligent Finance we are at the forefront of developing telephone and Internet banking. Intelligent Finance is a unique product concept which gives exceptional value for money for customers through 'netting off' a customer's borrowings and savings. In the first year of operation Intelligent Finance has built up over 155,000 customers and achieved a 9% share of the UK net mortgage lending market making it the most successful new generation bank in the UK.

To offer customers a complete choice of how they can do business with us through the Halifax and Bank of Scotland brands, we also run 11 Call Centres. Our 5,000 colleagues working in these Call Centres offer a complete range of products and services over the phone.

In addition, we also offer a comprehensive online banking service to Halifax and Bank of Scotland customers. Over 1 million customers now benefit from the convenience of this service and the great value offered by special online products, such as Websaver, a savings account customers can design for themselves and operate entirely over the Internet.

We are also the country's leading provider of mortgages through the intermediary channel. Operating under five different brands in this marketplace (Halifax, Bank of Scotland, Birmingham Midshires, The Mortgage Business and Intelligent Finance), we supplied over 30% of mortgages sold through intermediaries in 2001.

Our partnership and affinity relationships are very important to us and we are one of the leading providers of financial services through these channels. This enables us to reach an even wider customer base through joint venture operations with

major players such as Sainsbury's, Centrica and Zurich.

Being different and meaning it

For many years, retail banks in the UK have earned high profits from exploiting the inertia of their customer bases. Put most simply, banks have often offered expensive, complicated products which are difficult for customers to understand and all too often provided poor value for money. HBOS Retail Bank has set out to be fundamentally different:

We aim to offer customers outstanding value for money right across our product range.

Our products and prices are easy to understand.

We give our customers the choice of dealing with us through whatever channel suits them best – branch, telephone or the Internet.

Our biggest point of difference is that we are developing the friendliest and best motivated banking workforce in the UK. Nearly all of the 32,000 colleagues within the Retail Bank receive share options and all receive bonuses paid according to the performance of their individual branch. No other UK bank has such a radical approach to share based remuneration at all levels of the organisation.

Beating the competition

2001 has been an exceptional year for the HBOS Retail business. In each of our core markets we have delivered outstanding sales and market share growth:

We achieved an extraordinary 31% share of the net lending mortgage market. A 31% share of net lending means that HBOS has achieved around three times the market share of any other UK competitor. The main reasons for the substantial growth in 2001 were:

Mulhith Karim, Banking Advisor, Kensington High Street Branch, Halifax



Andi Wilby, Customer Service Advisor, Halifax Direct



Around 350,000 of our customers benefited from transferring to considerably cheaper long-term mortgage rates, definitive proof of Halifax's desire to be the 'customer's champion'.

Our mortgage market share in 2001 was also boosted by a massive contribution from Intelligent Finance who provided over £5.2bn of lending during the year, an extraordinary contribution for a new generation bank.

Birmingham Midshires and The Mortgage Business both had an exceptionally successful year in the specialist lending markets in which they operate. As a result HBOS is the clear market leader in buy-to-let mortgages and mortgages to self-employed customers.

Cross selling general insurance products on the back of our mortgages has made us a leading arranger of household insurance in the UK with over 778,000 policies sold through Retail channels in 2001.

Bank accounts

HBOS is the clear customer champion in current accounts in the UK. In 2001 we launched the high street account which currently pays 20 times more interest than the traditional high street banks. We also currently charge approximately half the overdraft rates of the main competitors. Identical pricing benefits have been offered to Bank of Scotland customers in 2002.

Most people who live in England, Wales and Northern Ireland will be familiar with the adverts starring Howard Brown from our Sheldon branch who has taken the nation by storm advertising to the tunes of 'Sex Bomb' and 'Angel'.

Bank of Scotland customers north of the border will similarly have found it hard to miss Angela Anderson from Glasgow and

her star performance in the Bank of Scotland's current account television advertisement.

The success of the new product range and the advertising has been extraordinary and HBOS has gained more than 22% market share nationally of new or transferred current account business over the last 12 months.

HBOS set out to establish itself as the clear No. 1 provider of new credit cards in the UK marketplace. In 2001, we issued more than 1.1m credit cards establishing us as comfortably the largest provider of new credit cards in the UK.

In the personal lending markets we have also achieved extraordinary growth in 2001 under both the Halifax and Bank of Scotland brands. Lending in these brands increased by 43% in secured personal loans and 35% in unsecured loans.

The Group also had an exceptional year in the savings market in 2001 and saw balances in savings and banking products increase by £8.5bn in the year.

The Group is comfortably the No. 1 savings provider in the UK with over 16 million customers and a massive £102bn of retail balances. Proof of the enduring popularity of the Halifax savings franchise stems from the fact that we achieved a 25% share of new money in to cash ISAs in the first six months of the 2002 tax year and sold over 115,000 Equity Tracker ISAs in 2001. This strong savings base gives us the platform on which we are building our successful investment business.

Our performance

Profit before tax, exceptional items and Intelligent Finance declined by £164m to £1,403m. The primary driver behind this change was the retail strategy of facing into unsustainable retail spreads. We have

therefore quite deliberately reduced our product spreads to improve customer retention and to compete aggressively for new business.

The planned reductions in retail spreads, the acceleration of sales and improvements in retention have all been in line with market expectations borne out of public statements on these issues. Overall the performance in operating income was stable despite accommodating the expected decline in the HBOS retail spread from 221bp to 207bp.

Non-interest income grew by £31m to £701m an increase of 5%. The pace of growth was impacted by a volume related increase in ATM interchange fees attributable to the success of our new current account product together with the withdrawal of surcharges for customers who use competitor ATMs, resulting in a £62m reduction in other income year on year.

Operating expenses grew by 10% in the year, primarily driven by additional staffing costs, technology investments and marketing. Staff costs grew by 6% overall as the growth momentum necessitated an increase in the numbers of front line colleagues to deliver the desired levels of sales performance and customer service. Technology spend particularly at Bank of Scotland increased as new investments were made in core branch banking systems. Marketing support for product sales required an increased investment in all broadcast media and in direct marketing with total spend here up 21%.

The overall charge for provisions increased by 3% reflecting the high quality asset growth and performance in the year. Overall, mortgage credit quality, as measured by arrears performance and closing provisions as a percentage of

Darren Scott, Customer Service Officer, Castle Terrace Branch, Bank of Scotland



31% of the UK's net mortgage lending

Halifax	£7.46bn
Bank of Scotland	£2.55bn
Intelligent Finance	£5.02bn
Birmingham Midshires	£0.76bn
The Mortgage Business	£1.21bn

The New Force in Retail Banking continued

loan assets again improved. Mortgages 3-6 months in arrears declined from 0.97% to 0.76% and total provisions as a percentage of advances declined from 0.38% to 0.32%. For the unsecured portfolio in total the level of provisions as a percentage of advances declined from 6.62% to 5.93%. In the credit card businesses, good progress has been made in reducing the provisions charge from 3.7% to 3.4% of average outstandings. Retail banking non-performing assets as a percentage of total lending has also reduced from 2.49% to 2.22%.

An improved performance in the Sainsbury's Bank and Centrica joint ventures has resulted in a 20% increase in overall contribution.

Credit quality improves again

Growth without strong asset quality merely devalues the earning quality. We target both growth and asset quality and have seen a further improvement in 2001. The credit risk performance of the retail lending portfolio is strong with all measures within agreed limits. Once again our focus in mortgage lending is towards the lower loan to value propositions and in consumer credit we have made good progress in reducing credit losses.

Excellent service is not optional

We continue to invest in delivering exceptional service to our customers. We use technology to make opening and running accounts easier for colleagues and customers. Service initiatives rolled out in 2001 include the new Halifax Mortgage Processing System which will enable most customers to get their mortgage offer at point-of-sale and a whole range of initiatives within call centres which ensure much faster response times for our customers.

Low cost advantage

Consistent with our desire to be the customer champion, we are fully committed to running the lowest cost retail bank in the UK. The merger provides us with the opportunity to extract £120m of cost synergies over the next three years.

The efficient way in which we manage our business means we can keep on giving our customers the sort of value which other banks simply don't provide. We are targeting total cost growth below 3% in 2002 and below RPI in subsequent years.

Making the merger work

Bringing together the Halifax and Bank of Scotland Retail businesses provides enormous benefits to customers and shareholders. Beginning in October 2002, the fascia of every branch in Scotland will be replaced to show Bank of Scotland as the primary name, flanked by the famous Bank of Scotland and Halifax logos.

Our product offer will reflect the individual strengths of each brand. North of the border Bank of Scotland will focus on banking and consumer credit and the Halifax on mortgages and savings. All our customers in Scotland will benefit from a wider, more competitive product range and even greater convenience. Halifax products will be available in five times as many Scottish branches as they are now.

The primary benefits to shareholders stem from the combination of product processing systems and the removal of duplicated central overheads.

We also expect a significant uplift in business volumes from the launch of Halifax branded mortgages, savings and long-term investment products into Bank of Scotland branches.

Where next?

HBOS is the most aggressive high street bank operating in the UK. Over the next three years we aim to consolidate our position as the clear No.1 in mortgages and savings in the UK marketplace. At the same time we will also continue our attack on the so-called 'Big Four' in their traditional markets of current accounts and credit cards. We are never afraid to set ourselves clear deliverables and in 2002 our aim is to deliver the following:

A net lending mortgage share of 25% to maintain our position as by far and away the nation's leading mortgage provider.

We will be the fastest growing UK bank in banking and consumer credit and aim to achieve a market share of 20% of both new current accounts and credit cards in 2002.

We will become the UK's number one bancassurer within three years.

Cost growth in HBOS Retail Banking including Intelligent Finance in 2002 of less than 3%.

This combination of industry leading sales growth, coupled with stringent cost control, will mean that the HBOS Retail Bank will provide exceptional returns for shareholders.

Over the next three years HBOS will ensure that the cosy world of the so-called 'Big Four' becomes a thing of the past. We are offering our customers a unique combination of outstanding value products, backed up with aggressive advertising, all sold by the friendliest banking workforce in the UK. The 'New Force in Banking' has truly arrived.

Emma Strachan, Executive Secretary, Intelligent Finance



Allan Scott, Customer Services Officer, Tollcross Branch, Bank of Scotland



Retail (excluding Intelligent Finance)	2001 £m	2000 £m
Net interest income	2,744	2,776
Non-interest income	701	670
Operating income	3,445	3,446
Operating expenses *	(1,798)	(1,640)
Operating profit before provisions *	1,647	1,806
Provisions for bad & doubtful debts		
Specific	(255)	(248)
General	(13)	(11)
Share of profits of associates and joint ventures	24	20
Profit before tax *	1,403	1,567
Net interest margin	2.22%	2.44%
Net interest spread	2.07%	2.21%

Net interest margin
The net interest margin fell 22 basis points from 2.44% to 2.22%. The movement is made up as follows:

	Basis Points	
Credit cards	2	
Mortgages	(9)	
Savings	(4)	
Banking	(3)	
Internal funding	(8)	
	(22)	

Cost: income ratio* 52.2% 47.6%

Total lending to customers** £130.6bn £116.7bn

Classification of advances	%	%
Home mortgages	92	93
Other personal lending:		
secured	1	1
unsecured	4	3
credit cards	2	2
banking	1	1

Total risk weighted assets £75.5bn £65.3bn

Non-interest income	2001 £m	2000 £m
Mortgages & Savings	338	304
Banking	191	214
Credit cards	113	87
Personal loans	8	11
Other	49	44
Net fees and commissions receivable	699	660
Profit on sale of investment securities	5	9
Other operating income	(3)	1
Total	701	670

Operating expenses* 2001 2000
£m £m

Staff	702	660
Accommodation, repairs and maintenance	55	50
Technology	73	54
Marketing and communication	246	203
Depreciation:		
Tangible fixed assets	33	31
Other	163	155
Subtotal	1,272	1,153

Recharges		
Technology	224	189
Accommodation	127	130
Other shared services	175	168
Total	1,798	1,640

* Excluding exceptional items.

** After securitisation of £1.5bn of mortgages.

Intelligent Finance	2001 £m	2000 £m
Net interest income	(22)	-
Non-interest income	(2)	-
Operating income	(24)	-
Operating expenses	(118)	(88)
Operating loss before provisions	(142)	(88)
Provisions for bad & doubtful debts		
Specific	(10)	-
General	(2)	-
Loss before tax	(154)	(88)
Total lending to customers	£5.4bn	£0.1bn
Total risk weighted assets	£2.8bn	£0.1bn

Sarah Rowleson, Customer Services Assistant, Strand Branch, Halifax



£102bn

HBOS has £102bn in savings and banking balances.



The New Force in Insurance & Investment



Phil Hodkinson

I've worked in the insurance industry throughout my career. After training with an actuarial consultancy, I joined Allied Dunbar in 1984 and rose to Managing Director before moving to Eagle Star Life as Chief Executive. More recently, I ran the UK Life business of Zurich Financial Services and immediately prior to joining HBO's was the founder of Zurich's UK Enterprise portfolio of new insurance, banking and e-commerce operations.

I was appointed Chief Executive of Insurance & Investment at HBO's plc in September 2001 upon the successful completion of the merger.

We are challenging the way traditional insurance & investment businesses drive value for customers and shareholders.

Phil Hodkinson, Chief Executive, Insurance & Investment

Strategic aims:

- to offer customers a wide choice of brands with multi-channel access
- growth in asset management business
- to leverage the cost advantage of a single customer service platform across our life and pensions businesses

A New Force in customer service
Julie Donaghy, Personal Financial Advisor, Halifax Estate Agents, Mansfield

The New Force in Insurance & Investment continued

The need for a personal safety net

People are increasingly aware that they will need to provide for and protect their own financial futures. Not only can they expect to live longer but also they realise that social welfare will only offer a minimum safety net. This growing realisation has made the UK insurance & investment market the largest and one of the fastest growing in Europe today.

At the same time, individuals are becoming more demanding in terms of the value for money and the service that they expect financial services organisations to deliver. They want to deal with brands they can trust, and with people who can advise them well. And so, an increasing amount of their business goes to fewer and fewer companies. Against this background, our aim is to be the 'New Force in Insurance & Investment' – the organisation that customers turn to first for advice and products that will help them protect and grow their personal assets.

Challenging the norm

Our strategy is to offer our customers a wide choice of brands, each capable of meeting customer specific needs, and a wide choice of access, whether it be through our branches, via financial advisers, or directly by phone or internet. This diversity of choice positions us well in a market in which customers are looking for expertise and many don't want to place all their eggs in one basket. Also, in the face of changing regulation, this diversity of distribution and access to customers provides our shareholders with the confidence that HBOS is well placed to continue expanding its offering whatever the regulatory regime.

Great brands

Under the Halifax brand we offer Halifax and Bank of Scotland retail and business banking customers straightforward, value for money products that enable them to invest for the future and to protect their finances and personal assets. These products form an integral part of the trusted service we provide customers, whether it be through our in-branch mortgage and savings reviews, or directly by phone, mail or Internet.

Halifax's strong franchise in savings and mortgages provides us with clear competitive advantages relative to other retail groups, and the acquisition of the Halifax Equitable sales force in 2001 gives us the opportunity to extend these advantages to our professional and business customers as we move forward.

Under the Clerical Medical brand, we offer pension and investment products through Independent Financial Advisers (IFAs), the most influential distribution channel in the UK investment market. Backed by a strong with profit fund and excellent investment performance, our focus is to deliver products and services to IFAs that will enable them to advise their customers well. Progress towards Clerical Medical's goal of being the 'choice of the professional' can be measured by our increasing share of the UK IFA market and the many awards we regularly win from the IFA community.

In Continental Europe, Clerical Medical is growing rapidly and is well placed to take advantage of many exciting opportunities, particularly in pensions.

St. James's Place Capital, in which we hold a 60% stake, offers expert advice and a broad range of wealth management services. The St. James's Place Partnership is one of the most productive financial

David Brown, Head of General Insurance Products & Pricing, Halifax General Insurance



James Mclellan, Director US Equities, Clerical Medical Investment Management



advisory businesses in the UK, and the development of St. James's Place Bank, in conjunction with IF, has further strengthened the range of services that Partners are able to offer.

esure, our telephone and internet joint venture start-up with Peter Wood the founder of Direct Line, offers competitive motor and home insurance directly to the public via the telephone and internet, as well as underwriting Halifax branded car insurance. Utilising state of the art management information and a unique pricing model, esure intends to 'break the mould' of traditional insurance.

The St. Andrew's Group has an established reputation within the industry as an expert provider of repayment insurance. It enables many partner organisations to offer 'own label' repayment insurance to their customers as well as providing insurance to Bank of Scotland customers.

One + one = £2bn +

With over £1bn in effective new premium income from the Investment businesses, 55% growth compared to 2000, and over £1bn in gross written premiums from the Insurance business, 21% growth compared to 2000, we have broken through the £2bn sales premium income barrier. Profit before tax and exceptional items in 2001 was £772m, an increase of 30% compared to 2000 and contributing 26% towards Group profit before tax, exceptional items and Intelligent Finance.

Insurance businesses ... capturing the market's imagination

Overall sales of insurance products through the Halifax, St. Andrew's and esure brands, as measured by gross written premiums, increased by 21% to £1,064m in 2001 and the number of in-force policies rose by 20% to 4.7 million.

	Number of In-force Policies		Gross Written Premiums	
	2001 000s	2000 000s	2001 £m	2000 £m
Household	1,963	1,857	344	337
Repayment	2,160	1,581	631	466
Motor	490	425	75	66
Other	87	48	14	12
Total	4,700	3,911	1,064	881

Household policies in force, grew by 6% in just one year as a result of the increased mortgage lending and improved cross-sell performance both direct and through intermediaries. We are one of the largest arrangers of household insurance in the UK. During the year, the Halifax household insurance team won the coveted 'claims team of the year' at the British Insurance Awards.

Repayment insurance grew strongly by 37% as a result of increased personal loan and credit card volumes but also reflecting St. Andrew's success in attracting more third-party business. The merger of St. Andrew's with Halifax's own insurance operations later in 2002 will create one of the largest suppliers of repayment insurance in the UK.

Motor insurance policies in force grew by 15% as a result of the successful launch of esure, which not only offers its own branded insurance directly to the public but also underwrites the Halifax branded car insurance. Its unique insight to the pricing of insurance is already challenging traditional competitors.

Investment businesses ... growing ahead of the market

Overall sales of investment products through Halifax, Clerical Medical and St. James's Place brands, as measured by effective premium income (new annual

premiums plus 10% of single premiums), increased by 55% to £1,104m in 2001, well above the predicted market growth.

Sales of pensions doubled and despite a second year of declining stock markets sales of collective investment products advanced by around a third.

Notwithstanding strong growth outside the UK, domestic business still accounts for around 90% of sales.

Effective Premiums*	2001 £m	2000 £m
Life	598	426
Pensions	373	183
Collective Investment Schemes	133	103
Total	1,104	712

Intermediary	593	354
Bancassurance	306	173
Wealth Management	205	185
Total	1,104	712

Regular	361	194
Single (10%)	743	518
Total	1,104	712

* One tenth of single premiums plus all annual premiums.

Bancassurance sales enjoyed very strong growth of 77% as a result of increased adviser numbers and productivity, the continued success of CAT marked tracker ISA sales via non-regulated branch staff and Halifax Equitable's first time contribution. In the existing bancassurance business, sales quality improved; first year persistency in 2001 was over 98%.

After an understandably slow start following the acquisition of Equitable Life's operating assets in March 2001, the Halifax Equitable sales force, ended the year strongly with new effective

Muhammad Arshad, Travel Sales Technician, Halifax General Insurance



£2bn

HBOS has broken through the £2bn barrier for total premium income.

The New Force in Insurance & Investment continued

premiums of £22m in the last quarter of 2001.

UK IFA sales grew strongly by 64% as Clerical Medical capitalised on its investment track record and financial strength. Sales of group pensions hit record levels following the Government's introduction of Stakeholder Pensions in April 2001.

Our developing cross border business in Continental Europe continues to show strong growth through sales of investment products through intermediaries in territories such as Germany, Italy, Austria and Belgium. Overall, overseas sales grew by 83%. The transition of our business systems to the Euro at the start of 2002 went smoothly.

Despite the depressed stock market, sales at St. James's Place Capital, the wealth management group, increased, by 11%, building on the previous year's exceptional 42% increase in sales. Partner numbers increased to over 1,100 and once again productivity improved as the partnership achieved a 41% increase in sales in the pensions market.

Our asset management business embarked on an expansion strategy designed to exploit its strong investment track record. Funds under management rose by 93% to around £64bn as a result of the acquisition of The Equitable's investment mandate, bringing total funds under management for the Group, including St. James's Place, to over £70bn. 2001 was another good year for performance, with 63% of funds above median. In 2001, Professional Pensions magazine voted Clerical Medical 'Best Major Balanced Fund Manager over 3 & 5 years' and we were also awarded the 'Golden Star Group of the Year' at the UK Pensions Awards 2001.

% funds above median	3 years	5 years
Life	78%	89%
Pension	75%	88%
Collective Investments	64%	64%
All funds	69%	74%

Source: CAPS, Hindsight @ Reuters Ltd

Strong financial performance

Profit before tax and exceptional items in 2001 was £772m, an increase of 30% compared to 2000, contributing 26% towards Group profit before tax, exceptional items and Intelligence Finance. Insurance profits advanced by 11% to £328m and profits across our investment businesses increased by 49% to £444m.

Overall operating income grew by 30% to £980m. General insurance premium income grew by 179% to £265m following the decision by Halifax during 2001 to underwrite its own repayment insurance business. This resulted in premium income of £122m in addition to the £143m generated by Bank of Scotland. Conversely the fall in other net fee income reflects the reduction in commissions previously received from the former underwriters of Halifax repayment insurance. This has, however, been more than offset by the increase in premium income.

The increase in OEIC and unit trust management fees reflects the full year impact of St. James's Place's contribution increasing from £18m to £33m, an increased contribution from Halifax Financial Services of £34m, up from £25m in 2000, and £4m from the Bank of Scotland Investors Club. Fund management fees of £26m relate to The Equitable investment mandate acquired in March 2001.

Overall expenses, before exceptional items have grown by 28%, the increase relating entirely to the additional running costs of the operations acquired from The Equitable

and the establishment of the Halifax repayment insurance business. These additional expenses were more than matched by additional income.

Step changes in 2002

Our Insurance & Investment business is already one of the largest in the UK and our ambition is to become the UK's leading Insurance & Investment group. Important milestones en route towards this goal are to be the UK's largest arranger of personal insurance, the UK's largest bancassurer and a top three IFA office.

In 2002, we have a number of initiatives designed to take us towards these milestones. We will extend the Halifax range of Insurance & Investment products to Bank of Scotland retail customers north of the border in the first quarter and to business banking customers south of the border by the second quarter of 2002. These initiatives will be further supported by the launch of a new range of simple, 'no load' Halifax investment products and the introduction of our new Investment Review Service through which we will offer our customers the opportunity to review their savings and investment provision.

Insurance product sales will also be strengthened by the launch of a new range of travel insurance products that will be underwritten 'in house' by St. Andrew's. The integration of our repayment insurance businesses will be complete by the end of 2002.

A significant development, planned for 2002, is the launch of our asset management business as a standalone, separately branded investment house which will be launched into the IFA market in the second half of the year. The asset management business will also have a major presence in the retail and institutional investment markets. With an excellent

Mark Bryan, Customer Service Advisor, Halifax General Insurance



Rachel Collingridge, Systems Developer, Clerical Medical Investment Management



reputation for performance, this development will enable us to 'punch our weight' in the investment market.

Another important initiative in 2002 will be the creation of a single customer service division for our life and pensions businesses. In time, this will enable us to process all life and pensions business on a single business model based on the platform acquired from Equitable Life and will further strengthen our ability to deliver value for money to our customers.

With excellent brands, diverse distribution, millions of customers, financial strength and many talented people, we are uniquely positioned to achieve our ambition to be the 'New Force in Insurance & Investment'.

	2001 £m	2000 £m
Net interest income	18	16
Non-interest income *	962	737
Operating income *	980	753
Operating expenses *	(194)	(152)
Operating profit *	786	601
Share of profits of associates and joint ventures	(14)	(8)
Profit before tax *	772	593

	2001 £m	2000 £m
Non-interest income		
Income from long-term assurance business	443	288
General Insurance premium income	265	95
Claims payable	(68)	(11)
OEIC/Unit trust management income	71	46
Fund management income	26	-
Other net fee income	212	318
Other operating income	13	1
Total	962	737

Operating expenses *	2001 £m	2000 £m
Staff	75	41
Accommodation, repairs and maintenance	12	2
Technology	1	1
Marketing and communication	8	7
Depreciation:		
Tangible Fixed Assets	3	1
Other	75	74
Subtotal	174	126
Recharges		
Technology	14	15
Accommodation	3	3
Other shared services	3	8
Total	194	152

* Excluding exceptional items

	2001 £bn	2000 £bn
Funds under management	70.2	39.9

Ruth Taylor, Sales Development and Marketing Assistant, Halifax General Insurance



4.7m

HBOS has 4.7m in-force insurance policies.



The New Force in Business Banking



Colin Matthew

I joined the Bank of Scotland straight from school and have a wealth of experience gained from the wide range of responsibilities I have held. I have been Assistant and also Divisional General Manager UK Banking - England and had responsibilities as General Manager for both Bank of Scotland Treasury Services PLC and UK Banking - England. In 1999 I joined the Group Management Board, became Chief Executive of the Division of Business Banking and was appointed as an executive director of the Bank of Scotland board in 2000.

Under my leadership the division has undergone a complete re-orientation of business and financial activities in the SME market and the strategic focus has been to:

Business Banking has huge opportunities in the SME market. There is real excitement at the prospect of taking a significant market share from the 'Big Four' Clearing Banks. We have a unique and compelling proposition. Success is now down to us.

Colin Matthew, Chief Executive, Business Banking

Strategic aims:

- to break the mould in business banking
- to seek creative solutions that deliver value to our customers
- to achieve a major market presence in England and Wales

Better business banking

Hilda Dewar, a SME customer, enjoys the benefits that Bank of Scotland's Business Banking experience provides.

The New Force in Business Banking continued

A wealth of experience

Business Banking has a wealth of experience in the key SME market providing a full range of banking services to businesses with a turnover up to £10m a year. We're also a leading player in Asset and Motor Finance and provide specialist support and finance in many sectors including Vehicle Management and Contract Hire. In addition the division has successful and rapidly growing businesses in Ireland and Australia.

Our 33% market share in Scotland demonstrates our success and provides a strong platform for growth across the entire UK. Our track record and product mix together with the Halifax network in England and Wales give us an unparalleled opportunity to provide good value products and services in a sector not known for it.

With the Competition Commission encouraging a further opening up of the SME market, there is a clear opportunity for a bank to take a strong lead in business banking – no one is better placed to do this than we are.

Breaking the mould

We aim to be the only dedicated business bank that can break the mould in business banking.

We will treat businesses like people, recognising that those running businesses are individuals. We have a passion to actively seek more creative solutions that deliver value to our customers.

Expectations are changing with a growing demand for more flexible banking arrangements. We will meet these expectations by providing the customer with a range of options for how they do business with us.

A recent NOP report showed that more than half of all small businesses would consider switching their business banking account if they could earn a competitive rate of interest. The same survey also showed that around two thirds of SMEs said that it would be a major incentive for them to change their bank if they were offered a switching service together with a competitive rate of interest.

We will give the business customer a helping hand in switching accounts, and give them superior banking arrangements. We have also introduced Interest Bearing Current Accounts as standard. No competitor from the 'Big Four' has matched this.

Customers already perceive us to be doing things differently from other banks. Our position is that of Business Champion, the Business Bank in tune with its customers requirements.

In Asset and Motor Finance we aim to continue to take market share. In Contract Hire the combination of Bank of Scotland and Halifax moves us into a strong leadership position.

Business customers recognise this market needs shaking-up. They want things to be done differently. They want better products and a better service. With innovative market leading products and a new approach, we will be the bank that dares to do things differently.

Bank of Scotland Business Banking... in England and Wales

The merger of the Bank of Scotland and Halifax opens up huge opportunities. Combining the strengths of both businesses provides an excellent base for a strong challenge to the four clearing banks. We are building on strong foundations with the Bank of Scotland brand. Potential customers see us as a bank with an

established track record of experience, stability, credibility and innovation. Following the merger we now have a nation-wide presence on the high street and can maximise those opportunities previously unavailable to us.

For our significant expansion plans over the next 3 years we will be recruiting 1,500 additional colleagues. We have drawn on resource from our Retail Division for a number of Business colleagues and have undertaken a major recruitment campaign to attract seasoned banking professionals away from the competitors. They will be based in Halifax branches with dedicated business banking facilities and on a mobile basis covering our key target areas. Our Retail colleagues are targeted to provide around 1,000 leads each and every day to these new business banking teams.

A large number of these leads will initially be picked up by our dedicated Direct Business Banking unit who will arrange for one-to-one contact where needed to secure the business proposition.

This combination of the Halifax retail network along with Bank of Scotland's business banking experience is the essential catalyst for the creation of the 'New Force in Business Banking'.

Growth continues

2001 has been a year of continued growth for the Division. Operating income rose 11% to £1,027m and operating profit rose 15% to £413m. Profit before tax and exceptional items was £308m, an increase of 6% on 2000.

Asset growth, including our major joint ventures and the ICC acquisition, was 11% in the year. Excluding the transfer of leased assets to Corporate Banking the growth would have been 20%. This growth has been achieved in a market where

Mary Robertson, Associate Director, Business Banking, Bank of Scotland



Graeme Galloway, Manager, Business Banking, Bank of Scotland



demand for asset finance has been flat and the business customers motor market has fallen 4%.

Notwithstanding the difficult economic climate asset quality remains stable with interest margins holding up well. Certain external factors resulted in a number of borrowers experiencing reducing income levels, and in line with our strategy we are working with these customers through the difficult time.

Our credit team is highly experienced and well placed to cope with a rapidly changing environment and the ever-increasing demands placed on them. The total asset portfolio is well spread, with no single classification representing more than 20% of the total. Through proper portfolio management the concentrations are closely monitored.

Our non-performing assets at the year-end totalled £515m, which represented 2.73% of total advances. This compares to 2.53% at the end of 2000. The total bad debt charge for 2001 increased to £125m which equates to 0.69% of average advances. The comparative figures for 2000 were £75m and 0.46%. This increase is against a backdrop of less benign economic conditions during the year and a number of one-off recoveries made in the previous year. 2000 also saw a general provision release of £18m against a charge in 2001 of £6m.

Residual values for motor vehicles have now entered a more stable period with improved results recorded by the Contract Hire businesses including the Lex Vehicle Leasing joint venture.

Deposit growth has been strong at 33% and we continue to focus heavily on this important element of the funding mix.

Our businesses in Ireland and Australia produced record results accounting for 18% of profit before tax and exceptional items. The integration of our two banks in Ireland is progressing well.

Technology costs increased by a total of £39m as a result of the development of core application and banking systems, designed to serve as a sound platform for aggressive future growth. Our people resource is growing as our expansion plans are implemented and this has had an impact on expenses in the year. Including the ICC Bank acquisition in Ireland which accounted for 360 new colleagues, divisional numbers have increased by 24% to 5,658 during the year.

Giving the Business customer extra Business Banking will be the only dedicated business bank to 'always give you extra'.

We have the drive, ambition, people and products to make us the first choice for business banking. Through our high-quality customer service and focus on sales we

aim to double market share in the next three years.

We are not complacent; we know we have to deliver even better products and solutions to today's demanding business banking customers. Our research shows that these customers want readily understandable products. They want to make their choice of banking partner and be able to move to their new banking relationships quickly and efficiently.

With our Easy to Join 'Switching Scheme' we aim to make the transfer of banking arrangements smooth and hassle-free.

The business banking market now has a new challenger, who for the first time is setting out a clear agenda of value and service to the UK's SME community.

Business Banking	2001 £m	2000 £m
Net interest income	551	494
Non-interest income	476	429
Operating income	1,027	923
Operating expenses *	(614)	(563)
Operating profit before provisions *	413	360
Provisions for bad & doubtful debts		
Specific	(119)	(93)
General	(6)	18
Share of profits of associates and joint ventures *	20	5
Profit before tax *	308	290
Net interest margin	3.04%	3.16%
Net interest spread	2.66%	2.71%

Net interest margin

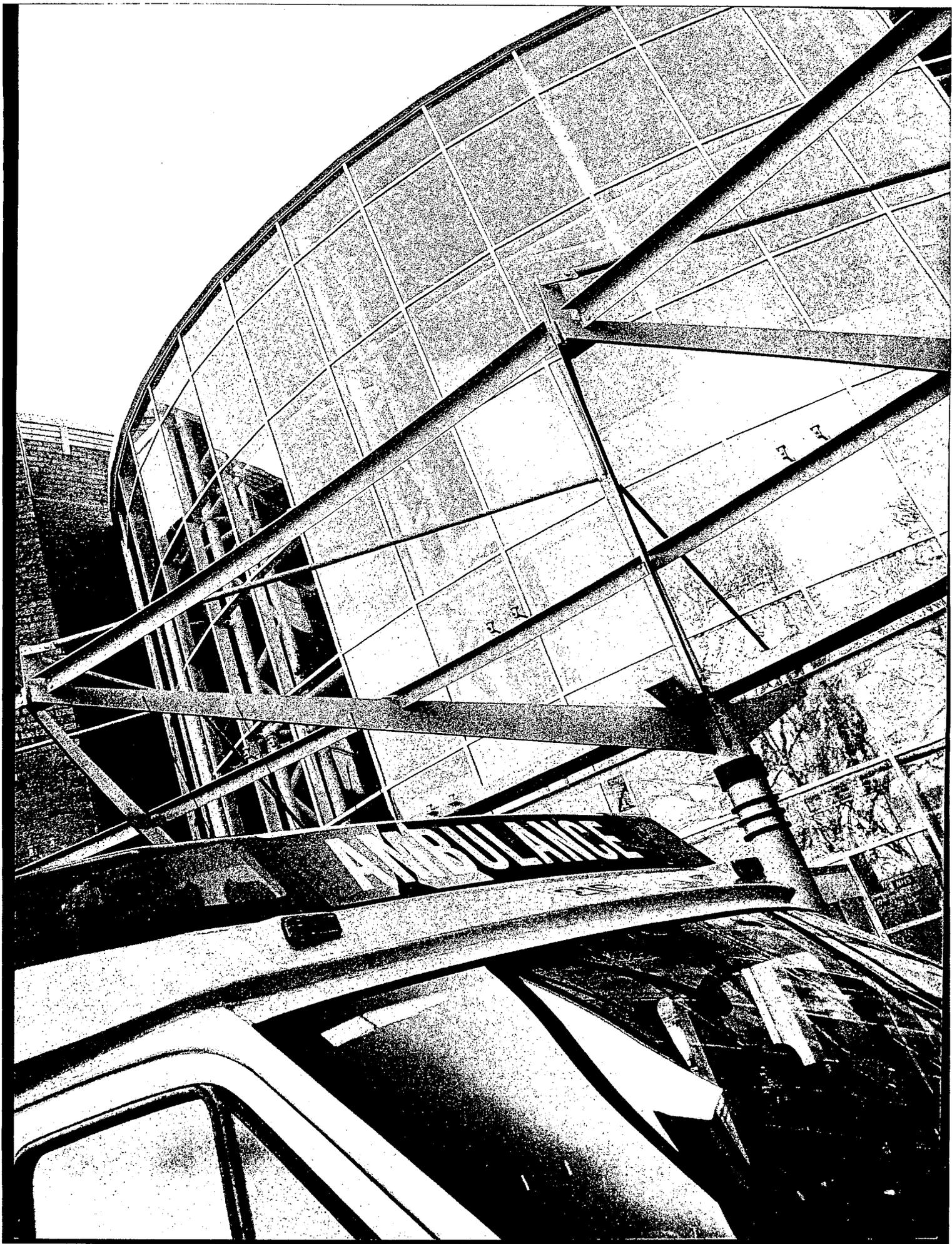
The net interest margin fell 12 basis points from 3.16% to 3.04%. The movement is made up as follows:

	Basis points	
ICC Bank inclusion	(4)	
Deposit margins	(3)	
Early termination of lease	(5)	
	(12)	
Cost:income ratio**	50.0%	49.5%
Total lending to customers	£18.9bn	£17.1bn
Classification of advances:	%	%
Agriculture, forestry and fishing	3	4
Energy	1	2
Manufacturing industry	10	11
Construction and property	17	13
Hotels, restaurants and wholesale and retail trade	15	13
Transport, storage and communication	3	2
Financial	13	13
Other services	26	31
Individuals		
Home mortgages	—	1
Other personal lending		
Motor finance	9	9
Overseas residents	3	1
Total risk weighted assets	£21.5bn	£19.8bn

Non-interest income	2001 £m	2000 £m
Business Centres	103	97
Asset Finance	10	15
Motor Finance	(21)	(18)
Other	19	(6)
Net fees and commissions receivable	111	88
Operating lease rental income	338	311
Profit on sale of investment securities	11	24
Amounts written off fixed asset investments	—	(2)
Other operating income	16	8
Total	476	429
Operating expenses *	2001 £m	2000 £m
Staff	198	164
Accommodation, repairs and maintenance	20	20
Technology	28	9
Marketing and communication	19	19
Depreciation:		
Tangible fixed assets	17	15
Operating lease assets	201	210
Other	51	60
Subtotal	534	497
Recharges		
Technology	32	12
Accommodation	2	3
Other shared services	46	51
Total	614	563

* Excluding exceptional items.

** Cost:income ratio has been calculated excluding exceptional items and after netting operating lease depreciation against operating lease income.



The New Force in Corporate Banking



George Mitchell

I joined Bank of Scotland straight from school and have worked in a wide range of business areas and a number of locations including London, New York and Hong Kong. I was appointed to Bank of Scotland's Group Management Board in 1994 and to the Main Board in 2000. I was Chief Executive of Bank of Scotland's Corporate Banking Division prior to the merger, a role I have taken into HBOS.

In Corporate Banking, Bank of Scotland and Halifax were already the market leaders in many of the areas in which they operated, and I am looking forward to developing that position further on the back of the larger and stronger balance sheet that the merger has created.

Over the years we have gained an enviable reputation for innovation, flexibility, having a can-do attitude, and responding quickly. The opportunities are simply immense.

George Mitchell, Chief Executive, Corporate Banking

Strategic aims:

- to capitalise on the growth opportunities arising from the enlarged HBOS balance sheet
- to extend our franchise in the UK, Europe and North America
- to deliver quality earnings growth based on sound credit quality
- to be the standard by which others are judged

Building a better Britain...

We are the leading funder of PFI/PPP projects in the UK, including health and education. Calderdale Royal Hospital was successfully delivered to the local NHS Trust in May 2001

The New Force in Corporate Banking continued

Across the board capability

Operating from 21 Corporate Banking locations in the UK and a further 12 overseas, we offer a full range of banking products and services to businesses with an annual turnover of more than £10m. In addition, we are involved in a wide range of specialist activities including acquisition finance. In particular we have significant experience in Management Buyouts where we have been the UK market leader by the number of deals for the last 10 years. Operating from our offices in Paris, Frankfurt and Amsterdam, we are now also the market leader in Continental Europe. Our close links with the venture capital industry with investments in 81 funds further enhances and complements our activity in this area.

In our integrated finance offerings we provide a complete funding package for our customers which includes mezzanine debt and equity in addition to more traditional senior debt and working capital facilities.

In joint venture relationships we partner with many of our customers to provide them with an alternative way of growing their businesses.

In project finance we have developed a truly global business particularly in the oil and gas and power transmission markets.

And in housing finance we are the leading bank provider of funds to Registered Social Landlords operating in the social housing market.

In the area of public private partnerships we partner with the Government to provide new hospital, school and infrastructure projects.

In asset finance we are a leading provider of debt and leasing structures to companies operating in a wide range of sectors.

Never a fair-weather friend

Our relationship driven, added value approach which we believe combines the innovation and creativity of an investment bank with the strengths of a traditional clearing bank has resulted in us becoming the Corporate Bank of choice for an ever-growing number of companies and intermediaries. Our can-do and flexible approach to business, the speed at which we move and the fact that we are not a fair-weather friend – we are there to help in bad times as well as good – has resulted in us seeing an ever increasing volume of opportunities.

Scale matters

But in Corporate Banking size is still important, and the bigger and stronger balance sheet that the merger has created will undoubtedly allow us to lead and arrange more transactions and underwrite and hold larger positions than either Bank of Scotland or Halifax could have done on their own. We have already seen clear

evidence of this in the months since the merger and we remain confident that we can continue the strong growth we have experienced in recent years as well as delivering significant revenue synergies – even in today's uncertain markets. As we do so, however, it is important that we never lose sight of the approach that has made us successful so far. In the past we have tended to shy away from the commodity end of the Corporate Banking market where it is difficult to develop a strong relationship, difficult to add value and difficult to generate an acceptable return for our shareholders. The merger will not change this. We will continue to pursue a relationship and partnership driven approach which has served us so well in the past and has led to us having an equity involvement in more than 1,000 UK companies.

Our performance

Corporate Banking has had another very successful year.

Our lending commitments grew by 32% in the year to £58bn and loans actually drawn grew by 33% to £34.8bn with all areas of the Division performing well. In Scotland where we already bank a significant portion of the corporate sector, our business continued to show strong growth. In England and Wales our lending grew further as did our network of offices with Crawley, Nottingham and Liverpool being added to our list of locations. Overseas, our North American business had another excellent year with all our offices making a significant contribution and our European and Australian operations both delivering strong growth.

Our income showed very strong growth in the year, increasing by 41% to £858m. Net interest income rose by 43% which was faster than the growth in our lending, reflecting an improvement in our overall net margin from 1.64% to 1.69%. Our non-interest income also showed strong growth, rising by 38% to £322m with increases being seen in fees, commissions and investment gains; the latter despite a less than favourable market for equity realisations.

Operating expenses before exceptional items rose by 28% largely as a result of our decision to significantly increase the number of our staff to ensure we were and are in a position to take advantage of the ever increasing number of business opportunities we are seeing, both in the UK and overseas. Although the increase in our expenses was significant, they grew in percentage terms far more slowly than our income, leading to yet a further improvement in our cost:income ratio, from 19.5% to 16.8%.

Our profit before tax and exceptional items showed very strong growth in the year, increasing by 37% to £515m,

notwithstanding the increase in provisions referred to below. This equates to 17% of the Group's profit before tax, exceptional items and Intelligent Finance which was achieved with only 2% of the Group's staff.

The slowing economies in the UK and overseas inevitably resulted in some strain being seen in our lending book and as a consequence of this our charge to provisions against bad and doubtful debts increased in 2001 by £71m to £198m which equates to 0.65% of our average advances for the year. This compares with a figure of 0.58% the previous year. This relatively modest increase is we believe a very acceptable outcome at this stage of the economic cycle. Our non-performing assets at the year end equalled 1.6% of our loans outstanding before securitisation. This compares with a figure of 1.1% at the end of 2000 and again, we consider this to be a very acceptable increase at what is a difficult time for many of our customers.

Although 2001 has not been without its challenges, we believe that our very strong lending skills at the front end and our strategy of working with our customers to help them through a difficult period significantly reduces the actual losses we incur on problem credits.

Growth prospects

Our prospects are excellent. In Corporate Banking both Bank of Scotland and Halifax were already the clear market leaders in many of the areas in which they operated. The bigger and stronger balance sheet that HBOS provides will allow us to build on that enviable position and grow even faster in the years ahead. Our reputation in the marketplace is excellent, and we have a highly talented and experienced staff that we believe is the best in the industry. We are looking forward to the year ahead with confidence.

Corporate Banking	2001 £m	2000 £m
Net interest income	536	375
Non-interest income	322	234
Operating income	858	609
Operating expenses *	(152)	(119)
Operating profit before provisions *	706	490
Provisions for bad & doubtful debts		
Specific	(168)	(90)
General	(30)	(37)
Share of profits of associates and joint ventures	7	13
Profit before tax *	515	376
Net interest margin	1.69%	1.64%
Net interest spread	1.35%	1.31%

Net interest margin

The net interest margin rose 5 basis points from 1.64% to 1.69%. The movement is made up as follows:

	Basis points	
Improved lending margins	6	
Benefit of securitisation	5	
Operating lease funding cost	(3)	
Fall in deposit margins	(3)	
	5	

Cost:income ratio ** 16.8% 19.5%

Total lending to customers *** £34.8bn £26.2bn

Classification of advances:	%	%
Energy	3	5
Manufacturing industry	11	13
Construction and property		
Property investment	11	8
Housing associations	6	8
Housebuilding	3	3
Other property	8	6
Hotels, restaurants and wholesale and retail trade	8	7
Transport, storage and communication	12	11
Financial	8	5
Other services	12	14
Overseas residents	18	20

Total risk weighted assets £40.8bn £30.6bn

Non-interest income	2001 £m	2000 £m
Arrangement fees	169	130
Commitment fees	36	25
Guarantee fees	14	10
Redemption fees	12	13
International services	8	11
Transaction fees	11	10
Other	18	10
Net fees and commissions receivable	268	209
Profit on sale of investment securities	28	21
Operating lease rental income	31	—
Dividend income from equity shares	4	8
Amounts written off fixed asset investments	(9)	(4)
Total	322	234

Operating expenses *	2001 £m	2000 £m
Staff	67	54
Accommodation, repairs and maintenance	9	7
Technology	6	1
Marketing and communication	3	3
Depreciation:		
Tangible fixed assets	2	2
Operating lease assets	9	—
Other	21	18
Subtotal	117	85
Recharges		
Technology	7	5
Accommodation	1	1
Other shared services	27	28
Total	152	119

* Excluding exceptional items.

** Cost:income is calculated excluding exceptional items and after netting operating lease depreciation against operating lease income.

*** Net of securitisation of £1.4bn of corporate loans.

Julie Main, Associate Director, Corporate Banking, Bank of Scotland



No.1
in MBO financing.



The New Force in Treasury



Gordon McQueen

My career with Bank of Scotland commenced in 1976 when I joined the International Division after which I was appointed its General Manager and became a member of the Bank's Management Board in 1989. In 1990, I became General Manager of Treasury Division and Executive Vice Chairman of Bank of Scotland Treasury Services PLC, then General Manager, UK Banking - England and afterwards General Manager, Accounting and Finance. In April 1999, I became Divisional Chief Executive, Group Treasury and Finance and Chief Executive of Bank of Scotland Treasury Services PLC. In May 2000 I became an Executive Director of Bank of Scotland and Chief Executive, Treasury at HBOS plc last year.

Not just good at what we do but rated as such, with earnings that will contribute to incremental group value.

Gordon McQueen, Chief Executive, Group Treasury

Strategic aims:

- o to be the first choice provider of innovative and creative treasury service solutions to customers of the HBOS group.
- o to deliver an earnings profile marked by its quality and sustainability
- o to achieve higher sector ratings for the profit contribution than competitors' Treasury operations

The Best people

The dealing room in London brings together the best people from Bank of Scotland and Halifax Treasuries

The New Force in Treasury continued

About our business

HBOS Treasury Services combines the treasury businesses of Halifax and Bank of Scotland. We provide wholesale multi-currency funding and manage liquidity and the Treasury investment portfolio for the HBOS Group. We manage the market risk arising from the Group's retail, business and corporate operations and also arrange the Group's debt capital issuance and asset securitisations.

As an example, in the second half of 2001, on behalf of the HBOS Group, we managed the issue of £600m of Tier 1 and €500m of Upper Tier 2 debt capital. These were the first debt capital issues by HBOS plc and the Tier 1 transaction was the largest sterling issue of its kind in the market to date. Treasury Services also managed a €1,000m issue of Lower Tier 2 debt in the name of The Governor and Company of the Bank of Scotland.

In addition to providing a number of key 'internal' services to the Group, we provide a complete range of treasury services to SMEs and large corporate customers of the Business and Corporate divisions and to our own customer base.

We have built up a professional sales team that works directly with our customers to build risk management solutions tailored to their specific requirements. We also seek to maximise opportunities from the underlying flows generated by the Group's operations and trade on our own account in the world's foreign exchange, money, derivatives, debt and capital markets.

HBOS Group, with a balance sheet of £312bn and capital resources of £14bn, has considerable balance sheet strength and quality. HBOS Group also has strong credit ratings (AA S&P and Aa2 Moody's senior debt at the authorised bank level). This makes HBOS Treasury Services particularly

attractive to wholesale market counterparties.

Our strategy

The merger of the two treasury businesses has resulted in an outstanding combination of two complementary businesses. Alongside the relatively standard core treasury activities, sit two very different but value-added business strategies. Bank of Scotland's Treasury has built up a large and growing stream of 'flow' earnings from the sales of Treasury products to the Group's Corporate and Business Banking customer bases. Halifax Treasury has built up greater expertise in more complex treasury products and activities, such as investment and trading in Asset Backed Securities and 'Relative Value Trading'. These two strategies together create a powerful combined business, with greater business and earnings diversification and with greater risk diversification, than either of the two component Treasury divisions.

The combined Treasury business aims to be a consistent long-term contributor to the generation of shareholder value through the four key strands of our strategy.

First, by leveraging the natural business growth stemming from the Group's growth strategy and increasing Treasury's penetration of the Corporate and Business Banking customer bases. Additionally, the range of treasury products offered will be expanded.

Second, by generating at least 75% of our total income from quasi-margin flow business to reduce the dependence on pure trading income and to enhance earnings quality.

Third, by continuing to focus on high asset quality, already a characteristic of Treasury's existing investment portfolio where 99% of total assets are rated A or better and 86% are rated AAA.

Finally, by sustaining above average profitability through the maximisation of operational efficiency and the optimisation of the Division's capital.

The success of our strategy hinges upon the delivery of a pro-active, efficient, professional high quality service, offering both internal and external customers a complete range of treasury products from the simple and straightforward at one end of the spectrum to the complex, bespoke, specialised structures at the other.

The immediate focus is on successfully integrating the two businesses and we are now moving at speed to integrate the treasury operations and infrastructure of both Banks. In addition to the obvious economies of scale, this will deliver increased strength and depth providing improved customer services and greater product coverage.

The merger will also provide significant cost savings for the Bank of Scotland element of wholesale funding. The higher credit ratings, now confirmed at AA for senior debt by S&P compared with A+ for Bank of Scotland on its own, will deliver improved pricing.

We will in addition continue to earn the wholesale spread, but on an increased funding requirement arising from the expansion of Corporate Banking business, possible as a result of the merger. We also expect to benefit from higher sales of hedging, foreign exchange and other treasury products from the increased Corporate and Business Banking customer base.

We are continuing to do business in the markets and with our corporate customers in the Bank of Scotland and Halifax names and at the present time the message for all our counterparties is 'business as usual'. However from an HBOS Group perspective we are now running the Group's Treasury

Richard Franks, Chief Dealer FX Spot, Treasury, London



Oksana Jacobowitz, Credit Manager, Credit Risk, Treasury, London



activities on a combined basis both in terms of overall strategy and in the management of credit and market risk.

Our external face to the market will change from the two existing treasury counterparty names to a new, single name, HBOS Treasury Services. We expect to start conducting new business in the new name during 2002. We expect our treasury activities to be fully integrated by the end of the first quarter of 2003. Leading up to this time we will see increased customer flows and we will also continue to develop our product capability to ensure that the expectations of our customers are fulfilled.

Our performance

Total pre-tax profit was £169m compared with £210m last year. The movement is attributable mainly to a reduction in the profit on the sale of fixed income securities. Adjusting for this, underlying operating profits achieved a modest improvement.

During 2001, we maintained our prominent position in the sterling money markets and continued the development of our sterling repo activities. Non-interest income, excluding amounts written off fixed asset investments, increased from £50m to £55m. This improvement stems from both the continuing growth in revenues from Treasury product sales to the Group's corporate and SME customers and an increase in trading profits helped by the favourable interest rate environment experienced through most of the year.

The business continues to diversify sources of revenues with an increasing contribution from new products such as repos and structured derivative transactions and from non-sterling currencies, including the Euro and US Dollar.

The results also reflect our cautious approach to credit, which stems from the high quality interbank and investment portfolios, concentrated on Financial Institutions, Sovereigns and asset-backed securities. The £9m charge, under amounts written off fixed asset investments, relates to a single asset backed security investment.

Costs increased from £78m to £83m reflecting significant spend on upgrading risk management systems and recruiting additional skilled personnel. The cost:income ratio remains excellent at 32.9%.

Our ambitions

We intend to build on the strengths of the existing Bank of Scotland and Halifax Treasury businesses and the increased scale and appetite of the combined Group.

The HBOS merger deepens and strengthens the existing competitive advantages of the combined treasury businesses and leverages the opportunities for HBOS Treasury Services. The scale of the HBOS business volumes together with the Bank of Scotland's powerful customer franchise and Halifax's more complex structuring

capabilities have created a strong base from which to develop further.

HBOS Treasury Services has a pool of talented staff with a 'can-do' culture, a flexible operating model and a hunger for growth. The business has a special opportunity to utilise these characteristics to develop a flexible growing business which is able to take advantage of activities and niches that, perhaps, other more cumbersome players would be unlikely to target.

The key goals for the Division are to become the preferred or sole provider of treasury services to the other Divisions of HBOS and the predominant provider of treasury services to Corporate and Business Banking customers.

The achievement of these goals, together with our on-going trading and investment activities, will make Treasury a substantial contributor to Group profits with a growing stream of high quality earnings.

Treasury	2001 £m	2000 £m
Net interest income	206	238
Non-interest income	46	50
Operating income	252	288
Operating expenses *	(83)	(78)
Profit before tax *	169	210
Net interest margin (bps)	18	27
Net interest spread (bps)	16	22

Net interest margin
Net interest margin has fallen 9 basis points from 27 to 18. The movement is made up as follows:

	Basis points	
Gains from sales of fixed income securities	(6)	
Increase in wholesale margins	1	
Other movements	(4)	
	(9)	
Cost:income ratio *	32.9%	27.1%
Total risk weighted assets	£11.8bn	£14.4bn

Non-interest income	2001 £m	2000 £m
Dealing profits	77	62
Fees payable	(22)	(12)
Net-fee income	55	50
Amounts written off fixed asset investments	(9)	-
Total	46	50

Operating expenses *	2001 £m	2000 £m
Staff	41	35
Accommodation, repairs and maintenance	9	8
Technology	7	5
Marketing and communication	-	1
Depreciation:		
Tangible fixed assets	1	1
Other	16	19
Subtotal	74	69
Recharges		
Technology	11	9
Accommodation	1	-
Other shared services	(3)	-
Total	83	78

* Excluding exceptional items.

Five Year Summary

For the years ended 31 December

	2001 £m	2000 £m	1999* £m	1998* £m	1997* £m
Profit and Loss Account					
Net operating income ^o	6,869	6,244	5,666	5,313	4,856
Operating expenses ^o	3,213	2,858	2,531	2,384	2,186
Provisions for bad and doubtful debts	608	471	440	364	321
Underlying profit before tax ^o	3,007	2,925	2,719	2,555	2,365
Balance Sheet					
Total assets	312,275	266,143	233,891	204,370	185,797
Total assets (excluding long-term assurance assets attributable to policyholders)	274,674	235,085	209,656	185,238	169,856
Subordinated debt	7,626	5,985	5,140	3,626	3,694
Share capital	1,292	1,278	1,162	1,197	1,211
Reserves	10,176	9,260	8,482	8,923	8,532
	%	%	%	%	%
Performance Ratios					
Post-tax return on mean equity ^o	18.2	19.5	19.1	17.5	17.6
Cost:income ratio [†]	44.7	43.3	44.4	44.9	44.7
Net interest margin	1.77	1.95	2.17	2.32	2.39
	per ordinary share				
	pence	pence	pence	pence	pence
Shareholder Information					
Dividends	28.0	22.4	20.2	17.3	15.0
Underlying earnings excluding exceptional items, Intelligent Finance and goodwill amortisation	56.6	55.6	51.5	45.2	41.8

* The HBOS Group figures are an aggregate of, or calculation based on, the Halifax Group accounts for the year ended 31 December, and Bank of Scotland Group accounts for the year ended 28 February following.

^o Excluding exceptional items and Intelligent Finance.

[†] The cost:income ratio is calculated excluding exceptional items, Intelligent Finance, goodwill amortisation and after netting operating lease depreciation against operating lease income.

Financial Review and Risk Management



Mike Ellis
Group Finance Director

I joined the Halifax Building Society in June 1987 as Treasurer. I became Group Treasurer in June 1989. General Manager, Treasury and European Operations in August 1992 and Managing Director, Treasury and Overseas Operations in August 1995. In December 1996, I became Banking and Savings Director and in January 1999, became Retail Financial Services Director with responsibility for Mortgages and Savings, Banking and Consumer Credit, General Insurance, Long Term Savings and Marketing, with additional Board responsibility for Distribution. On 1 October 1999, I was appointed Chief Operating Officer of Halifax Group plc and became Group Finance Director of HBOS plc last year.

Presentation of Results

Following the merger of Halifax Group and Bank of Scotland Group to form HBOS Group, merger accounting principles have been used and the results have been presented as if the new group had been established throughout the current and comparative accounting periods.

Following a detailed review of the accounting policies of both entities, a number of policies have been aligned. Their effect on the assets and profits of the combined group are not material. Full details of the accounting policies are presented on pages 65 to 66.

Overview of Results

Group profit before tax increased by £82m to £3,007m before charging the start up loss of Intelligent Finance of £154m, merger costs of £76m, restructuring costs of £132m and other net exceptional costs of £15m, as shown below:

	2001 £m	2000 £m
Group profit before tax	2,630	2,668
Add back:		
Merger costs	76	-
Restructuring costs	132	124
Other	15	45
Intelligent Finance	154	88
Group profit before tax, exceptional items and Intelligent Finance	3,007	2,925

Group profit before tax, exceptional items and Intelligent Finance on a divisional basis is as follows:

Segmental analysis	2001 £m	2000 £m
Retail Banking	1,403	1,567
Insurance & Investment	772	593
Business Banking	308	290
Corporate Banking	515	376
Treasury	169	210
BankWest	80	73
Group Items	(240)	(184)
Total	3,007	2,925

Underlying earnings per share before exceptional items, Intelligent Finance and goodwill amortisation rose 2% to 56.6p (2000 55.6p) and the proposed final dividend is 18.7p, bringing the total for the year to 28.0p, 25% higher than the weighted average dividends paid by Halifax and Bank of Scotland in respect of the previous financial year. The basic dividend cover is 1.6 times and 2.0 times on an underlying basis. If approved at the Annual General Meeting, the final dividend will be paid on 31 May 2002 to shareholders on the register at the close of business on 15 March 2002.

The Directors have decided to introduce a Share Dividend Plan and to offer ordinary shareholders the choice of electing under the Plan to receive the whole of their dividends in new ordinary shares credited as fully paid instead of cash in respect of the proposed final dividend for the year ended 31 December 2001 and for future dividends. A circular containing details of the Plan, key dates in respect of the new shares to be allotted to shareholders who elect to join the Plan and the relevant mandate form will be sent to shareholders during March and April 2002.

Group operating profit before provisions for bad and doubtful debts, exceptional items and Intelligent Finance rose by 6% to £3,567m.

Group Net Interest Income

Group net interest income, excluding exceptional items and Intelligent Finance increased by £164m to £4,195m.

	2001 £m	2000 £m
Interest receivable	16,021	15,111
Interest payable	(11,826)	(11,080)
Net interest income*	4,195	4,031
Average balances		
Interest earning assets:		
– Loans and advances	182,718	160,922
– Securities and other liquid assets	53,912	46,069
	236,630	206,991
Net interest margin*	1.77%	1.95%

* Excluding net interest payable within Intelligent Finance of £22m (2000 £nil).

The reduction in the Group net interest margin of 18bps is analysed below (more detail is provided in the Divisional reports):

	Basis Points
Retail Banking	(18)
Business Banking	(1)
Corporate Banking	3
Treasury	(2)
	(18)

Financial Review and Risk Management continued

Non-Interest Income

Non-interest income increased by £392m (18%) to £2,585m.

	2001 £m	2000 £m
Net fees and commissions receivable	1,404	1,304
Income from long-term assurance business*	443	288
General insurance premium income	265	95
General insurance claims	(68)	(11)
Operating lease rental income	369	311
Dealing profits	82	66
Profit on sale of investment securities	45	47
Amounts written off fixed asset investments	(21)	(9)
Other operating income [†]	66	102
Total	2,585	2,193

* Excluding exceptional income of £27m (2000 £nil) within St. James's Place Capital.

† Excluding charges within Intelligent Finance of £2m (2000 £nil).

The movement in non-interest income is attributable to the various divisions as follows:

	£m
Retail Banking	31
Insurance & Investment	225
Business Banking	47
Corporate Banking	88
Treasury	(4)
BankWest	5
Total	392

Operating Expenses

Total operating expenses excluding exceptional items and Intelligent Finance were £355m (12%) higher at £3,213m. New business developments including acquisitions and the associated goodwill accounted for approximately half of this increase. The increase in the goodwill amortisation is attributable to a full year's charge in respect of St. James's Place Capital and also the acquisition of ICC Bank and the operating assets, sales force and unit linked and non-profit business of The Equitable Life Assurance Society ('The Equitable') during the year. A further contributing factor to the increase related to significant expenditure on IT development.

	2001 £m	2000 £m
Staff	1,369	1,286
Accommodation, repairs & maintenance	294	245
Technology	342	259
Marketing and communication	336	271
Depreciation:		
Tangible fixed assets	248	234
Operating lease assets	210	210
Goodwill amortisation	68	43
Other	346	310
Total*	3,213	2,858

* Excluding exceptional items of £174m (2000 £124m) and Intelligent Finance of £118m (2000 £88m).

The increase in expenses is attributable to the divisions as follows:

	£m	% increase
Retail Banking	158	10
Insurance & Investment	42	28
Business Banking	51	9
Corporate Banking	33	28
Treasury	5	6
BankWest	10	8
Group Items	56	30
Total	355	12

The underlying cost:income ratio excluding exceptional items, Intelligent Finance and the amortisation of goodwill and after netting operating lease depreciation against operating

lease income (as in previous years) increased slightly to 44.7% (2000 43.3%), as shown in the table below:

	2001 £m	2000 £m
Operating expenses	3,505	3,070
Exceptional items	(174)	(124)
Intelligent Finance	(118)	(88)
Goodwill amortisation	(68)	(43)
Operating lease depreciation	(210)	(210)
Underlying operating expenses	2,935	2,605
Net operating income	6,872	6,244
Exceptional items	(27)	-
Intelligent Finance	24	-
Amounts written off:		
fixed asset investments	(21)	(9)
General insurance claims	(68)	(11)
Operating lease depreciation	(210)	(210)
Underlying operating income	6,570	6,014
Cost:income ratio	44.7%	43.3%

Group Items

Group items, which comprises costs incurred in the management of the Group as a whole and the amortisation of goodwill, are analysed below:

	2001 £m	2000 £m
Staff	223	271
Accommodation, repairs & maintenance	179	150
Technology	223	185
Marketing and communication	53	30
Depreciation	184	176
Goodwill amortisation	68	43
Other	(20)	(49)
Sub Total	910	806
Less Recharges ¹ :		
Technology	(288)	(230)
Accommodation, repairs & maintenance	(134)	(137)
Other shared services	(248)	(255)
Total	240	184

¹ Shown under the operating expenses analysis for each division.

Michael Cockburn, Manager, Business Banking, Bank of Scotland



Sue Revueita, Branch Manager, Sutton Branch, Halifax



Merger Cost Synergies and Revenue Benefits

Merger cost synergies and net revenue benefits are now estimated at £690m to be achieved by 2005, split £340m cost synergies and £350m net revenue benefits. The financial impact of such synergies and benefits in 2001 was some £22m. One-off costs associated with the achievement of synergies are estimated at £390m with £132m being charged in 2001.

The estimated cumulative profit and loss impact of total synergies (excluding one-off costs) in each financial year is shown below:

	£m
2001	22
2002	130
2003	420
2004	670
2005	690

Balance Sheet Growth

Advances to customers increased by 16% to £198bn. During the year, £2.2bn of loans were securitised. The mix of the Group's lending portfolio at the year end is summarised in the following table and gross lending exposure is shown in more detail in Note 16 on page 79.

	2001		2000	
	£bn	%	£bn	%
Commercial ¹	58	29	49	29
Residential				
Mortgages ¹	127	64	110	65
Other Personal	13	7	11	6
Total	198	100	170	100

¹ After securitisation.

Customer deposits grew by 11% to £141bn and wholesale funds by £21bn to £100bn.

Bad Debt Provisions & Non-Performing Assets

	Specific £m	General £m	Total £m
At 1 January 2001	971	607	1,578
Amounts written off during the year	(478)	—	(478)
Charge for the year	556	52	608
Recoveries of amounts previously written off	39	—	39
Other movements	14	8	22
At 31 December 2001	1,102	667	1,769

The total charge for bad and doubtful debts against Group profits was £608m (2000 £471m) including Intelligent Finance of £12m. Within this the charge for specific provisions increased 27% to £556m (2000 £438m), representing 0.30% of average customer lending (2000 0.27%).

General provision policy has been standardised based on an expected loss methodology. The general provision charge for the year amounted to £52m (2000 £33m which includes a credit in respect of a utilisation to cover losses arising from the structural decline in vehicle residual values).

Closing provisions as a % of year end customer advances are analysed in the following table:

	2001		2000	
	As % of customer £m advances	As % of customer advances	As % of customer advances	As % of customer advances
Specific Provisions	1,102	0.56	971	0.57
General Provisions	667	0.34	607	0.36
Total	1,769	0.90	1,578	0.93

Non-performing assets (NPAs) amounted to 2.06% of customer advances (2000 2.16%). The amount of NPAs increased to £4,072m (2000 £3,666m). The cumulative provisions and interest in suspense, which are deducted from advances in the balance sheet, together with their percentage cover of NPAs are as follows:

	2001		2000	
	As % of £m NPAs	As % of NPAs	As % of £m NPAs	As % of NPAs
Specific Provisions	1,102	27	971	26
General Provisions	667	16	607	17
Interest in Suspense	123	3	96	3
Total	1,892	46	1,674	46

Acquisitions

ICC Bank plc – On 16 February 2001, Bank of Scotland acquired 99.99% of the share capital of ICC Bank plc, which is based in Ireland. The remaining equity has been acquired during the year.

The consideration (inclusive of fees and expenses) was £227m, which was satisfied partly in cash raised from the proceeds of a placing of Bank of Scotland stock and partly by stock issued. Net assets of £163m were acquired which created goodwill on acquisition of £64m. This is being amortised over 20 years, resulting in a charge of £3m for the year ended 31 December 2001.

Equitable Life Assurance Society ('The Equitable') – On 1 March 2001, the Halifax Group acquired the operating assets, salesforce and unit linked and non-profit business of The Equitable. The initial consideration (including costs of acquisition) was £507m.

Net assets with a fair value of £341m were acquired creating a balance of goodwill on the acquisition of £166m. This is being amortised over 20 years, resulting in a charge of £7m for the year ended 31 December 2001.

On 11 January 2002, The Equitable's guaranteed annuity rate and non-guaranteed annuity rate policyholders voted in favour of a scheme of arrangement to compromise their respective claims against the with-profits fund. The scheme became effective on 8 February 2002.

As a result of this, in accordance with the terms of the acquisition, in addition to the consideration paid of £507m, Halifax plc

Alex Harrison, Head of Sales and Marketing, Household Insurance, Halifax General Insurance



£690m

Merger cost synergies and net revenue benefits estimated to be achieved by 2005.

Financial Review and Risk Management continued

agreed to pay a further £250m which it has done by unconditionally waiving the repayment of £250m of loans advanced by it to The Equitable under a fully collateralised loan facility of £251m, which was granted in 2001.

Share of Operating Profit/(Loss) in Associates and Joint Ventures

Included within the share of operating profit/(loss) in associates and joint ventures are the following items:

	2001 £m	2000 £m
Lex Vehicle Leasing:		
– exceptional	–	(45)
– ongoing*	12	(1)
Centrica Personal Finance	17	14
Renault Financial Services	9	6
esure	(14)	(8)
Sainsbury's Bank	8	5
Other	4	14
Total	36	(15)

* After charging goodwill amortisation.

Taxation

The tax charge for the year of £765m (2000 £757m), represents 29% (2000 28%) of profit before tax compared with a UK corporation tax rate applicable to the year of 30% (2000 30%).

Capital Structure

	2001 £m	2000 £m
Regulatory Capital		
Risk Weighted Assets	157,532	135,196
Tier 1		
Share capital	1,292	1,278
Less: own shares	(5)	(6)
	1,287	1,272
Eligible reserves	10,203	9,180
Minority interests (equity)	530	416
Minority and other interests (non-equity):		
Preferred securities	1,789	899
Preference shares	198	198
Less: goodwill	(1,537)	(1,344)
Total tier 1 capital	12,470	10,621

	2001 £m	2000 £m
Tier 2		
Undated subordinated debt	2,464	1,936
Dated subordinated debt	4,614	3,814
General provisions	622	554
Total tier 2 capital	7,700	6,304
Supervisory deductions		
Unconsolidated investments – life	(2,894)	(2,212)
Unconsolidated investments – other	(298)	(284)
Investments in other banks and other deductions	(355)	(17)
Total supervisory deductions	(3,547)	(2,513)
Total capital	16,623	14,412
Tier 1 capital ratio (%)	7.9	7.9
Risk asset ratio (%)	10.6	10.7

There was an increase in total regulatory capital during 2001, from £14,412m to £16,623m.

£193m of Tier 1 capital was raised in February 2001, through a placing in the market of Ordinary Stock in connection with the acquisition of ICC Bank plc. Also in February 2001, two tax efficient issues were completed, each of £150m of Perpetual Regulatory Tier 1 securities redeemable at the issuer's option in 2016 and 2026 carrying coupons of 7.286% and 7.281% respectively. In addition, on 28 November 2001, Tier 1 capital was strengthened further by an issue of £600m innovative, tax efficient perpetual preferred securities redeemable at the issuer's option in 2018 and having a distribution rate of 6.461%. Tier 1 capital also benefited from increased retained earnings offset by additional deductions for goodwill, mainly in relation to ICC Bank plc.

Tier 2 capital was increased during the year by subordinated debt issues of €325m in February 2001, Japanese Yen 42.5bn in February 2001, €500m in November 2001 and €1bn in December 2001.

Supervisory deductions mostly reflect investments in subsidiary undertakings that are not within the banking group for

regulatory purposes. Deductions are made for the investments in Clerical Medical, St. James's Place Capital and St. Andrew's Group. Total deductions increased from £2,513m to £3,547m.

The Tier 1 ratio is 7.9% at 31 December 2001 and the risk asset ratio is 10.6%.

BankWest

	2001 ASm	2000 ASm
Net interest income	419	378
Non-interest income	218	194
Operating income	637	572
Operating expenses	(393)	(349)
Operating profit before provisions	244	223
Provisions for bad & doubtful debts		
Specific	(11)	(20)
General	(7)	(9)
Profit before tax	226	194
Total lending to customers*	AS18.8bn	AS16.4bn
Risk Weighted Assets	AS14.9bn	AS13.5bn
Net interest margin [†]	2.20%	2.21%
Cost:income ratio [†]	60.6%	59.9%

* After securitisation.

† Including income grossed up on a fully tax equivalent basis at 30% (2000 34%) with the ratios adjusted for the gross up.

BankWest, in which HBOS's shareholding at 31 December 2001 was 56.3%, is a full service bank with its headquarters in Perth, the capital city of Western Australia. It is the biggest bank in its home state where it has a market share of nearly 25%, and in interstate markets it has continued to grow its business and increase its share of the national market.

BankWest's shares are listed on the Australian Stock Exchange and it has more than 68,000 shareholders.

During the 12 months BankWest successfully implemented a major organisational restructure, as part of a major strategic review undertaken in 2001, designed to significantly improve performance and deliver greater shareholder value. A feature of the new

Tracey Buckle, Team Leader Personal Loans, Halifax Direct



Simon Wicksted, Customer Service Officer, Castle Terrace Branch, Bank of Scotland



structure was the creation of two national operating divisions – BankWest Consumer Solutions and BankWest Business Solutions. Each is headed by a chief executive officer and will pursue strategies aimed at accelerating West Australian and national growth.

The new structure also created a leaner and more efficient head office to support new growth initiatives. An integrated programme to maximise the impact of a number of strategic initiatives aims to achieve cost savings of A\$25m and revenue growth of A\$25m by 2004.

Net interest income increased by 11% reflecting the growth in total lending. However, strong growth in housing lending (at lower interest rate margins) combined with the declining interest rate environment, diluted the net margin. Non-interest income increased by 12%, with solid growth in fees and commissions and a sizeable contribution from the Bank's Financial Markets operation.

The cost:income ratio increased slightly to 60.6%, largely as a result of costs associated with the restructure and subsequent redundancies. Cost savings and reduced consultancy and reorganisation costs in the next 12 months are expected to improve efficiency in the next year.

Operating expenses are analysed in the table below:

	2001 A\$m	2000 A\$m
Staff	183	168
Accommodation, repairs & maintenance	26	22
Technology	11	12
Marketing & communication	22	22
Depreciation:		
Tangible fixed assets	23	22
Fees & commissions payable	11	26
Other	117	77
Total	393	349

Pre-tax profits increased by A\$32m. The combined charge for specific and general provisions was A\$18m (in 2000 the combined charge was A\$29m, which included a specific

provision of A\$18m for one large bad debt). This includes a charge to maintain the balance sheet general provision at 0.6% of risk weighted assets. Net impaired assets as a % of total lending to customers were 0.6%.

Post-tax return on equity of 16.2% was up on the previous period's 15.3% and earnings per share of 31.0 cents was up on 26.0 cents for the previous period.

Highlights of the year were the continuing strong growth in housing lending which increased by 18% to A\$9.4bn and the growth in retail deposits of 13% to A\$8.7bn.

The Australian economy rebounded strongly in the middle of 2001, after contracting in the final quarter of 2000 as timing issues associated with the new tax system coincided with a post-Olympic trough. The recovery was fuelled by residential construction, which generated strong growth in housing lending. Housing construction continues to expand, aided by historically low interest rates and government incentives. BankWest's home State of Western Australia will be at the forefront of an expected recovery of business investment.

European Economic and Monetary Union (EMU)

The final changeover of non cash operations to the Euro in the EMU countries was completed on 31 December 2001 and the introduction of Euro notes and coins commenced on 1 January 2002. This process entailed the replacement of the current national currency notes and coins with Euro notes and coins and was expected to be completed no later than the end of February 2002. In practice, the bulk of this cash changeover was completed successfully within the first few weeks of the new year. Development work to cater for the changes that this brought to the Group's operations was completed successfully. The expenditure incurred is not regarded as significant.

There continues to be uncertainty as regards a UK decision to enter the single currency although the current Government has confirmed that they will make a decision on

UK entry within 2 years of commencement of the current parliament. The Group remains actively involved in discussions within the banking industry and other sectors of the economy to help assess the implications for the Group and its customers. This work is undertaken under the direction of the Group's Euro Preparations Task Force, comprising senior representatives of all the Group's UK business areas and Group Office functions.

The Group's Operating Controls

This section reviews the Group's approach to risk management by describing:

- general principles for internal control and operating practices;
- the governance structure for the Group's controls;
- the Group Risk functions which oversee risk management activities; and
- the major types of risks to which the Group is subject.

Internal Control

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. This system was established on the commencement of the merged business on 10 September 2001 and has been in place throughout the period from then to the date of approval of the Report and Accounts. It is regularly reviewed by the Board and accords with the Turnbull Guidance on internal control.

In addition the Board has reviewed the effectiveness of the system of internal control specifically for the purposes of this statement.

The system of internal control provides for a documented and auditable trail of accountability and applies across the Group's operations. It covers strategic, financial, regulatory and operational risks and provides for assurances to successive levels of management and, ultimately, to the Board.

The system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can provide only

Tamara Holt, Business Development Officer at BankWest's Bicton Customer Service Centre in Perth, Western Australia and Peter Knight, BankWest's Media Relations Manager



A\$226m

BankWest increased pre-tax profits by A\$32m to A\$226m

Financial Review and Risk Management continued

reasonable – and not absolute – assurance against material misstatement or loss.

Operating Principles and Practices

The Group seeks to maintain high standards of business conduct across all of its operations.

The risk appetite of the Group is set by the Board. The strategy for managing risk is formulated by the executive and recommended to the Board for approval. The Group Management Board also reviews the effectiveness of the risk management systems through reports from management and from the Risk Committees. Management has the prime responsibility for identifying and evaluating significant risks to the business and for designing and operating suitable controls. Internal and external risks are regularly assessed, including control breakdowns, disruption of information systems, competition and regulatory requirements.

The assessment process is consistent across the divisions and Group Functions and uses an iterative challenge process to provide successive assurances to ascending levels of management up to the Board.

In judging the effectiveness of the Group's controls, the Board reviews the reports of the Audit Committee and management. It also considers key performance indicators and reviews monthly financial and business performance showing variances against budgets.

Group Level Controls

The Group committee structure considers risks and risk management from the Group's perspective and is supported by the Group Risk Functions, notably Group Financial Risk and Group Audit, Regulatory and Operational Risk. Together they provide central oversight by reviewing and challenging the work of the Divisions' own risk committees and by providing leadership in the development and implementation of risk management techniques.

Audit Committee

Without diminishing its own accountability, the Board 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 and that there is a proper compliance structure throughout the Group. The Audit Committee acts as the Audit Committee for regulated entities that are not wholly within a single division and is supported by five Divisional Risk Control Committees.

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

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

The Audit Committee, which summarises its findings to the Board, uses a combination of assessment techniques designed to give the Board the assurance it requires about the internal control and risk management environment. These include reviews of regular reports from Group Financial Risk and from Group Audit, Regulatory and Operational Risk, consideration of external Auditors' reports and review of the minutes and work of Divisional Risk Control Committees.

The Divisional Risk Control Committees operate under delegated authority from the Audit Committee and the planning and co-ordination of their activities is reviewed by the Audit Committee. These committees review, on behalf of the Audit Committee, the adequacy of the five Divisions' systems of internal control (including financial, regulatory and operational risk management).

Group Credit Risk Committee

The Group Credit Risk Committee (GCRC) is responsible for assisting the Board to formulate the Group's risk appetite and strategies for managing the credit risk facing the Group.

It is also responsible for the implementation and maintenance of the Group's Credit Risk Management framework.

Group Risk Management Committee

The Group Risk Management Committee (GRMC) is responsible for assisting the Board to formulate the Group's risk appetite and strategies for managing all risks facing the Group, other than credit risk.

The Group Risk Management Committee is supported by three sub-committees:

- Group Asset and Liability Committee
- Group Insurance and Investment Risk Committee
- Group Operational and Regulatory Risk Committee

Group Asset and Liability Committee

The Group Asset and Liability Committee (GALCO) is responsible for the implementation and maintenance of the overall risk management framework relating to balance sheet structure, market risks, trading, funding and liquidity management across the Group's banking business. It recommends policy and guidelines to the Board. It is supported by Group Financial Risk, which monitors compliance with Group policies, standards and limits and aggregates all market risks to monitor the overall Group position independently from the business divisions.

Group Insurance & Investment Risk Committee

The Group Insurance & Investment Risk Committee (GIIRC) is responsible for the implementation and maintenance of the

Elaine Shaw, Customer Service Advisor, Halifax Direct



Kevin Jouhar, Head of FX Derivatives, Treasury, London



overall risk management framework relating to investment and insurance risks within the Insurance & Investment Division of the Group. It recommends policy limits and guidelines to the Board via the Group Risk Management Committee.

It is supported by Group Financial Risk (GFR), which will monitor compliance with Group policies, standards and limits and aggregate all investment and insurance risks to monitor the overall Group position.

Group Operational and Regulatory Risk Committee

The Group Operational and Regulatory Risk Committee (GORRC) is responsible for the overall operational and regulatory risk management framework across the Group. It recommends policy and guidelines to the Board via the Group Risk Management Committee. It is supported by Group Regulatory Risk and Group Operational Risk, which recommend and monitor compliance with Group policies and standards.

Group Risk

Group Risk consists of two functions; Group Financial Risk and Group Audit, Regulatory and Operational Risk both of which report to the Group Finance Director. The Chief Financial Risk Officer, Head of Group Audit, Regulatory and Operational Risk and Head of Group Internal Audit all have direct access to the Audit Committee Chairman, Group Chairman and Group Chief Executive.

The Group Risk areas provide functional leadership for specialist personnel throughout the Group's businesses and oversee risk management activities across the Group to ensure minimum standards are met, including monitoring of aggregate risk data at Group wide and regulated entity levels.

Group Financial Risk has three main areas of focus:

Group Asset and Liability Management monitors compliance with group policies,

standards and limits and aggregates all market risks to monitor the overall group position.

Group Credit Risk monitors compliance with group policies, standards and limits and aggregates all credit risks to monitor the overall group position.

Group Insurance & Investment Risk is a new area. Its role will be to monitor compliance with group policies, standards and limits and aggregate all insurance and investment risks to monitor the overall Group position.

Group Audit, Regulatory and Operational Risk has three main areas of focus:

Group Internal Audit supports the Audit Committee and Divisional Risk Control Committees to review independently and objectively the effectiveness of the control and risk environment.

Group Regulatory Risk supports the GORRC to recommend policies and standards on regulatory risk and cultural issues for approval by the Board.

Group Regulatory Risk is responsible for monitoring the Group's adherence to regulatory requirements and for oversight of communications with regulators on a Group-wide basis, with direct responsibility for relations with the Financial Services Authority (FSA), the Group's principal regulator.

Group Operational Risk supports the GORRC to recommend policies and standards on operational risk for approval by the Board and to provide operational risk oversight of policies and standards.

Divisional Level Controls

Divisional Chief Executives have responsibility for managing strategic, market, credit, regulatory and operational issues affecting their own operations within the parameters of the Group policies set by the Board. All divisions have Divisional Risk Control Committees which comprise at least two independent Non-executive Directors and

an Executive Director, independent of that division, to provide independent and objective assurance on the effectiveness of the division's internal control and risk management. These committees meet regularly to review the significant risks facing their business and the techniques used to assess and to manage them. Each division also has its own risk management committee or committees.

Regulatory Controls

The Group's businesses are regulated by a range of authorities including the FSA and regulators in overseas jurisdictions in which the Group operates.

The Group's activities are monitored by the regulators through periodic reviews and inspections. External auditors report periodically to the regulators, when requested, on certain aspects of internal controls and other matters. The findings of those reports are also considered by the appropriate Divisional Risk Control Committees, Audit Committees and Boards.

Mapping and Managing Risk

The Group is subject to risks, inherent in financial services activity. The Group's principal activities are the provision of retail, business and corporate banking services, investment management and insurance. It consequently makes loans to and takes deposits from customers and wholesale counterparties. The activities of Insurance & Investment Division carry investment management and insurance underwriting risks.

Credit Risk

This is the risk of financial loss from a customer's failure to settle financial obligations as they fall due. The GCRC, chaired by the Executive Deputy Chairman and comprised of senior executives, meets monthly and reviews the Group's lending portfolio to ensure a Group-wide understanding and control of credit risk.

Sarah Chan, Travel Sales Technician, Halifax General Insurance



Sarah Smith, Advertising Assistant, Intelligent Finance



Financial Review and Risk Management continued

Day to day management of credit risk is undertaken by specialist credit teams working within each business unit and in compliance with approved Group policies. Performance of each portfolio is reported to the GCRC monthly.

In all retail businesses, lending policy frameworks are determined centrally to ensure consistency in the management and monitoring of credit risk exposure. Full use is made of software technology in credit scoring new applications and current account overdraft extensions. In addition, behavioural scoring is used for credit cards and current accounts. Collections activity for credit card and current accounts, and for personal loans, is centralised for the various products, and sophisticated systems are used to prioritise action. Mortgage collection is conducted through a number of collection payment departments.

Within Business Banking, small business customers may be rated using scorecards in a similar manner to retail customers. Larger SME customers are typically rated in the same way as corporate customers. Corporate Banking conduct a full credit assessment of the financial standing of each customer and its future prospects and an internal rating is awarded. Internal ratings are reviewed regularly.

For Treasury operations policies are established and reviewed by the Group Wholesale Credit Committee, a sub-committee of the Group Credit Risk Committee, including limits for exposure to individual countries, sectors and corporate and financial institutions.

The controls applied to lending processes consider environmental risk and the potential impact this may have on the value of the underlying security.

Insurance & Investment Risk

Investment risk is the potential for financial loss arising from poor management of fund management assets (arising from both third parties and insurance policyholders), whilst insurance risk is the potential for loss arising from poor experience in relation to insurance

contract pricing parameters (for both life and general insurance products).

Day to day management of such risk is undertaken both by line management and by specialist teams within Insurance & Investment Division. Full use is made of the statutory appointed Actuary and (Pension) Scheme Actuary roles, both to ensure regulatory compliance (in respect of the authorised insurance companies in the Group) and to meet HBOS control standards.

Once the Group Insurance & Investment Risk Committee is fully operational, regular reports will be made of aggregate risks across the Group.

Regulatory Risk

This is the risk that the Group, or any part of it, fails to meet the requirements or expectations of regulatory authorities or supervisors responsible for enforcing legislation, codes, or regulations governing the way that the Group's business activities are conducted within the UK or elsewhere. Regulatory risk can also arise where the Group fails to anticipate and manage regulatory change adequately.

Day to day management of regulatory risk is undertaken both by line management and specialist teams of compliance experts working within business units. Reports on regulatory risk management are made by business areas and divisions to their Risk Control Committee and individual company Audit Committee. Group Regulatory Risk provides a high level assessment to the Audit Committee.

Operational Risk

HBOS has adopted the industry standard Basel definition of operational risk:

"The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events."

The management of operational risk is an intrinsic part of every business manager's role. HBOS's approach is to ensure business managers identify, assess, prioritise and manage all substantial risks in a cost effective and consistent manner.

To this end HBOS uses a combination of self assessment, risk event and indicator analysis, appropriate insurance cover and contingency arrangements, together with sound control procedures and systems. This approach is entirely consistent with the current proposed amendments to the Basel Capital Accord. These activities will continue to be implemented throughout 2002.

Each line of business is required to compile an operational risk profile which sets out the internal assessment of risk and controls against consistent categories as a form of self certification. These profiles are presented to the Board and are subject to half-yearly updates and independent review by the relevant risk teams. They are also validated by Internal Audit during the course of their work.

In addition a number of specialist support functions provide centralised expertise in operational risk areas such as information security, fraud, corporate insurance and business continuity planning.

Liquidity Risk

Liquidity risk is the risk that the Group will be unable to meet financial commitments arising from the cashflows generated by its business activities. This risk can arise from mismatches in the timing of cashflows relating to assets, liabilities and off-balance sheet instruments.

The Group's UK liquidity is managed by Treasury Services Division. It operates to GALCO guidelines which ensure that the Group's funding requirements can be met at all times and that a stock of high quality liquid assets is maintained in a form and at a level which reflect prudent banking practice.

A further objective is to raise funding as cheaply as possible whilst ensuring that no significant unintended mismatches arise between loans and deposits. Close control is exercised over both volume and quality of short-term deposits, with the sources and maturities being managed to avoid a concentration of funding requirements at any one time from any one source. The framework ensures that the Group meets regulatory authority requirements.

Activity	Risk	Type of Derivative
Management of the investment of reserves and other non-interest bearing liabilities	Sensitivity to falls in interest rates	Receive fixed interest rate swaps Purchase of interest rate floors
Fixed and capped rate mortgage lending	Sensitivity to increases in interest rates	Pay fixed interest rate swaps Purchase of interest rate caps
Fixed rate savings products	Sensitivity to falls in interest rates	Receive fixed interest rate swaps
Fixed rate funding	Sensitivity to falls in interest rates	Receive fixed interest rate swaps
Fixed rate asset investments	Sensitivity to increases in interest rates	Pay fixed interest rate swaps
Investment and funding in non-sterling currencies	Sensitivity to changes in foreign exchange rates and interest rates	Cross currency interest rate swaps Foreign exchange contracts
Investment in assets/issuance with embedded options	Sensitivity to changes in underlying rates and rate volatility	Interest rate swaps, caps and floors Matched swaps with embedded options

Market Risk

This is the risk of financial loss from changes in market prices of financial instruments – typically resulting from movements in interest rates (Interest Rate Risk), equity or other indices, and foreign exchange rates (Foreign Exchange Risk). Overall accountability for the management of market risk and responsibility for setting limits for business areas lies with the GALCO.

Interest Rate Risk

The primary market risk faced by the Group is interest rate risk. Interest rate risk exists where the Group's financial assets and liabilities have interest rates set under different bases or reset at different times.

The Group assumes interest rate risk from dealings with customers, through fixed term lending, deposit taking or derivative contracts. This risk is monitored by Group and Divisional Asset and Liability Management within a framework determined by the GALCO. Trading activity is undertaken by Treasury Services Division.

The effect of interest rate movements is assessed using sensitivity analysis and other modelling techniques. Sensitivity to interest rate movements is shown in Note 44 to the Accounts on pages 99 and 100 which provides the year end repricing profile for the Group's financial assets and liabilities in the non-trading book, which includes lending, funding and liquidity activities. These activities typically lead to a surplus of liabilities over assets repricing in the short-term.

A liability (or negative) gap exists when liabilities reprice more quickly or in greater proportion than assets during a given period. This tends to benefit net interest income when rates are falling.

An asset (or positive) gap exists when assets reprice more quickly or in greater proportion than liabilities during a given period. This tends to benefit net interest income when rates are rising.

Interest rate risk is held in several currencies.

Foreign Exchange Risk

Structural foreign exchange exposures, which are set out in Note 46 of the Accounts on page 101, arise from the Group's investments in overseas subsidiaries, branches and other investments.

Foreign exchange exposures in Treasury Services Division, which arise in the normal course of business, are transferred to the trading book where they are managed within the GALCO approved limits.

Trading

The Group's market risk trading activities are principally conducted by Treasury Services Division in the UK. The regulatory capital charge for market risk trading exposures represents less than 1.36% of the Group's capital base.

The Group employs several complementary techniques to measure and control trading activities including: Value at Risk (VaR), sensitivity analysis, stress testing and position limits. The VaR model used forecasts the Group's exposure to market risk within an estimated level of confidence over a defined time period.

The year end VaR value was £13.8m. The calculation is based upon a confidence interval of 99% with a one day holding period. The Group recognises that the VaR methodology cannot guarantee the maximum loss that may be suffered in any trading period, particularly in the event of market turmoil. Therefore, stress testing is used to simulate the effect of selected adverse market movements.

The Group's trading market risk exposure for the year ended 31 December 2001 is analysed in Note 45 on page 100 of the Accounts.

The VaR figures reported for 2001 are more indicative of the on-going market risk profile in HBOS Treasury than those reported for 2000. Halifax Treasury trading activity was only initiated from June 2000 and was still at an embryonic stage by the end of that year.

Derivatives

In the normal course of banking business, the Group uses a limited range of derivative instruments for both trading and non-trading purposes. The principal derivative instruments used are interest rate swaps, interest rate options, cross currency swaps, forward foreign exchange contracts and futures. The Group uses derivatives primarily as a risk management tool for hedging interest rate and foreign exchange rate risk.

The table on the previous page provides an illustration of the traditional banking services and activities which can give rise to market risk exposures and the way in which this can be managed and mitigated by using derivatives.

The Group's activity in derivatives is controlled within risk management limits set by GALCO. This framework recognises the principal risks including credit, operational, liquidity and market risk associated with derivatives. Details of derivative contracts outstanding at the year end are included in Note 41 of the Accounts on pages 95 and 96.

Pedro Da Silva, Mortgage Advisor, Strand Branch, Halifax



Ian Lee, Global Analyst, Clerical Medical Investment Management





The New Force in the Community

Our performance is underpinned by a set of principles. We believe in conducting business in the right way. We owe our success to our shareholders, customers, people and the communities in which we operate. We have responsibilities to all of them.

Halifax and Bank of Scotland have both earned strong reputations for their approach to social responsibility and the merger now provides us with the opportunity to share best practice to establish an even more powerful force within the Community.

In 2001 we were included in the FTSE 4Good UK and European Indexes which recognise only companies 'moving towards best practice' in promoting practices that mitigate damage to the environment, that encourage respectful and constructive relations with stakeholders and that support and respect the protection of international human rights.

Building on the Corporate Citizen Report produced by Bank of Scotland and the Environment Report produced by Halifax in 2001, we plan to issue our first report on our approach and performance on social responsibility later this year.

Our business ... what we do best

Our biggest contribution to the Community is through the products we offer and the customers we serve. Our commitment to great value products coupled with transparent and honest communication enables as many people as possible to save for and protect their futures.

We are committed to tackling social exclusion and our approach to community banking is leading the way for other banks to follow. The award-winning Bank of Scotland EasyCash Account was one of the first in the UK to offer customers the same benefits enjoyed by current account holders but without the risk of running up unwanted overdrafts or bank charges. Together with the Halifax CardCash Account this gives HBOS over 30% of the total market for social banking accounts. Mobile banking units in rural Scotland and facilities for non-English speaking customers are just two further examples of our approach to financial inclusion.

We're also committed to making our products easily available to as many people as possible. We provide customers with literature in alternative formats such as Braille and large print and over 250 branch staff are now qualified British sign language interpreters. We also provide induction loops for customers with hearing impairments.

Our efforts to make our products and services accessible to customers with disabilities were recognised by Halifax winning the 2001 Queen Elizabeth Foundation BSA Award for Bank & Building Societies.

Our people ... the reason behind our success

We are passionate about promoting dignity at work and are determined to create the most friendly, most motivated workforce wherever we do business. We will achieve this by creating a culture in which individual and team performance is valued, and in which people are helped to develop to their full potential in an open, honest and non-hierarchical working environment. We recognise the diversity of our workforce and are committed to remaining at the forefront of progressive companies in our 'work life' policies. We aim to achieve a workforce that is reflective of our current and potential customer base to better serve the changing communities in which HBOS operate. For example, we are working with Mencap to increase employment opportunities for people with learning disabilities and offer supported employment via Remploy.

We also recognise that everyone has a voice in a fast moving organisation, where positive dialogue is encouraged and valued. In addition to an annual opinion survey amongst all staff and monthly tracking of these opinions, we encourage discussion and consultation on all topics that are of interest to our people. Our internal communication programme is extensive and includes both

Forging a brighter future
Mike Robertson, a member
of FORGE, a cross-charity
organisation sponsored by the
Bank of Scotland, inspects new
saplings planted in the Loch
Lomond and the Trossachs
National Park, Scotland.

The New Force in the Community continued

group-wide communications, such as HBOS TV, as well as local business communications. Through our recognition of the Independent Union of Halifax Staff (IUHS) and Unifi, the banking and financial services sector union, we provide staff with formal mechanisms for consultation and representation. In 2001, we invested more than £50 million in developing the skills of our people. Our development programmes range from job related training and graduate induction courses through to MBA style management courses at Harvard and secondments to enterprise bodies and charities.

Our reward philosophy ensures that every colleague can share in the success of the business. We aim to be an employer of choice, and recognise that our remuneration package must provide real value to recruit and retain quality staff, particularly in view of the extremely competitive market for financial services staff.

A structured approach to salaries, bonuses, share ownership plans and benefits designed to provide a strong framework ensures that rewards are directly linked to performance and builds upon the commitment of our colleagues. The Bank of Scotland's flexible benefits plan gives employees the opportunity to tailor their benefits package to suit their own lifestyle, and the majority have already chosen to do so. We will build on this success by introducing a flexible benefits package for all colleagues within HBOS.

Colleagues are incentivised through both short-term cash bonuses, based on the business parameters they can influence through their actions, and longer term by share ownership plans based on the added value to shareholders. In September 2001, the HBOS Sharesave was launched which resulted in over 62% of colleagues participating. In addition, employees have the opportunity to invest some or all of their

short-term cash bonus in HBOS shares, with an enhancement of one free share for every two purchased if the shares are held for three years.

A long-term share option plan has been developed, which will provide the majority of employees with options to buy HBOS shares during a set period. For more senior colleagues a long-term conditional share grant will be available, with shares being granted upon delivery of demanding corporate performance. Shareholder approval will be sought as required for those plans which have yet to be implemented.

Our community... from which we draw our success

Wherever we do business, we aim to support the local community from which we draw our success.

Over the past 5 years, we have contributed over £23m to benefit thousands of community organisations throughout the UK. We also offer our support by using our business resources, for example through the donation of computers and furniture, and by offering collection account facilities in our branches enabling charities to fundraise for major appeals at very low cost. Above all, community organisations benefit significantly through the fundraising and volunteering efforts of our people. Whilst money and gifts in kind are welcomed by community organisations, for many the most valuable contribution is the giving of our time and skills. We actively encourage our people to get involved. As further encouragement, we match the money raised for charity by staff. This has benefited hundreds of good causes. For example, in October last year, our people raised over £35,000 for Cancer Research UK. Taken together, these activities make HBOS one of the UK's most actively involved businesses.

In the future our activity will be organised under the umbrella of the HBOS Foundation

due to launch later this year. Its activities will focus on a number of broad themes.

Debt counselling and money advice

Supporting independent agencies such as Citizens Advice Bureaux (CAB) and Money Advice Trust provide assistance for people experiencing severe financial difficulties. In 2001 we funded the development of an online debt counselling module for CAB offices which will help them manage workloads more efficiently.

Online technology

Developing sites for charities which enable them to communicate with their supporters and clients over the Internet. For example, the development of the National Asthma Association's website aimed at encouraging young people to discuss issues relating to asthma.

Education and Life Long Learning

Helping those with learning difficulties and people taking second chance learning opportunities. For example, in 2001 we funded the development of an Access Bus for the Open University.

Community support

Helping small community groups in those locations where we have offices and branches, especially those that encourage involvement in community life or supporting groups on low incomes and who experience exclusion. For example in 2001, we made bank accounts and business start-up loans available to vendors of the Big Issue. Since 1988 over £15m has been donated to British Heart Foundation, Imperial Cancer Research, Mencap and many other medical charities through our charity Visa cards. In 2001, we helped the Princess Royal Trust for Carers raise significant new funds for their important work and sponsored a volunteers day.

Ann Little, Banking Advisor, Derry's Cross Plymouth Branch, Halifax



Our environment...

We recognise our responsibility to minimise the long-term impact, whether direct or indirect, that our business activities have on the environment.

In 2001, Bank of Scotland was classified as AA and Halifax as AA- under the Bureau Veritas Safety and Environmental Risk Management rating system that provides an indication of the extent that an organisation manages its operational and environmental risk exposure. Bank of Scotland was ranked 2nd across the UK banking sector. Both businesses also contribute to the Business in the Environment index.

Our lending and leasing policies ensure that our teams are kept abreast of potential environmental risks and actions that are required to mitigate such risks. We are a leading provider of limited-recourse finance to the renewable energy sector, and have participated in many environmentally friendly projects such as municipal waste-to-energy facilities, poultry litter-fired power stations and landfill gas schemes.

Our procurement decisions take account of environmental issues and we encourage suppliers and contractors to commit to good practice in line with our policies. We purchase renewable 'green energy' to meet 10% of our annual electricity requirements in Scotland. This reduces our energy-related greenhouse gas emissions by around 4,300 tonnes of CO₂ per annum.

Throughout our business we are introducing Environmental Action Plans aimed at reducing energy consumption, waste and paper usage. As we refurbish offices and branches we are introducing new measures to reduce energy and water consumption, and we are deploying environmentally friendly travel plans.

In conjunction with our desire to support the local community, we also seek to foster a wider understanding of environmental issues

within the Community by sponsoring a variety of initiatives in support of our environmental policies. For example, in 2001 we funded the development of Ergo, a quarterly online environment magazine produced by the environmental charity Global Action Plan, we sponsored the Action at School programme in the North West of England and in Calderdale, we supported the foundation of the Calderdale Sustainable Business Forum.

In Scotland we were instrumental in bringing together 16 charities under one umbrella project called Our Future for Forests with the aim of supporting woodland conservation and the protection of wildlife. This is one of the largest business environment sponsorships in the UK, and at the prestigious 2001 Hollis Awards, Bank of Scotland won the Best Environment Sponsorship award for this initiative.

Our health and safety responsibilities...

Both the Bank of Scotland and the Halifax recognised their corporate responsibility for ensuring the Health and Safety of colleagues and customers alike, with both companies regarding the control of health and safety as an integral part of their risk management philosophy.

A cornerstone of their approach to health and safety management is the principle of partnership, with both companies participating actively in 'Lead Authority' partnerships with Glasgow and Calderdale MBC. In practice this means that the enforcing authority has audited health and safety management systems and is actively involved in developing the management of safety within Bank of Scotland and Halifax. The concept of partnership also included the relationship with the Unifi and the IUHS, to ensure that the spirit of the obligation to consult with employee representatives was also part of the approach to managing health and safety.

Bank of Scotland has also established a partnership with the enforcing authority for Fire legislation, Lothian and Borders.

The success of the Halifax was recognised by both a gold award and a commendation for Safety training, from RoSPA, together with a prestigious award from the Health and Safety Executive recognising the contribution of the Halifax to European Week of Safety and Health.

Following the merger of Bank of Scotland and Halifax a HBOS Group policy has already been produced as part of the Group risk management structure, this will provide a solid foundation for the development of a pragmatic and consistent approach to health and safety management across the Group.

The existing partnerships with both the Unions and the Lead Authority will be continued and further developed. It is also planned that the implementation of Group policy will be supported by a network of trained health and safety co-ordinators – based on a successful approach developed by the Bank of Scotland.

Rocky, Big Issue Salesman, Princes Street, Edinburgh



£23m

HBOS has contributed more than £23m over the past 5 years to benefit thousands of community organisations.

The Board

Lord Stevenson
Chairman

Peter Burt
Executive Deputy Chairman

James Crosby
Chief Executive

Executive Directors

Andy Hornby
Chief Executive, Retail Banking

Phil Hodgkinson
Chief Executive, Insurance & Investment

Colin Matthew
Chief Executive, Business Banking

George Mitchell
Chief Executive, Corporate Banking

Gordon McQueen
Chief Executive, Treasury

Mike Ellis
Group Finance Director

Non-Executive Directors

Charles Dunstone
Age 37, Charles was appointed to the Board of Halifax in February 2000. He is Chairman and Chief Executive Officer of the Carphone Warehouse plc, Europe's largest independent retailer of mobile communications equipment, which he founded in 1989.

Sir Ronald Garrick
Age 61, Sir Ronald was appointed to the Board of Bank of Scotland in March 2000. He is Chairman of The Weir Group PLC having previously been Chief Executive of that Company for over 16 years. Sir Ronald was appointed CBE in 1986 and knighted in 1994 for services to industry and public life in Scotland.

Tony Hobson
Age 54, Tony joined the Board of Halifax in May 2001. He was formerly Group Finance Director at Legal and General from 1987, retiring from the Board on 28 February 2001. He was previously with Sperry Corporation, SG Warburg, and Arthur Andersen and was the senior independent director of Thames Water PLC until November 2000. He is a non-executive director of Glas Cymru and Jardine Lloyd Thomson Group.

Brian Ivory
Age 52, Brian was appointed to the Board of Bank of Scotland in 1998. He is Chairman of The Scottish American Investment Company PLC, a director of Remy Cointreau SA and Chairman of the National Galleries of Scotland. He was Chairman and Chief Executive of Highland Distillers plc until 1999 and was appointed CBE in 1999.

John Maclean
Age 58, John was appointed to the Board of Bank of Scotland in 1995. He is a non-executive director of Scottish Value Trust PLC and a number of unlisted companies and was a founder and director of Kelvin Shipholdings Limited.

Coline McConville
Age 37, Coline was appointed to the Board of Halifax in February 2000. She is Chief Operating Officer of Clear Channel International Ltd, a media group with operations in 56 countries. Previously, she was with management consultants McKinsey and Co in London and The LEK Partnership in Munich.

Sir Bob Reid
Age 67, Sir Bob was appointed to the Board of Bank of Scotland in 1987 and was appointed as Deputy Governor in 1997. He was Chairman and Chief Executive of Shell UK Limited until 1990 and Chairman of British Railways Board between 1990 and 1995. Sir Bob is Chairman of the International Petroleum Exchange of London and of Sondex Limited. He is a non-executive director of Avis Europe plc, The Merchants Trust plc, Siemens Holdings plc and the Sun Life Assurance Company of Canada Inc. He is Chancellor of the Robert Gordon University, Chairman of each of Kings Cross Partnership, Foundation for Management Education, Edinburgh Business School and Learning through Landscapes.

Louis Sherwood
Age 60, Louis joined the Board of Halifax in January 1997. He is Chairman of Govett European Technology and Income Trust PLC. He was formerly Chairman of HTV Group plc between 1991 and 1997. He is a non-executive director of ASW Holdings PLC, ROK Property Solutions plc and Wessex Water Services Ltd.

Lord Simpson of Dunkeld
Age 59, Lord Simpson is a non-executive director of Nestle SA and Alstom SA and was Chief Executive of Marconi plc, formerly The General Electric Company plc, from September 1996 to September 2001. Created a life peer in the Prime Minister's Honours List in August 1997, Lord Simpson is a former Chief Executive of Lucas Industries (1994-96) and in the early 1990s held the posts of Chairman and Chief Executive of Rover Group and Deputy Chief Executive of British Aerospace plc.

Philip Yea
Age 47, Philip joined the Board of Halifax in October 1999. He was formerly Finance Director of Guinness PLC and subsequently Diageo plc before joining Investcorp in 1999. He is a non-executive director of Manchester United PLC.

Directors' Report

The Directors have pleasure in presenting the Report and Accounts of HBOS plc for the period ended 31 December 2001.

Principal Activities

HBOS plc was incorporated on 3 May 2001. As a consequence of the approval of schemes of arrangement of the Governor and Company of the Bank of Scotland and Halifax Group plc, which became effective on 7 September and 10 September 2001 respectively, it became the holding company of the HBOS Group. Prior to that date HBOS plc had not traded.

The principal activities of the Group are the provision of banking and other financial services in the UK and overseas. The Group's existing business and future prospects are reviewed by the Chairman and the Chief Executive on pages 2 and 3 and pages 6 to 8 respectively and in the Divisional Reviews on pages 11 to 33. Financial aspects are covered in the Financial Review and Risk Management report on pages 35 to 43. A list of the main subsidiary undertakings, and the nature of each company's business, is given in Note 55 to the Accounts on page 107.

Results and Dividends

The Group profit attributable to shareholders for the year ended 31 December 2001, as shown in the Consolidated Profit and Loss Account, was £1,676 million (2000: £1,778 million). An interim dividend of 9.3p per Ordinary Share was paid on 31 October 2001. The Directors propose a final dividend of 18.7p per Ordinary Share to be paid on 31 May 2002 to shareholders on the register at the close of business on 15 March 2002, subject to approval at the Annual General Meeting. Shareholders will be offered the choice of receiving additional ordinary shares rather than cash in respect of this dividend. In addition shareholders will be asked at the Annual General Meeting to give Directors the authority to offer shares instead of cash in respect of future dividends.

Directors

On incorporation the Directors of HBOS plc were Jordans (Scotland) Limited and Oswalds of Edinburgh Limited. Both Directors resigned on 3 May 2001 and were replaced by Precis Company Services Limited and Peregrine Secretarial Services Limited, who served as Directors from that date until 31 May 2001 when they also resigned. No remuneration was paid in respect of any of these directorships. On 31 May 2001 Mike Ellis and Sir Bob Reid were appointed Directors. The following additional Directors were appointed on 5 June 2001: Peter Burt, James Crosby, Charles Dunstone, Sir Ron Garrick, Tony Hobson, Andy Hornby, Brian Ivory, John Maclean, Colin Matthew, Coline McConville, Gordon McQueen, George Mitchell, Louis Sherwood, Lord Simpson of Dunkeld, Lord Stevenson of Coddanham and Philip Yea. Phil Hodgkinson was appointed a Director on 24 September 2001.

Details of the present Directors are given on page 48. With the exception of Lord Simpson, who will retire at the conclusion of the meeting, all will stand for election by shareholders at the Annual General Meeting. Particulars of Directors' remuneration and interests in shares of the Company are given in the Report of the Board in relation to Remuneration Policy and Practice on pages 51 to 60.

Employees

HBOS Group encourages applications for employment from disabled people and gives full consideration to such applicants based on their skills and abilities. In the event of an existing employee becoming disabled, the Group provides counselling and training support and seek to provide a suitable alternative position within the Group if the individual is unable to continue in their previous role. The Group offers training and career development for all disabled staff. The views of colleagues with a disability are sought through disability forums to ensure that the Group's policies continue to recognise their requirements.

Employee communication issues are reviewed on pages 45 and 46.

Charitable and Political Donations

During the year the Group made charitable donations in the UK of £4.5 million. Additionally £2.2 million in total has been made available to charities as a result of their affinity to the Visa Charity credit cards offered by Halifax plc and Bank of Scotland. No political contributions were paid in the year.

Payment Policy

For the forthcoming period the Group's policy for the payment of suppliers will be as follows:

- Payment terms will be agreed at the start of the relationship with the supplier and will only be changed by agreement;
- Standard payment terms to suppliers of goods and services will be 30 days from receipt of a correct invoice for satisfactory goods or services which have been ordered and received unless other terms are agreed in a contract;
- Payment will be made in accordance with the agreed terms or in accordance with the law if no agreement has been made; and
- Suppliers will be advised without delay when an invoice is contested and disputes will be settled as quickly as possible.

HBOS plc complies with the Better Payment Practice Code. Information regarding this Code and its purpose can be obtained from the Better Payment Practice Group's website at www.payontime.co.uk.

The Company's main trading subsidiary undertakings, Halifax plc and the Governor and Company of the Bank of Scotland had trade creditors outstanding at 31 December 2001 representing 23 days of purchases for each company.

The Company itself owed no amounts to trade creditors at 31 December 2001.

Directors' Report

Continued

Share Capital

Full details of the movements in the authorised and issued share capital of the Company during the year are provided in Note 36 to the financial statements on pages 91 and 92.

The Company has authority to purchase up to 355,800,000 of its ordinary shares. The authority remains valid until the Annual General Meeting in 2002 or, if earlier, 12 December 2002. A resolution will be put to shareholders to renew the authority at the Annual General Meeting. At the date of this report no disclosable interest in the issued share capital has been notified to the Company in accordance with sections 198 to 208 of the Companies Act 1985.

Unclaimed Shares

Between 31 July and 30 August 2001 Halifax Group plc ordinary shares held by the unclaimed shares trust were sold at an average price of £8.34 per share. This trust was established, on the conversion of Halifax Building Society to a listed public company in 1997, to hold Halifax plc ordinary shares to which qualifying members of Halifax Building Society and others might be entitled, but which had not been claimed. This trust was terminated when the Halifax Group plc ordinary shares, which represented the original Halifax plc ordinary shares after the corporate restructuring in June 1999, were sold in accordance with the conversion terms and the Articles of Association of Halifax Group plc. The net sale proceeds belong to Halifax Group plc until claimed. Halifax Group plc has recorded the name of the person previously believed to be entitled to claim the shares as a creditor for the net sales proceeds in its accounts and, if a valid claim is made during the period of nine years from the date of sale, will pay the proceeds (without interest) to the person who would have been entitled to the shares. After the expiry of this nine-year period the money will belong to Halifax Group plc absolutely.

Post Balance Sheet Events

On 1 March 2001, the Halifax Group acquired the operating assets, sales force and unit linked and non-profit business of The Equitable Life Assurance Society ('The Equitable'). Subsequently, on 11 January 2002, The Equitable's guaranteed annuity rate and non-guaranteed annuity rate policyholders voted in favour of a scheme of arrangement to compromise their respective claims against the with-profits fund. The scheme became effective on 8 February 2002. As a result of this, in accordance with the terms of the acquisition, in addition to the consideration paid of £507 million, Halifax plc (a subsidiary of HBOS plc) agreed to pay a further £250 million which it has done by unconditionally waiving the repayment of £250 million of loans advanced by it to The Equitable under a fully collateralised loan facility of £251 million, which was granted in 2001. The accounting implications arising from this are set out in Note 50 of the accounts.

Properties

The Directors are of the opinion that the current market value of the Group's properties is not significantly different from the amount at which they are included in the balance sheet.

Auditors

A resolution to re-appoint KPMG Audit Plc as auditors will be put to shareholders at the Annual General Meeting.

On behalf of the Board

H F Baines
Company Secretary
26 February 2002

Report of the Board in relation to remuneration policy and practice

1. Introduction

1.1 Composition and Operation of the Remuneration Committee

The remit of the Committee is given on page 61 in the Corporate Governance Statement. The Committee is chaired by Brian Ivory, a Non-executive Director. The Committee's members are all Non-executive Directors. The Group Chairman, who is not a member of the Committee, together with the Chief Executive and the Group Human Resources Director, attend meetings at the Committee's request.

The Board determines overall remuneration policy for the Executive Directors based on recommendations from the Committee. The Committee determines the remuneration arrangements of the Group Chairman and the Executive Directors. The Group Chairman and the Executive Directors determine the remuneration arrangements of the Non-executive Directors. No Director is present at any meeting of the Board or the Committee when his or her own remuneration or contractual terms are being discussed.

The Committee has access to independent and external advice on remuneration matters.

1.2 Compliance

Full details of the Group's approach to corporate governance, including compliance with the Combined Code appended to the Listing Rules of the UK Listing Authority, are included in the Corporate Governance Statement on pages 61 and 62.

The Committee has followed Schedule A to the Combined Code in designing performance-related bonus schemes for executives. The Board has followed Schedule B to the Combined Code in preparing this Report.

1.3 Service Contracts

The Executive Directors have service contracts which can be terminated by the Group on not less than one year's notice and by the Director on not less than six months' notice. The contract relating to the provision of the services of Lord Stevenson will expire in June 2002, but can be extended by mutual consent for a three year term to June 2005. If terminated prior to expiry of the initial term, or any extension thereof, compensation up to the equivalent of 12 months' fees may be payable. The Non-executive Directors do not have service contracts.

1.4 Basis of Preparation

Directors' remuneration and Directors' share interests for 31 December 2000 and 2001 include those Directors of Bank of Scotland and Halifax Group plc, who were appointed to the Board of HBOS plc, together with those Directors appointed during the year.

2. Remuneration Policy for Executives

2.1 Policy

To deliver its objective of creating real increases in shareholder value relative to the finance sector, the Group needs to attract and retain the most capable and committed people and create the right employment conditions and reward opportunities for them.

The remuneration policy for Executive Directors and other executives is aligned with this objective. Accordingly, the focus of remuneration policy is not primarily on annual salary but is on incentive plans that are closely aligned with the delivery of both operating plans and shareholder value. Group executives will not be well rewarded, in relation to comparable roles in the finance market, unless shareholders are well rewarded.

Therefore, for 2002 and beyond:

- salary policy will be set at market median;
- short-term bonus plans will be based on the delivery of annual operating plans. Executives will be able to opt to take their annual bonus in shares rather than in cash (as will nearly all Group employees). Those that do and retain their shares for three years will receive a 50% enhancement of their shareholding;
- subject to shareholder approval, long-term bonus plans will be based, for the most senior executives, on conditional share grants. Participants will not receive any of these shares unless the Group's relative total shareholder return is above that of the finance sector as measured using the weighted average total shareholder return of a comparator group of companies. This long-term scheme is highly geared so that average performance generates no reward but outstanding performance generates high levels of reward.

The Group believes that share ownership by employees throughout the Group enhances their alignment with shareholders' interests. Therefore colleagues in the Group are able to own shares through:

- the save as you earn scheme where there is a participation level of 62%;
- the annual bonus plans where, from January 2002, all employees can opt to take annual bonus in shares rather than in cash, with those who take their annual bonus in shares and retain them for three years receiving a 50% enhancement of their shareholding.

Shareholder approval is being sought this year for a share option plan. Under the first operation, employees who are not in the most senior executive group would receive a grant of share options equivalent to 20% of salary.

These schemes apply to the vast majority of employees throughout the Group. They form a key element in the Group's commitment to creating a competitive, flexible and performance-oriented reward structure that is designed to attract, inspire and retain skilled people throughout the Group.

Report of the Board in relation to remuneration policy and practice

Continued

2.2 Salary

Salary benchmarks for executives are reviewed annually, taking account of information from independent sources on salary rates for comparable jobs in the finance industry and in other selected major public companies. Actual salaries will normally be reviewed annually but can be reviewed at any time. There is no automatic annual salary increase.

Pension entitlement is based on salary only.

2.3 Bonus Schemes

The purpose of the bonus schemes is to provide a direct link between each individual's remuneration and his or her performance, that of the business he or she works in and that of the Group, both annually and over the longer term.

All Executive Directors and a substantial majority of other executives will participate in new Group-wide bonus schemes in 2002. Levels of participation will differ in order to align overall individual remuneration with the Group's policy objectives outlined earlier. Different, market-appropriate, arrangements will exist for a small number of executives within the Group.

Payment of bonuses, for Executive Directors and certain other senior executives, is subject to the approval of the Committee. Except in circumstances in respect of initial periods of employment, no Executive Director has a contractual right to a bonus.

Bonus arrangements applying during 2001 in Halifax Group plc ("Halifax") and Bank of Scotland (the "Bank") are set out below.

2.3.1 Short Term Bonus Scheme for 2001 – Former Halifax Executives

The levels of payments under the scheme are dependent, for Executive Directors and most other executives, on the extent to which participants achieve their operating plan objectives. In 2001, for Executive Directors, payment of target bonus required the achievement of targets for earnings per share (EPS) and return on equity (ROE) and the attainment of a certain level of profit before tax (PBT). Threshold bonus is paid if EPS and ROE are achieved at 95% of target levels. Maximum bonus is paid if EPS and ROE are achieved at 105% of target levels. No bonus is paid if performance falls below the threshold levels for EPS and ROE and bonus is halved if PBT falls below 97.5% of target. The benchmark payment levels which applied for 2001 were as follows:

Executive category	Bonus as a % of salary			
	Threshold	Just Below Target	Target	Maximum
Tier 1 including Executive Directors	20.00%	39.99%	55.00%	82.50%
Tier 2	16.25%	32.49%	45.00%	67.50%
Tier 3	12.50%	24.99%	35.00%	52.50%
Tier 4	8.75%	17.49%	25.00%	37.50%

2.3.2 Long Term Bonus Scheme for 2001-2003 – Former Halifax Executives

Participants in the scheme are granted conditional shares at the start of each operation of the scheme equal to a number of shares secured by a percentage of the participant's salary and based on the price of the Group's shares, using the average market price in the ten business days ending at the previous year end, as follows:

Executive category	Conditional share grant as a % of salary
Tier 1 including Executive Directors	100%
Tier 2	75%
Tier 3	50%
Tier 4	25%

The number of shares actually released to participants under the scheme is dependent on the Group's annualised total shareholder return (TSR) (defined as the gross overall return on ordinary shares of Halifax Group plc (now HBOS plc) after all adjustments for capital actions and re-investment of dividends or other income) over three-year periods, compared to the annualised weighted average TSR of a basket of comparator companies over equivalent periods, as follows:

Group's relative TSR performance	Proportion of share grant released
0% p.a. (or below)	0%
+4% p.a.	100%
+8% p.a. (or above)	200%

Intermediate positions are determined by interpolation.

There is, however, a guaranteed minimum release of 60% of the share grant, for both this scheme and the 2000-2002 scheme, as agreed by Halifax shareholders at the time of the merger. This reflected the comparative performance position at the time of the merger announcement.

2.3.3 Share Option Schemes – Former Halifax Executives

These schemes, which were introduced early in 2001, apply to a substantial majority of employees but do not apply to executives, for whom the above long-term scheme was already in place.

2.3.4 Short Term Bonus Schemes for 2001 – Former Bank of Scotland Executives

Executive Directors and other executives participate in an annual performance bonus plan which is payable in cash.

The maximum overall bonus is determined by the Board on the recommendation of the Remuneration Committee. For the ten month period to 31 December 2001 the bonus pool has been set at 52.5% of total relevant salaries. Individual awards have been decided by the Remuneration Committee based on a combination of Group, business and individual performance.

Executive Directors and other executives were eligible to participate, on the same basis as all other eligible staff, in the Bank of Scotland's profit sharing schemes which make payments based on the level of the pre-tax return on shareholders' funds.

There are two profit sharing schemes, a stock scheme and a cash scheme, run in parallel. The maximum total annual amount payable under these schemes is 15% of a participant's eligible salary. Subject to Inland Revenue limits, participants can choose to take their profit sharing entitlement (if any) as ordinary shares, with such shares held in trust for them for three years, or as cash.

2.3.5 Long Term Bonus Scheme for 2001 – Former Bank of Scotland Executives

Executive Directors and other executives have been eligible to participate in the Bank of Scotland's Inland Revenue approved and unapproved Executive Stock Option Schemes, which were adopted by shareholders in 1985, 1995 and 1996 respectively.

The rules of the 1995 Scheme contain a performance pre-condition on exercise which is that options are not capable of being exercised unless growth in diluted earnings per share has exceeded the growth in the Retail Price Index over a period of not less than three consecutive financial years by not less than 2% per annum. For the 1985 Scheme no such performance condition required to be satisfied. Following the merger, the rules of the 1996 Scheme, which were virtually identical to those of the 1995 Scheme, were amended to allow participants who leave within 18 months of the Bank's Scheme of Arrangement becoming effective and participants who remain employed on the 3rd anniversary of the option grant to exercise such options without reference to performance.

However, as a result of the merger no options were granted under these schemes during 2001. In lieu of such a grant, a cash payment of 5% of salary was made to all executives who would otherwise have received an option grant in 2001.

2.4 Benefits

Each executive is provided with benefits which principally comprise a company car, pension arrangements, paid leave, healthcare cover and a preferential terms mortgage.

Executives are eligible for membership of tax-approved final salary pension arrangements and, for certain executives who joined the Group after 1989, separate unfunded final salary pension arrangements. These arrangements, taken together, provide a personal pension benefit based on salary only, with a maximum pension of two thirds of final salary (in broad terms, the last 12 months' salary) at normal retirement age (age 60), subject to the necessary pensionable service. The arrangements also provide a lump sum life assurance benefit of four times salary and pension benefits for spouses and qualifying children. All tax-approved benefits are subject to Inland Revenue limits.

3. Directors' Remuneration for the year ended 31 December 2001

3.1 Directors

3.1.1 Year-on-Year Comparison for Executive Directors

Details of the remuneration of the Executive Directors are summarised in Table 1 below:

Table 1

	2001			2000		
	Salary, taxable benefits	Annual bonus	Total	Salary, taxable benefits	Annual bonus	Total
	(Note 2)	(Note 1)		(Note 1)	(Note 1)	
£000	£000	£000	£000	£000	£000	
Peter Burt	593	401	994	458	224	682
James Crosby	578	495	1,073	472	218	690
Mike Ellis	430	371	801	353	165	518
Phil Hodgkinson	94	132	226	–	–	–
Andy Hornby	346	301	647	270	125	395
Gordon McQueen	361	231	592	195	85	280
Colin Matthew	343	231	574	184	85	269
George Mitchell	398	280	678	183	88	271

Report of the Board in relation to remuneration policy and practice

Continued

Notes to Table 1

Note 1:

In respect of 2001, the annual cash bonus for former Halifax Executive Directors was 82.5% of salary at the year end, excluding any enhancements of bonus if taken as shares.

In respect of 2000, the annual bonus shown is based on the cash element only. Messrs Crosby, Ellis and Hornby chose to take all their bonus in shares which means that these bonuses will qualify for a 50% share enhancement after three years.

The annual bonus shown for the same year for Messrs Burt, Matthew, McQueen and Mitchell includes both their profit sharing entitlement of 15% of eligible salary and the annual performance bonus.

Note 2:

The salary and taxable benefits shown for Phil Hodgkinson includes a £60,000 bonus agreed on his appointment.

3.1.2 Regulatory Presentation for Directors

Table 2 below has been prepared in accordance with regulatory requirements in respect of Directors' remuneration for the year ended 31 December 2001:

Table 2

	Notes	Salary £000	Taxable Benefits £000	Annual cash bonus £000	Fees and further remuneration £000	Total year ended 31.12.01 £000	Comparative total year ended 31.12.00 £000
Chairman							
Lord Stevenson	5	350	—	—	13	363	265
Deputy Chairman							
Peter Burt	2	575	10	401	8	994	682
Executive Directors							
James Crosby	1	555	23	495	—	1,073	690
Mike Ellis	1	417	13	371	—	801	518
Phil Hodgkinson	1,3	94	—	132	—	226	—
Andy Hornby	1	334	12	301	—	647	395
Gordon McQueen	2	325	28	231	8	592	280
Colin Matthew	2	325	10	231	8	574	269
George Mitchell	2	377	13	280	8	678	271
Non-executive Directors							
Charles Dunstone	—	—	—	—	36	36	28
Sir Ronald Garrick	—	—	—	—	48	48	27
Tony Hobson	3	—	—	—	73	73	—
Brian Ivory	—	—	—	—	54	54	39
Coline McConville	—	—	—	—	44	44	33
John Maclean	—	—	—	—	73	73	70
Sir Bob Reid	—	—	—	—	128	128	154
Louis Sherwood	4	—	—	—	99	99	77
Lord Simpson	—	—	—	—	33	33	—
Philip Yea	—	—	—	—	45	45	32
Total		3,352	109	2,442	678	6,581	3,830

Notes to Table 2

Note 1:

The terms of the Short Term Bonus Scheme for former Halifax Executive Directors are set out in 2.3.1. The amounts approved by the Committee relate to 2001. They exclude any potential enhancements if bonus is taken in shares.

Note 2:

The terms of the Short Term Bonus Scheme for former Bank Executive Directors are set out in 2.3.4. The amounts approved by the Committee relate to 2001. The amounts reflect the bonus paid on a proportionate basis for the 2 month period to 28 February 2001 and the 10 month period to 31 December 2001.

Note 3:

Tony Hobson was appointed as a Director on 5 June 2001. Phil Hodgkinson was appointed as a Director on 24 September 2001, at which time a guaranteed bonus of £60,000 was agreed.

Note 4:

Payments to Louis Sherwood include fees of £46,150 (2000 – £41,892) in respect of services as Chairman of Clerical Medical Investment Group Ltd.

Note 5:

The fee payment to Lord Stevenson of £12,500 (2000 – £14,583) relates to his services as a Director of St. James's Place Capital plc. The amount shown as 'salary' relates to payments made in respect of the services of Lord Stevenson as Chairman of the Company (and, prior to the merger, of Halifax Group plc).

3.1.3 Non-Executive Directors

In 2001 the annual fee payable to Non-executive Directors was at a rate of £30,750 p.a. The annual fee previously payable to Non-executive Directors in the Bank was £22,000 p.a. and to Non-executive Directors in Halifax was £30,750 p.a. These fees covered duties and responsibilities associated with Board meetings and the Annual General Meeting. Further remuneration is paid to Non-executive Directors for the responsibilities associated with Board committees and subsidiary boards.

3.2 Pension Benefits as at 31 December 2001

Details of each Executive Director's pension and lump sum life assurance entitlement, and the costs of providing those benefits, are as follows:

Table 3

	Pension as a % of final salary (Note 1)	Lump sum life assurance as a multiple of salary (Note 1)	Cost of benefits as a % of salary (Note 2)
Peter Burt	55.0%	4	31%
James Crosby	66.7%	4	49%
Mike Ellis	66.7%	4	53%
Phil Hodgkinson	39.0%	4	50%
Andy Hornby	66.7%	4	44%
Gordon McQueen	50.0%	4	28%
Colin Matthew	66.7%	4	28%
George Mitchell	66.7%	4	28%

Notes to Table 3

Note 1:

Pension is based on retirement from service at normal retirement age (age 60) and is based on final salary, disregarding, where relevant, the earnings cap as defined in the Finance Act 1989. Pension and lump sum life assurance is provided from the Halifax Retirement Fund (the "Fund") and from the Bank of Scotland 1976 Pension Scheme (the "Scheme") to the extent permitted by legislation, and otherwise from separate arrangements with the Group.

Note 2:

Costs are based on estimates, by the Actuaries to the Scheme and to the Fund, of the costs to the Group over the future service periods of the Executive Directors. Costs are calculated on the funding assumptions adopted for the latest actuarial valuations of the Scheme and the Fund and do not distinguish between the costs of providing benefits from the Scheme and the Fund and the costs of providing benefits from separate unfunded arrangements.

Report of the Board in relation to remuneration policy and practice

Continued

Details of each Executive Director's accrued pension benefits are as follows:

Table 4

	Age at 31.12.01	Accrued pension p.a. at 31.12.01 £000	Increase in accrued pension for year to 31.12.01 £000	Director's contribution in year to 31.12.01 £000
Peter Burt	57	296	72	–
James Crosby	45	284	61	13
Mike Ellis	50	236	48	11
Phil Hodgkinson	43	3	3	3
Andy Hornby	34	30	15	9
Gordon McQueen	55	144	45	–
Colin Matthew	51	196	55	–
George Mitchell	51	225	82	–

Notes to Table 4

Note 1:

The accrued pension at 31 December 2001 is the pension which the Director would have been entitled to receive based on his completed pensionable service, had he left on 31 December 2001, payable from normal retirement age (age 60) and subject to revaluation increases between leaving and retirement.

Note 2:

The increase in accrued pension is the accrued pension at 31 December 2001 less the accrued pension at 31 December 2000, after allowance for RPI-linked revaluation increases over the year.

Note 3:

The Director's contribution is the personal contribution required under the terms of the Fund (no personal contribution is required under the terms of the Scheme) and is exclusive of any voluntary contributions made. There were no contributions by the Group to any money purchase pension arrangements in respect of any Director during 2001.

Note 4:

The Scheme and the Fund have a normal retirement age of 60. On death after retirement or after leaving service, a spouse's pension equal to 50% of the member's pension for the Scheme and 66.6% of the member's pension for the Fund would be payable. Children's benefits may also be payable.

Members of the Scheme require the consent of the Bank before retiring early. Under the Fund, Executive Directors have a contractual right to retire at age 55 with a non-reduced pension.

Pension increases after retirement are a mixture of guaranteed and discretionary. Increases to Bank of Scotland pensions in respect of service before 6 April 1997 are not guaranteed, but the Bank has an established policy of reviewing pensions on a discretionary basis in line with increases in the Retail Price Index. Increases to Scheme pensions in respect of service after 5 April 1997 are guaranteed to increase in line with the increase in the Retail Price Index, subject to a maximum of 5% per annum. The Fund guarantees to increase pensions in line with the increase in the Retail Price Index, subject to a maximum of 5% per annum and a minimum of 3% per annum.

Allowance is made in transfer values on leaving in respect of the discretionary increases outlined above.

3.3 Directors' Share Interests

3.3.1 Shares

The beneficial interests of the Directors and their immediate families in the ordinary shares of the Group are set out below:

Table 5

	Number of shares at 31.12.01	Number of shares at 31.12.00*
Chairman		
Lord Stevenson	118,303	118,303
Deputy Executive Chairman		
Peter Burt	508,615	482,588
Executive Directors		
James Crosby	55,299	21,775
Mike Ellis	39,638	4,893
Phil Hodgkinson	197	197
Andy Hornby	17,228	4,492
Gordon McQueen	54,445	54,233
Colin Matthew	41,348	39,704
George Mitchell	32,833	31,830
Non-Executive Directors		
Charles Dunstone	100,000	100,000
Sir Ronald Garrick	3,773	2,000
Tony Hobson	1,000	-
Brian Ivory	11,000	11,000
Coline McConville	2,070	2,070
John Maclean	5,030	5,000
Sir Bob Reid	27,160	26,819
Louis Sherwood	10,000	10,000
Lord Simpson	3,863	3,863
Philip Yea	6,185	2,185

* or date of appointment if later.

Note to Table 5

James Crosby, Brian Ivory, John Maclean, George Mitchell and Sir Bob Reid all have a non-beneficial interest as at 31 December 2001, in 7,723,565 ordinary shares as Trustees of the Bank of Scotland Profit Sharing Stock Ownership Scheme.

Brian Ivory has a non-beneficial interest over 4,500 ordinary shares (2000 – 18,000).

Certain Directors will receive further interests in the ordinary shares of the Group arising out of the Short Term Bonus Schemes and, potentially, the Long Term Bonus Schemes and the Executive Stock Option Schemes, as set out in Tables 6, 7 and 8.

Lord Stevenson has a non-beneficial interest over 120,000 ordinary shares of 15 pence each (2000 – 120,000) in St. James's Place Capital plc.

Except as disclosed no Director had any interest in the preference shares of HBOS plc nor in the loan or share capital of any Group undertaking at the beginning or end of the financial year. No options to subscribe for shares in other Group companies are granted to Directors of the Group.

3.3.2 Short Term Bonus Scheme (pre-2000) – Former Halifax Executives

Details of the ordinary shares of the Group in which Directors had an interest under the pre-2000 scheme are set out below:

Table 6

	Grant effective from	At 31.12.00	Granted in Year	Transferred to Participants in Year	At 31.12.01
James Crosby	March 1999	5,943	572	6,515	-
	March 2000	15,906	1,063	16,969	-
Mike Ellis	March 1999	6,466	623	7,089	-
	March 2000	12,164	813	12,977	-
Andy Hornby	March 2000	1,544	103	1,647	-

Note to Table 6

The shares, which relate to the 1998 and 1999 operations of the Short Term Bonus Scheme, were granted at £8.63 and £6.78 respectively, the average market prices in the ten business days ending on 31 December 1998 and 31 December 1999.

The shares granted in 2001 are dividend reinvestment shares received in relation to the 1999 and 2000 grants.

The shares were released to individuals on the merger of the Bank and Halifax.

Report of the Board in relation to remuneration policy and practice

Continued

3.3.3 Short Term Bonus Scheme for 2001 – Former Halifax Directors

Certain Directors have a conditional entitlement to shares arising from the annual bonus. Where the annual bonus for 2000 was taken in shares and these shares are retained in trust for three years, the following shares will also be transferred to the Directors.

Table 7

	Grant effective from	Granted in Year and as at 31.12.01
James Crosby	March 2001	9,710
Mike Ellis	March 2001	7,308
Andy Hornby	March 2001	5,533

Note to Table 7

The shares, which relate to the 2000 operation of the Short Term Bonus Scheme were granted at £6.75.

These shares will be released after 3 years, subject to the bonus shares still being held at that time.

3.3.4 Long Term Bonus Scheme and Special Long Term Bonus Scheme – Former Halifax Executives

Details of the ordinary shares of the Group which have been conditionally awarded to Directors under the schemes are set out below. The performance conditions relating to these conditional awards in respect of schemes effective from 1 January 2000 or later are set out in 2.3.2, other than in respect of the services of Lord Stevenson, where different but equivalent conditions apply.

Table 8

	Grant effective from	At 31.12.00	Granted in Year	Lapsed in Year	At 31.12.01
James Crosby	January 1999	13,867	–	13,867	–
	January 2000	62,684	–	–	62,684
	January 2001	–	70,992	–	70,992
		76,551	70,992	13,867	133,676
Mike Ellis	January 1999	15,088	–	15,088	–
	January 2000	47,935	–	–	47,935
	January 2001	–	53,435	–	53,435
		63,023	53,435	15,088	101,370
Andy Hornby	January 2000	80,752	–	–	80,752
	January 2001	–	40,458	–	40,458
		80,752	40,458	–	121,210
Phil Hodgkinson	January 2001	–	53,435	–	53,435
		–	53,435	–	53,435
Lord Stevenson	July 1999	15,853	–	–	15,853
	January 2000	36,873	–	–	36,873
	January 2001	–	38,168	–	38,168
		52,726	38,168	–	90,894

Notes to Table 8

Note 1:

Shares under these schemes were granted using the average market price in the ten business days ending at the previous year or period end, as follows:

Scheme	Share Grant Price
January 1999 – December 2001	£8.63
July 1999 – December 2002*	£7.885
January 2000 – December 2002	£6.78
January 2001 – December 2003	£6.55

* This scheme applies only in respect of the services of Lord Stevenson.

In respect of the schemes effective from July 1999, January 2000 and January 2001, up to 200% of the grants can be released as outlined in 2.3.2.

The grant effective from January 2000 for the period to December 2002 for Andy Hornby includes 44,248 shares which are related to his joining arrangements. He is guaranteed a minimum release based on an amount of 22,124 shares at the end of that period.

Subject to performance, shares under these long-term schemes will be released to individuals shortly after the three year anniversary (three and a half year anniversary in respect of the first grant relating to Lord Stevenson (see Note 2 below)) of the relevant effective grant date.

Note 2:

In the case of Lord Stevenson the grants are awards of notional shares. For technical reasons he will become entitled to the cash value of the relevant shares on vesting.

This value will, subject to any withholdings for tax or National Insurance, be applied in acquiring shares on his behalf.

Note 3:

As part of the arrangement necessary to facilitate Phil Hodgkinson's recruitment in September 2001, it was agreed that he should receive an award over 53,435 shares, subject to the terms of the Long Term Bonus Scheme, effective from January 2001 (as disclosed above) and (in addition to any award he receives under the normal operation of the proposed new HBOS Long Term Executive Bonus Plan in 2002 (as disclosed in the AGM notice)) an award over shares having a value equal to 100% of salary (with maximum vesting of 200%), subject to the terms of the proposed new HBOS plan, effective from January 2002. Awards are not pensionable.

3.3.5 Long Term Option Scheme – Former Bank of Scotland Executives

Table 9

	Grant effective from	At 31.12.00	Granted in Year	Exercised in Year	At 31.12.01 Note 1	Unit (p)	Exercisable
Peter Burt	October 1995	72,000	–	72,000	–	259.83	–
	October 1996	90,000	–	90,000	–	273.67	–
	October 1997	53,000	–	53,000	–	535.33	–
	October 1998	60,000	–	60,000	–	583.50	–
	May 2000	75,000	–	–	75,000	551.50	2003-2010
	October 2000	90,000	–	–	90,000	610.00	2003-2010
		440,000		275,000	165,000		
Gordon McQueen	October 1995	48,000	–	–	48,000	259.83	2002-2005
	October 1996	45,000	–	–	45,000	273.67	2002-2006
	October 1997	32,000	–	–	32,000	535.33	2002-2007
	October 1998	5,223	–	–	5,223	574.33	2002-2008
	October 1998	29,777	–	–	29,777	583.50	2002-2008
	May 2000	35,000	–	–	35,000	551.50	2003-2010
	October 2000	40,000	–	–	40,000	610.00	2003-2010
		235,000			235,000		
Colin Matthew	October 1995	48,000	–	–	48,000	259.83	2002-2005
	October 1996	50,000	–	–	50,000	273.67	2002-2006
	October 1997	28,000	–	–	28,000	535.33	2002-2007
	October 1998	5,223	–	–	5,223	574.33	2002-2008
	October 1998	29,777	–	–	29,777	583.50	2002-2008
	May 2000	40,000	–	–	40,000	551.50	2003-2010
	October 2000	40,000	–	–	40,000	610.00	2003-2010
		241,000			241,000		
George Mitchell	October 1996	50,000	–	–	50,000	273.67	2002-2006
	October 1997	35,000	–	–	35,000	535.33	2002-2007
	October 1998	40,000	–	–	40,000	583.50	2002-2008
	May 2000	5,572	–	–	5,572	538.33	2003-2010
	May 2000	39,428	–	–	39,428	551.50	2003-2010
	October 2000	50,000	–	–	50,000	610.00	2003-2010
		220,000			220,000		

Report of the Board in relation to remuneration policy and practice

Continued

Notes to Table 9

Note 1:

Executive stock options granted in 1995 and subsequently under the 1995 Scheme are subject to a performance pre-condition on exercise, as outlined in 2.3.5. No Directors' executive stock options lapsed in the period 1 January 2001 to 26 February 2002.

Note 2:

The grants effective from October 1995, October 1996, October 1997 and October 1998 were all exercised by Peter Burt on 9 November 2001. The mid-market price on the date of exercise was 822.46p, resulting in a potential pre-tax gain of £1,195,000.

3.3.6 Sharesave Scheme

The Group's Sharesave Scheme is available to the majority of staff.

62% of eligible staff participate in the scheme. The scheme allows staff to save a fixed amount of money on a monthly basis. At the end of a pre-determined period, of three, five or seven years, staff have the right, if they so choose, to use the funds accumulated to purchase shares in the Group at a fixed price.

Certain eligible Executive Directors have taken up membership of the Sharesave Scheme and the projected numbers of shares which they would be entitled to purchase at the end of the relevant pre-determined period are set out below:

Table 10

	Grant effective from	At 31.12.00		Lapsed in Year	Exercised in Year	At 31.12.01		Initial Exercise Date	Expiry Date
		Granted in Year							
James Crosby	Sept 1997	2,980	–	–	–	2,980	–	Sept 2002	Mar 2003
Mike Ellis	Sept 1997	2,980	–	–	–	2,980	–	Sept 2002	Mar 2003
Andy Hornby	Oct 2000	2,362	–	–	–	2,362	–	Oct 2003	Apr 2004
Gordon McQueen	Nov 2000	3,571	–	–	–	3,571	–	Dec 2005	June 2006
George Mitchell	Oct 2001	–	1,723	–	–	1,723	–	Jan 2005	June 2005

Note to Table 10

Certain eligible Executive Directors make monthly contributions to the scheme. The share grants vary by reference to the monthly contributions, the start dates from which and the periods over which participants have elected to save.

3.3.7 Interest in Shares under Trusts

The former Halifax Executive Directors, together with certain other executives, are deemed to have an interest as potential discretionary beneficiaries under the Group's Employee Share Ownership Plan. As such, they were each treated as at 31 December 2001 as being interested in the 2,100,617 ordinary shares (31 December 2000 – 2,000,000 ordinary shares) held by the trustee of that Trust. The shares held in the Trust will be used to satisfy share awards under the former Halifax Short Term and Long Term Bonus Schemes. The relevant Executive Directors' specific individual interests are shown in Tables 6 and 8.

The former Halifax Executive Directors, together with certain other executives and staff, are deemed to have an interest as potential discretionary beneficiaries under the Group's Qualifying Employee Share Ownership Trust (previously the Halifax plc Qualifying Employee Share Ownership Trust). As such, they were each treated as at 31 December 2001 as being interested in the 14,626,075 ordinary shares (31 December 2000 – 14,626,075 ordinary shares) held by the trustee of that Trust. The shares held in the Trust are available to satisfy the exercise of rights granted under the former Halifax Sharesave Scheme. The former Halifax Executive Directors' specific individual interests are shown in Table 10.

The former Bank Executive Directors, together with certain other executives and staff, are deemed to have an interest as potential discretionary beneficiaries under the Group's Qualifying Employee Share Ownership Trust (previously Bank of Scotland Qualifying Employee Share Ownership Trust). However, as the Trust was not pre-funded, they were each treated as at 31 December 2000 and 31 December 2001 as having no interest as a consequence of that Trust. The Trust was established to satisfy the exercise of rights granted under the former Bank of Scotland S.A.Y.E. Stock Option Schemes. The former Bank Executive Directors' specific individual interests are shown in Table 10.

The Group's Executive Directors, together with certain other executives and staff, are deemed to have a potential interest as discretionary beneficiaries under the Group's Qualifying Employee Share Ownership Trust. However, as the Trust was not pre-funded, they were each treated as at 31 December 2001 as having no interest as a consequence of that Trust. The Trust was established to satisfy the exercise of rights granted under the HBOS Sharesave Scheme. The Group's Executive Directors' specific individual interests are shown in Table 10.

3.3.8 General

The market price of the Group's ordinary shares at 31 December 2001 was £7.96. The market price of the Bank's ordinary stock at 31 December 2000 was £7.005. The market price of Halifax's ordinary shares at 31 December 2000 was £6.635. The ranges during the year were £6.16 to £8.73 (Bank), £6.195 to £8.74 (Halifax) and £6.435 to £8.60 (HBOS).

The register of Directors' interests, which is open to inspection, contains full particulars of the Directors' shareholdings and options to subscribe for shares in the Group.

There has been no change in the Directors' interests in shares or options granted by the Group and its subsidiaries between the end of the financial year and 26 February 2002, the date of approval of this Annual Report & Accounts.

Corporate Governance Statement

HBOS plc was admitted to listing on 10 September 2001 in respect of its ordinary shares and so became subject to the Combined Code ('the Code') issued by the UK Listing Authority. This report explains how HBOS plc developed its governance structure and how it applies the principles set out in the Code. It also reports on compliance with the Code's detailed provisions during the period.

Applying the Principles of the Code

The Code sets out principles of good governance under four headings and these are reviewed below:

The Board

The Board meets regularly (normally 10 times per year) to determine the strategic direction of the Group and review its operating and financial performance. The Board has a formal schedule of matters specifically reserved to it, which can only be amended by the Board itself.

Directors

In addition to the Chairman, the Board comprises eight Executive Directors and ten Non-executives. All of the Non-executive Directors are considered to be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. Their remuneration consists only of fees. The roles of the Chairman and Chief Executive are separate, and Sir Bob Reid has been identified as the Senior Independent Director.

The Articles of Association provide for all Directors to stand for re-election at intervals of no more than 3 years. All of the Directors except Lord Simpson, who will retire at the end of the meeting, will stand for election by the shareholders of HBOS plc at its first Annual General Meeting following the merger, to be held on 15 May 2002.

Any Directors appointed to the Board in future will undergo an induction programme tailored to their own specific requirements to ensure that they are conversant with their obligations as a Director of a public company operating in the financial services sector.

Board Committees

The principal Board committees, their composition and Terms of Reference are:

Audit Committee

Tony Hobson (Chairman)

John Maclean

Louis Sherwood

Lord Simpson of Dunkeld

This committee, which consists entirely of Non-executive Directors, reviews the Group's interim and annual financial statements, its accounting policies and the risk and control environment. It is supported by Risk Control Committees, comprising Non-executive and Executive Directors, for each business division. The Audit Committee also considers the nature and scope of the work to be performed by the external and internal auditors, the results of that work and management's response. The committee makes recommendations to the Board on the appointment and remuneration of external auditors and reviews the non-audit services provided by the external auditors.

The Audit Committee meets with Executive Directors and management, as well as privately with both external and internal auditors. The Terms of Reference of the Audit Committee include all matters indicated by the Combined Code.

Remuneration Committee

Brian Ivory (Chairman)

Sir Ronald Garrick

Coline McConville

Philip Yea

This committee also consists solely of Non-executive Directors. It considers remuneration policy for Executive Directors and other senior executives and decides the remuneration arrangements for each Executive Director including the operation of the executive bonus schemes, service contracts and compensation payments. It also decides the remuneration arrangements for the Chairman.

Nomination Committee

Dennis Stevenson (Chairman)

Peter Burt

James Crosby

Brian Ivory

Sir Bob Reid

This committee meets from time to time, and at least annually, to review the composition of the Board and considers new appointments, making recommendations on suitable candidates to the Board.

Special Committee

Comprising four directors of whom one must be the Chairman, Senior Independent Director, or another Non-executive Director, this committee can make decisions on matters of urgency which cannot await the next meeting of the Board. It can only act by unanimous decision: where this is not reached the matter must be referred to the full Board.

A Board Control Manual defines the terms of reference of these committees and also of the main management committees including the Group Management Board, which comprises the executive management team, and the various risk management committees, and the relationship between HBOS plc and its subsidiaries and joint ventures.

Directors' Remuneration

The report on remuneration policy and practice is set out on pages 51 to 60.

Relations with Shareholders

The Company communicates with institutional shareholders through a combination of analysts' briefings, both at the interim and year end results stage, site visits and individual discussions with key members of the management team, co-ordinated by Investor Relations. This regular dialogue helps to ensure that the Company's strategy is understood and that any issues are addressed in a constructive way.

The Company keeps its almost three million shareholders informed of progress using a range of media. Each year they receive the Annual Review and Summary Financial Statement or, at the choice of the shareholder, the Annual Report and Accounts. The Annual General Meeting, at which shareholders are invited to approve the Report and Accounts, allows the Group's performance and the Directors' stewardship to be presented to shareholders and reviewed in an open manner. The Chairmen of the Audit and Remuneration Committees attend the meeting along with other Directors and are available to answer shareholders' questions on the activities of their own committees.

Corporate Governance Statement

Continued

During the year shareholders can receive up-to-date information through the corporate website, www.hbosplc.com. This provides share price information, financial results, management presentations and answers to frequently asked questions. A telephone helpline is also available from Shareholder Services on 0870 702 0102 providing a contact point for shareholders on issues such as dividends and announcements.

Developing the Corporate Governance Structure

Both the Bank of Scotland and Halifax Group plc, as listed companies, had well defined procedures to ensure that proper governance arrangements were in place. As part of the planning for the merger these procedures were reviewed and a new governance structure was developed for the merged group.

This started with the business philosophy that responsibility should as far as possible be delegated to the individual business areas within the Group – Retail Banking, Insurance & Investment, Corporate Banking, Business Banking and Treasury – within a sound and practical framework of corporate governance. The arrangements, which were finalised by the Board of HBOS plc at its first meeting following the merger, identify three layers of responsibility for the management of the business:

- At the first level, executive and divisional management are identified as having primary responsibility for strategy, performance management and risk control;
- At the second level, the Group functions (primarily Finance, Financial Risk, Operational Risk and Regulatory Risk) define policy and standards and provide objective oversight of performance and risk management across the Group;
- At the third level, the Audit Committee, supported by a series of divisional Risk Control Committees and Group Internal Audit, provides independent and objective assurance on the effectiveness of the Group's system of internal control.

Statement of Internal Control

The Board has overall responsibility for the Group's system of internal control and for reviewing its effectiveness. The implementation and maintenance of the risk management and internal control systems are the responsibility of the Executive Directors and senior management. The system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can provide only reasonable – and not absolute – assurance against material misstatement or loss.

The Group has mechanisms for monitoring at executive level the risk management practices approved and adopted by individual business areas for strategic, financial, regulatory and operational risk. Information on these mechanisms and on the Group's compliance with 'Internal Control: Guidance for Directors on the Combined Code' ('the Turnbull Guidance') is provided in the Financial Review and Risk Management (on pages 35 to 43).

Compliance with the Combined Code

The Board supports the principles of good governance and code of best practice set out in the Combined Code. The Company has complied with all provisions of the Code throughout the period from 10 September 2001 (date of listing) to 31 December 2001.

Although the Company was formed on 3 May 2001, the Corporate Governance Structure for HBOS plc was not implemented until the date of listing on 10 September 2001. The Boards of both Bank of Scotland and Halifax Group plc continued to oversee the effectiveness of their own systems of internal control throughout the periods from the end of their last financial year to the effective date of the merger.

The Board is satisfied, after due enquiry, that both Bank of Scotland and Halifax Group plc complied with all of the provisions of the Code throughout the period from the end of their last financial year to 9 September 2001.

Directors' Accounting Responsibilities

The following statement, which should be read in conjunction with the Report of the Independent Auditors on page 64, enables shareholders to distinguish the respective responsibilities of the Directors and the Auditors in relation to the accounts.

The Directors are required by the Companies Act 1985 to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss for the financial year. The Directors are required to prepare the accounts on the going concern basis unless it is inappropriate to do so.

The Directors consider that in preparing the accounts on pages 65 to 110 suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used and that all accounting standards which they consider applicable have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Going concern

The Directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the financial statements.

Independent Auditor's Report to the Members of HBOS plc

We have audited the accounts on pages 65 to 110.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report and Accounts. As described on page 63, this includes responsibility for preparing the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding Directors' remuneration and transactions with the Group is not disclosed.

We review whether the statement on pages 61 and 62 reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and Accounts, including the corporate governance statement, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2001 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh, 26 February 2002

Accounting Policies

Accounting Convention

The accounts have been prepared under the historical cost convention in compliance with the special provisions of Part VII of the Companies Act 1985 applicable to banking groups modified by the revaluation of items held for trading purposes. The financial statements have been prepared in accordance with applicable accounting standards and in accordance with the Statements of Recommended Accounting Practice issued by the British Bankers' Association, the Irish Bankers' Federation, and the Finance and Leasing Association.

Basis of Consolidation

i. Basis of Preparation

The merger of Bank of Scotland Group and Halifax Group has been accounted for using the merger accounting principles set out in Financial Reporting Standard (FRS) 6 "Acquisitions and Mergers" and the results have been presented as if the new Group had been established throughout the current and comparative accounting periods.

The Directors are satisfied that the substantially equal proportion of equity in HBOS plc held by former institutional shareholders of the Bank of Scotland and Halifax Group plc at the date of merger, rebuts the presumption of dominant influence contained in FRS 6 resulting from the 63% interest in ordinary share capital of HBOS plc held by former Halifax Group plc shareholders at that date.

Prior to the merger, Bank of Scotland Group prepared accounts to 28/29 February. Upon the merger becoming effective, Bank of Scotland changed its year end to 31 December. In preparing the merged financial statements of HBOS plc for the year ended 31 December 2000, the financial statements of Bank of Scotland have been prepared to cover the year to that date.

The Group's accounting policies, detailed below, represent the development of a consistent set of accounting policies derived from those followed by Bank of Scotland Group and Halifax Group prior to the merger of the two groups. The effect on the results of the Group of adopting these accounting policies is not material.

Prior to the merger, Bank of Scotland Group adopted the transitional rules of FRS 15 "Tangible Fixed Assets" whereby the gross value relating to previously revalued fixed assets was retained. Halifax Group's accounting policy was to state property at cost with no revaluation. In adopting a standard set of accounting policies for HBOS plc, the fixed assets of Bank of Scotland Group, previously revalued, have been restated at 1 January 2000 to show property at cost. The impact of this merger related adjustment is set out in Note 59.

In the current year the Group has implemented the transitional arrangement of FRS 17 "Retirement Benefits" and implemented FRS 18 "Accounting Policies". The effect of the implementation of FRS 17 and 18 on the current results and financial position is not material.

ii. Consolidation

The Group's financial statements include the audited results of the Company and its subsidiary undertakings. The accounts of all principal subsidiary undertakings are made up to 31 December. The value of the long-term assurance business attributable to shareholders and the assets and liabilities attributable to policyholders are presented separately on the consolidated balance sheet from those of other businesses in order to reflect the different nature of the shareholders' and policyholders' interests therein.

iii. Associated Undertakings and Joint Ventures

The Group's share in associated undertakings is stated in the consolidated balance sheet at the Group's share of their net tangible assets plus attributable goodwill. The attributable share of results of associated undertakings, generally based on audited accounts, is included in consolidated profit using the equity method of accounting. Joint ventures in which the Group has a long-term interest and shares control under a contractual agreement with other parties are accounted for using the gross equity method.

iv. Goodwill

The excess of the fair value of purchase consideration over the fair value of net assets at the date of acquisition of subsidiary undertakings, associated undertakings, joint ventures and other businesses arising on acquisitions after 31 December 1997 is capitalised. This goodwill is amortised by equal instalments over its estimated useful life, normally 20 years.

Goodwill arising on acquisitions prior to 1 January 1998 was written off to reserves in the year in which it arose and has not been reinstated, as permitted by FRS 10 "Goodwill and Intangible Assets". On the disposal of subsidiary undertakings and other businesses any related goodwill charged directly to reserves prior to 1 January 1998 is reinstated and included in the calculation of the profit or loss on disposal.

Goodwill is subject to impairment review when events or changes in circumstances indicate that the carrying amount may not be recoverable and is written down by the amount of any impairment loss identified in the year. Impairment charges are included within operating profit.

Long-Term Assurance Business

The value of the long-term assurance business to shareholders comprises the surplus retained in the long-term assurance assets and liabilities attributable to policyholders together with a prudent estimate of the net present value of in-force business. The change in this value, grossed up at the effective rate of taxation, is included within other operating income.

Loans and Advances

Loans and advances are held at cost less provisions.

Specific provisions are made for advances that are recognised to be bad or doubtful. A general provision, to cover advances that are latently bad or doubtful, but not yet identified as such, is also maintained. Provisions made during the year are charged to revenue, net of recoveries. If the collection of interest is considered doubtful, it is suspended and excluded from interest income in the profit and loss account. Provisions and suspended interest are written off to the extent that there is no longer any realistic prospect of recovery.

Securitisation

Loans and advances to customers include loans that are subject to non-returnable finance arrangements following securitisation of portfolios of mortgages and other loans. The principal benefits of these loans were acquired from the Group by special purpose securitisation companies which fund their purchase primarily through the issue of floating rate notes. In accordance with FRS 5, "Reporting the Substance of Transactions", the proceeds of these note issues are shown deducted from the securitised assets on the face of the balance sheet.

Accounting Policies

Continued

Finance Leases, Instalment Credit and Operating Leases

Assets leased to customers which transfer substantially all the risks and rewards of ownership to the customer are classified as finance leases and, together with instalment credit agreements, are recorded within loans and advances to customers or loans and advances to banks. The net investment in finance leases and instalment credit agreements represents total minimum payments less gross earnings allocated to future periods. Obligations under leases with third party finance lessors are included in customer accounts.

All other assets leased to customers are classified as operating leases. These assets are separately disclosed in the balance sheet and are recorded at cost less cumulative depreciation.

Income from finance leases and instalment credit agreements is credited to the profit and loss account using an actuarial method to give a constant periodic return on the net cash investment. Operating lease rentals are recognised in the profit and loss account on a straight line basis with depreciation charged using an actuarial method to give a constant periodic return on the net cash investment.

Debt Securities

(i) Debt securities and other fixed interest securities held for trading are included at market value with gains or losses included in dealing profits.

(ii) Debt securities and other fixed interest securities held for the longer term are included at cost less amounts written off and adjusted for the amortisation of premiums or discounts arising on purchase of investments redeemable at fixed dates. Such premiums or discounts are taken to interest receivable on a straight line basis over the period to redemption. Gains or losses on realisation are taken to revenue as they arise.

(iii) Debt securities sold subject to repurchase agreements are retained within the balance sheet where the Group retains substantially all of the risks and rewards of ownership. Funds received under these arrangements are included within deposits by banks or customer accounts. Conversely, debt securities acquired under commitments to resell are not recognised in the balance sheet where substantially all the risks and rewards do not pass to the Group. In this case, the purchase price is included within loans and advances to banks or loans and advances to customers.

Equity Shares

Equity shares are stated at cost less amounts written off. Income from listed equity shares is credited to revenue on the ex-dividend date and from unlisted equity shares on an equivalent basis.

Tangible Fixed Assets and Depreciation

Freehold land is not depreciated. Freehold and leasehold property is stated at cost and depreciated over 50 years or the length of the lease term if shorter. Improvements to leasehold properties with unexpired lease terms of fifty years or less are stated at cost and are depreciated in equal instalments over the lesser of the remaining life of the lease or eight years. Premiums are amortised over the period of the lease.

Equipment, including fixtures and fittings, vehicles and computer hardware is written off in equal instalments over the expected lives of the assets, generally between three and fifteen years. Software development costs which lead to the creation of a definable software asset, subject to a *de minimis* limit, are capitalised and depreciated over their expected lives, generally 4 years.

Provision is made for the diminution in value of any fixed asset where impairment is identified. The resulting net book value of the asset is

written off over its remaining expected economic life. Impairment charges are included within operating profit.

Taxation

The charge for taxation takes into account all timing differences in the accounting and taxation treatment of certain items. Deferred taxation is provided on the liability method.

Dated and Undated Loan Capital

Dated and undated loan capital is included at the nominal value adjusted for premiums, discounts and expenses, all of which are amortised evenly over the period to redemption or reset.

Income Recognition

Arrangement fees and commissions receivable for the continuing servicing of loans and advances are recognised on the basis of work done. Those receivables in respect of bearing risk, including premiums received by the Group on high loan to value mortgages, are recognised over the expected period of the advance or risk exposure. Other fees are recognised when receivable. All costs associated with mortgage incentive schemes are charged in full in the year in which the expense is incurred.

Retirement Benefits

The cost of providing retirement pensions and related benefits is charged against profits on a systematic basis over the employees' service lives in accordance with Statement of Standard Accounting Practice No.24 "Accounting for pension costs". The full provision basis has been used in accounting for the deferred tax implications of pensions and other post-retirement benefits.

Foreign Currencies

Assets and liabilities and profit and loss accounts are translated at the rates of exchange ruling on the balance sheet date or at the forward exchange rate, as appropriate. Exchange differences arising on the translation of foreign equity investments are taken to reserves except to the extent that they are offset by corresponding differences arising on the translation of related borrowing. All other exchange differences are included in dealing profits.

Derivatives

Derivative financial instruments used for trading and non-trading purposes include interest rate swaps, cross currency swaps, futures, options, forward rate agreements and caps, floors and collars.

(i) Trading derivatives, which include customer driven and proprietary transactions and hedges thereof, are carried in the accounts at fair value with gains or losses included in dealing profits.

(ii) Non-trading derivatives, which are used primarily as a risk management tool for hedging interest rate and foreign exchange rate risk arising on on-balance sheet assets and liabilities, are accounted for on an accruals basis reflecting the treatment of the underlying items being hedged.

A derivative is designated as a hedge if its purpose is to match or eliminate the risk inherent in the Group's non-trading assets, liabilities and cash flows arising from potential movements in interest rates, exchange rates and market values. Gains and losses on instruments used for hedging purposes are not recognised until the exposure that is being hedged is itself recognised. Where a hedge transaction is terminated early, any profit or loss is spread over the remaining life of the underlying asset or liability being hedged. In other circumstances, where the underlying item subject to the hedge is extinguished, the hedge transaction is measured at fair value and any profit or loss is recognised immediately.

Consolidated Profit and Loss Account

For the year ended 31 December 2001

	Notes	2001 £ million	2000 £ million
Interest receivable			
Interest receivable and similar income arising from debt securities		1,426	1,745
Other interest receivable		14,689	13,366
		16,115	15,111
Interest payable		(11,942)	(11,080)
Net interest income		4,173	4,031
Fees and commissions receivable		1,921	1,711
Fees and commissions payable		(517)	(407)
Dealing profits	1	82	66
Other operating income	3(i)	1,213	843
Net operating income (all from continuing operations)	1	6,872	6,244
Administrative expenses	2, 3(ii)	(2,967)	(2,580)
Depreciation and amortisation			
Tangible fixed assets		(260)	(237)
Operating lease assets		(210)	(210)
Goodwill amortisation		(68)	(43)
		(538)	(490)
Operating expenses		(3,505)	(3,070)
General insurance claims		(68)	(11)
Provisions for bad and doubtful debts	18	(608)	(471)
Amounts written off fixed asset investments	20, 21	(21)	(9)
Operating profit (all from continuing operations)		2,670	2,683
Before exceptional items and Intelligent Finance		2,971	2,895
Exceptional items	3	(147)	(124)
Intelligent Finance	4	(154)	(88)
Share of operating profits/(losses) of joint ventures	3(iv)	20	(35)
Share of operating profits of associated undertakings		16	20
Merger costs – exceptional	3(iii)	(76)	
Profit on ordinary activities before taxation		2,630	2,668
Before exceptional items and Intelligent Finance		3,007	2,925
Exceptional items	3	(223)	(169)
Intelligent Finance	4	(154)	(88)
Tax on profit on ordinary activities	10	(765)	(757)
Profit on ordinary activities after taxation		1,865	1,911
Before exceptional items and Intelligent Finance		2,155	2,062
Exceptional items	3	(182)	(89)
Intelligent Finance	4	(108)	(62)
Minority interests (equity)		(77)	(54)
(non-equity)		(112)	(79)
Profit attributable to shareholders		1,676	1,778
Dividends	11		
Preference		37	37
Ordinary		993	789
		1,030	826
Retained profit of the year	12	646	952
Underlying earnings per share	13	56.6p	55.6p
Basic earnings per share	13	46.4p	49.9p
Diluted earnings per share	13	45.9p	49.7p

There were no material gains or losses other than the profit shown above in either year.

It is estimated that Group profit on ordinary activities before taxation and retained profit of the year calculated solely on a historical cost basis would not differ materially from those stated in the consolidated profit and loss account above.

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110 form part of these accounts.

Consolidated Balance Sheet

As at 31 December 2001

	Notes	2001 £ million	2000 £ million
Assets			
Cash and balances at central banks		1,150	1,252
Items in course of collection		983	754
Treasury bills and other eligible bills	14	4,071	3,196
Loans and advances to banks	15	12,929	18,117
Loans and advances to customers	16	201,034	171,009
Less: non-returnable finance	16	(3,141)	(1,121)
		197,893	169,888
Operating lease assets	19	2,042	1,519
Debt securities	20	42,449	29,543
Equity shares	21	224	147
Interest in joint ventures	22(i)		
Share of gross assets		2,214	1,737
Share of gross liabilities		(1,998)	(1,553)
		216	184
Interest in associated undertakings	22(ii)	134	123
Intangible fixed assets	24	1,245	1,047
Tangible fixed assets	25	1,627	1,576
Other assets	26	4,205	2,703
Prepayments and accrued income		2,241	2,636
Long-term assurance business attributable to shareholders	29	3,265	2,400
		274,674	235,085
Long-term assurance assets attributable to policyholders	29	37,601	31,058
Total Assets		312,275	266,143
Liabilities			
Deposits by banks	30	30,449	25,328
Customer accounts	31	140,516	127,012
Debt securities in issue	32	69,528	53,678
Notes in circulation		737	653
Corporate taxation		69	425
Dividends payable		679	547
Other liabilities	33	5,153	2,837
Accruals and deferred income		5,167	5,948
Provisions for liabilities and charges			
Deferred taxation	34(i)	628	497
Other provisions	34(ii)	252	163
		880	660
Subordinated liabilities	35		
Dated loan capital		4,966	3,854
Undated loan capital		2,660	2,131
		7,626	5,985
		260,804	223,073
Capital and Reserves			
Called up share capital	36		
Preference shares (non-equity)		400	400
Ordinary shares		892	878
		1,292	1,278
Share premium account	38	27	209
Other reserves	38	492	9,051
Profit and loss account	38	9,657	
		11,468	10,538
Shareholders' funds (including non-equity interests)	39	415	377
Minority interests (equity)		1,987	1,097
Minority and other interests (non-equity)	37		
		13,870	12,012
		274,674	235,085
Long-term assurance liabilities attributable to policyholders	29	37,601	31,058
Total Liabilities		312,275	266,143

Consolidated Balance Sheet

As at 31 December 2001

	Notes	2001 £ million	2000 £ million
Memorandum Items	40		
Contingent liabilities			
Acceptances and endorsements		202	160
Guarantees and assets pledged as collateral security		2,133	1,713
		2,335	1,873
Commitments			
Other commitments		37,272	27,532

Approved by the Board on 26 February 2002 and signed on its behalf by:

Lord Stevenson
Chairman

A J Hobson
Chairman of Audit Committee

P A Burt
Executive Deputy Chairman

J R Crosby
Chief Executive

M H Ellis
Group Finance Director

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110 form part of these accounts.

Company Balance Sheet

As at 31 December 2001

	Notes	2001 £ million
Fixed Assets		
Investments		
Shares in Group undertakings	23	1,301
Own shares	27	5
		1,306
Current Assets		
Debtors		
Amounts owed by Group undertakings		974
Dividends receivable		679
Other debtors		7
		1,660
Current Liabilities		
Creditors: Amounts falling due within one year		
Amounts owed to Group undertakings		27
Dividends payable		679
Accruals		2
Other creditors		4
		712
Net Current Assets		948
Total Assets Less Current Liabilities		
Creditors: Amounts falling due after more than one year		
Subordinated liabilities	35	902
Net Assets		1,352
Capital and Reserves		
Called up share capital		
Preference shares (non-equity)		400
Ordinary shares		892
		1,292
Share premium account	38	27
Profit and loss account	38	33
Shareholders' Funds	39	1,352

Approved by the Board on 26 February 2002 and signed on its behalf by:

Lord Stevenson
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P A Burt
Executive Deputy Chairman

J R Crosby
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M H Ellis
Group Finance Director

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110 form part of these accounts.

Consolidated Cash Flow Statement

For the year ended 31 December 2001

	Notes	2001 £ million	2000 £ million
Net cash inflow from operating activities	48	671	4,781
Merger costs – exceptional		(76)	
Dividends received from joint ventures		16	11
Returns on investments and servicing of finance	49(i)	(638)	(534)
Taxation		(860)	(801)
Capital expenditure and financial investment	49(ii)	(1,076)	(1,554)
		(1,963)	1,903
Acquisitions and disposals	49(iii)	(739)	(986)
Equity dividends paid		(837)	(654)
		(3,539)	263
Financing	49(iv)	2,662	1,184
(Decrease)/Increase in cash	51	(877)	1,447

The statement of accounting policies on pages 65 and 66 and the notes on pages 72 to 110 form part of these accounts.

Notes on the Accounts

1. Net Operating Income

	Notes	2001 £ million	2000 £ million
Net operating income includes:			
Mortgage incentives		(1,027)	(805)
Interest payable on subordinated liabilities		(467)	(422)
Dealing profits			
Foreign exchange		44	32
Interest rate related		38	34
Finance lease rental income		671	615
Income from long-term assurance business	29	470	288
Operating lease rental income		369	311
General insurance premium income		265	95
Profit on sale of investment securities		92	116
Dividend income from equity shares		7	8

Dealing profits arise from the Group's trading book. The types of instrument in which the Group trade are as set out in Note 41.

2. Administrative Expenses

	Notes	2001 £ million	2000 £ million
Administrative expenses (excluding exceptional items) includes:			
Staff costs	5	1,425	1,311
Property rentals		135	111
Hire of equipment		24	32
Gain on sale of fixed assets		(7)	(19)

The Group operates Inland Revenue approved Savings-Related Stock Option Schemes and has utilised the exemption under UITF Abstract 17.

3. Exceptional Items

Exceptional items include the following:

- (i) Included within other operating income is an exceptional credit of £27 million (tax – £8 million) arising from St. James's Place Capital plc's share of profits from an arrangement to transfer Life Assurance Holding Corporation Ltd's (LAHC) investment management business to Aberdeen Asset Management plc. LAHC is an associated undertaking of St. James's Place Capital plc.
- (ii) Included within administrative expenses, exceptional costs have been charged as follows:

	Notes	2001 £ million	2000 £ million
HBOS merger integration costs	(a)	(132)	
Equitable Life integration costs	(b)	(42)	
Restructuring costs	(c)		(124)
		(174)	(124)
Tax effect		49	31

- (a) The HBOS merger integration costs cover the costs of integrating and reorganising Bank of Scotland Group and Halifax Group following the merger.
- (b) The Equitable Life integration costs relate to expenses incurred during the integration of The Equitable sales force, acquired on 1 March 2001 (see Note 50(b)) into the new Halifax Equitable structure together with other ancillary integration costs associated with the transaction.
- (c) During 2000, Bank of Scotland Group charged £80 million relating to the restructuring of the Bank of Scotland UK Group; costs of £31 million were incurred to cover Halifax Group's rationalisation programmes instigated across central sites, regional offices and Birmingham Midlands. Halifax Group charged a further £13 million during 2000 for the rationalisation of the Halifax retail branch network.

3. Exceptional Items continued

- (iii) Merger costs of £76 million (tax – £nil) comprise the deal costs incurred in connection with the merger of Bank of Scotland Group and Halifax Group.
- (iv) During 2000, the Group's share of operating losses of joint ventures included an exceptional charge of £45 million (tax – £9 million) reflecting a provision against Lex Vehicle Leasing Ltd's impairment of the residual value of leased vehicles.
- (v) At a hearing in March 2000, the Special Commissioners decided in favour of Halifax Group that the costs of conversion to listed company status were a deductible expense for tax purposes and an exceptional tax credit of £40 million was recognised and included within the Group's 2000 tax on profit on ordinary activities.

4. Intelligent Finance

Intelligent Finance commenced trading in September 2000. The result for 2001 was an operating loss before taxation of £154 million (2000 – £88 million) and an operating loss after taxation of £108 million (2000 – £62 million). The results in 2001 and 2000 have been presented separately on the face of the profit and loss account. This disclosure was made due to the business still being in its start-up phase and thus to aid comparability of existing business performance.

5. Staff

	2001 Number	2000 Number
The average number of persons employed by the Group during the year was:		
Full time	47,979	45,378
Part time	14,869	14,909
	62,848	60,287

	2001 £ million	2000 £ million
The aggregate remuneration payable to those employees comprises:		
Wages and salaries	1,432	1,264
Social security costs	112	99
Other pension costs (Note 9)	73	60
Other post retirement benefits (Note 9)	2	6
	1,619	1,429
Less: long-term assurance business staff costs	(194)	(118)
Staff costs charged to administrative expenses	1,425	1,311

Staff costs in respect of long-term assurance business are not charged to administrative expenses but are taken into account in determining the increase in value of long-term assurance business (Note 1).

6. Directors' Remuneration

	2001 £000	2000 £000
Total emoluments	6,581	3,830
Total potential pre-tax gains on stock options exercised	1,195	735
Highest paid Director – emoluments	994	682
– potential pre-tax gains on stock options exercised	1,195	735
– accrued pension entitlement per annum	296	216

Retirement benefits accrued to 8 Directors under pension schemes in the year to 31 December 2001.

The figures for the years to 31 December 2000 and 2001 include the emoluments of the Directors of Bank of Scotland and Halifax Group plc who were appointed to the Board of HBOS plc.

A detailed analysis of Directors' emoluments, pension entitlements, stock interests and stock options is given on pages 51 to 60 in the Report of the Board in relation to remuneration policy and practice.

Notes on the Accounts

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7. Auditors' Remuneration

The aggregate remuneration of KPMG Audit Plc and its associates for audit and other services (excluding VAT) is analysed below. KPMG Audit Plc were the auditors of both Halifax Group and Bank of Scotland Group for 2000 and 2001, and since 5 June 2001 have been the auditors of HBOS plc.

	Within UK £ million	Outwith UK £ million	2001 Total £ million	Within UK £ million	Outwith UK £ million	2000 Total £ million
Group						
Statutory audits	2.9	0.5	3.4	2.7	0.2	2.9
As auditors or reporting accountants	3.4	0.1	3.5	2.6		2.6
	6.3	0.6	6.9	5.3	0.2	5.5
Merger and acquisitions	8.1		8.1	1.1		1.1
Tax advisory	0.5	0.3	0.8	0.9	0.2	1.1
Other accounting, advisory and consultancy	6.6	0.6	7.2	3.8	0.3	4.1
	21.5	1.5	23.0	11.1	0.7	11.8

Statutory audit fees include £10,000 within the UK in respect of the Company.

Non-audit fees include £2.0 million which has been capitalised by the Group in the year ended 31 December 2001 (2000 – £0.4 million). The increase in non-audit fees relates primarily to work conducted in connection with the merger of Bank of Scotland Group and Halifax Group and the acquisition of the operating assets, salesforce and unit linked and certain non-profit business of The Equitable.

The Group has a policy of requiring a competitive tendering process for the appointment of consultants where the expected fee exceeds £50,000. If the tendering process results in the external auditors being the recommended supplier, the decision has to be approved by the Chief Executive and the Group Finance Director. The Chief Executive and the Group Finance Director also have the authority to appoint the external auditors for consultancy or advisory roles in cases where an urgent appointment is necessary or for certain specific areas of work where they consider that the auditors' experience of the Group's activities is required. Immediately following the merger, this latter authority was used to ensure that urgent projects and tasks arising from the merger were initiated and completed in time.

Fees payable to the external auditors are reported regularly to the Audit Committee, which reviews the background to the use of KPMG Audit Plc and its associates for non-audit work and considers the impact of these fees on their independence as auditors.

8. Operating Leases

	Group			
	2001 Property £ million	2001 Other £ million	2000 Property £ million	2000 Other £ million
There are commitments to make payments in the following year in respect of non-cancellable operating leases which expire:				
within 1 year	3	3	3	4
between 1 and 5 years	18	13	15	21
after 5 years	106	3	91	3
	127	19	109	28

9. Pension Costs

The Group operates several pension schemes, all of which are funded.

The principal schemes are the Halifax Retirement Fund and the Bank of Scotland 1976 Pension Scheme (together, "the Schemes"). These Schemes cover 84 per cent of the Group's pensionable employees, and provide defined benefits based on final pensionable salary. The assets of the Schemes are held in Trust Funds which are independent of the Group's own assets.

In determining the level of contributions required to be made to the Schemes and the relevant charges to the Group's profit and loss account, the Group has been advised by Watson Wyatt Partners, Actuaries and Consultants. The most recently published formal valuation of the Halifax Retirement Fund took place as at 31 March 2000; a formal valuation of the Bank of Scotland 1976 Pension Scheme was carried out as at 31 December 1998. The main financial assumptions adopted for these calculations were as follows:

	Halifax Retirement Fund Rates per annum	Bank of Scotland 1976 Pension Scheme Rates per annum
Future price inflation	3.00 per cent	3.00 per cent
Return on new investments	7.25 per cent	7.10 per cent
Return on existing investments	5.75 per cent	5.80 per cent
Increases in earnings	4.50 per cent	4.50 per cent
Increases in pensions*	3.00 per cent	3.00 per cent

* on the excess over the Guaranteed Minimum Pension

The pension costs for accounting purposes have been calculated using the same assumptions as those adopted for the formal valuations. The following disclosures are based on these assumptions using the projected unit method of valuation:

	Halifax Retirement Fund	Bank of Scotland 1976 Pension Scheme
Effective date of valuation	31/3/2000	31/12/1998
Market value of assets	£2,148m	£1,343m
Asset cover level	119 per cent	116 per cent
Regular pension charge (as a percentage of pensionable salaries)	16.75 per cent	19.4 per cent

The asset cover levels disclosed in the above table represent the ratios of the respective Schemes' assets to the value of the benefits that had accrued to members and pensioners at the valuation dates after allowing for expected future increases in earnings and pensions.

The regular pension charge for the Halifax Retirement Fund is inclusive of employee contributions which were increased from 2% to 3% of pensionable salaries from 1 May 2001. The regular pension charge for the Bank of Scotland 1976 Pension Scheme increased to 19.8% from 1 July 2001 following changes made to the Scheme's benefit structure at that date.

These charges have been reduced by spreading surplus assets in each of the Schemes over the average future working lifetimes of the memberships (15 years for the Halifax Retirement Fund and 14 years for the Bank of Scotland 1976 Pension Scheme) by fixed capital instalments plus interest on the reducing balances. These elements, together with interest on the opening balance sheet positions amount to £15 million (2000 – £20 million) in respect of the Halifax Retirement Fund and £30 million (2000 – £15 million) in respect of the Bank of Scotland 1976 Pension Scheme. The Bank of Scotland 1976 Pension Scheme charge takes account of the merger of the Capital Bank Pension Scheme and Bank of Wales plc 1973 Pension and Life Assurance Scheme into that Scheme on 1 January 2001.

Contributions to the Schemes of £22 million were paid during the year. As contributions overall differ from the amount charged in the Profit and Loss Account a provision of £53 million (2000 – £29 million) for future contributions is included in the Balance Sheet, net of prepayments. Included in prepayments and accrued income is a pension prepayment of £25 million (2000 – £27 million) which relates to excess pension contributions.

The pension costs charged in the Profit and Loss Account include £28 million (2000 – £25 million) relating to schemes other than the Schemes.

Other Post-Retirement Benefits

The Group also provides post-retirement health care benefits and concessionary rate mortgages for certain pensioners and dependent spouses.

An independent actuarial review as at 31 December 2001 estimated the present value of the accumulated other post-retirement benefit obligations at £37 million for the Group (2000 – £36 million). The main additional financial assumption used was that over the long-term the rate of increase in health care costs would be 7.25% per annum, being 4.25% per annum higher than the rate of inflation. The charge for the year ended 31 December 2001 for other post-retirement benefits was £2 million (2000 – £6 million). Included in provisions for liabilities and charges is £33 million (2000 – £31 million) which represents the accrued amount for other post-retirement benefits.

Notes on the Accounts

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9. Pension Costs continued

FRS 17

The actuarial valuations used in assessing the FRS 17 disclosures are:

- the Halifax Retirement Fund valuation as at 31 March 2000, updated by Watson Wyatt Partners to take account of the requirements of FRS 17 and to assess the assets and liabilities of that Fund as at 31 December 2001
- the preliminary results of the valuation of the Bank of Scotland 1976 Pension Scheme as at 31 December 2001

Scheme assets are stated at their market value at 31 December 2001.

The liabilities of the Schemes under FRS 17 were calculated using the Projected Unit method using the following financial assumptions:

	Rates per annum
Future price inflation	2.50 per cent
Discount rate	6.00 per cent
Increases in earnings	3.50 per cent
Increases in pensions*	2.50 per cent

* on the excess over the Guaranteed Minimum Pension. Pensions which are guaranteed to increase at a rate of 3.0 per cent per annum have been assumed to increase at 3.0 per cent.

The assets of the Schemes and the expected rates of return were:

	Long-term expected rate of return per annum at 31 December 2001	Value at 31 December 2001 £ million
Equities	7.75 per cent	2,715
Bonds	5.25 per cent	305
Property	6.50 per cent	88
Cash	4.50 per cent	88
Total market value of assets at 31 December 2001		3,196
Present value of liabilities of the Schemes		3,194
Surplus in the Schemes		2

The remaining defined benefit schemes in the Group account for less than 17% of the Group's total defined benefit pension liabilities.

Other Post-Retirement Benefits

An independent actuarial review as at 31 December 2001 estimated the present value of the accumulated other post-retirement benefit obligations under FRS 17 at £40 million for the Group. There are no assets backing these obligations, and hence the notional balance sheet provision under FRS17 is also £40 million. The main additional financial assumption used was that over the long-term the rate of increase in health care costs would be 6% per annum, being 3.5% per annum higher than the rate of inflation.

10. Taxation

	2001 £ million	2000 £ million
UK Corporation Tax at 30 per cent (2000 – 30 per cent)	429	589
Relief for overseas taxation	(12)	(11)
	417	578
Tax relating to change in value of long-term assurance business (Note 29)	115	67
	532	645
Overseas taxation	97	59
Deferred taxation (Note 34(i))	121	92
Share of joint ventures' taxation	11	(6)
Share of associated undertakings' taxation	4	7
	765	797
Exceptional credit – UK Corporation Tax (Note 3(v))		(40)
Tax on profit on ordinary activities	765	757

11. Dividends

	2001 £ million	2000 £ million
Preference dividends paid payable	25 12	25 12
	37	37
Ordinary dividend		
Interim dividend of 9.30p per ordinary share (2000 – 7.35p)	330	258
Proposed final dividend of 18.70p per ordinary share (2000 – 15.05p)	667	535
Adjustments	(4)	(4)
	993	789
	1,030	826

Of the adjustment in 2001 £2 million reflects a credit for dividends declared on unclaimed Halifax Group plc ordinary shares that were sold by Halifax Group plc in 2001. The dividends accrued on these shares are no longer required to be paid.

The other adjustments in 2001 and 2000 result from the waiver of dividends by the QUEST (Note 27(b)) which took place subsequent to the dividends being accrued but before the ex-dividend date.

12. Retained Profit

	2001 £ million	2000 £ million
The profit of the Group has been retained by		
HBOS plc	43	
Subsidiary undertakings	598	979
	641	979
Associated undertakings and joint ventures	5	(27)
	646	952

By virtue of the exemption contained within Section 230 of the Companies Act 1985, the Profit and Loss Account of the Company is not presented.

13. Earnings per Ordinary Share

Basic and diluted earnings per Ordinary Share are based upon Group profit attributable to Ordinary Shareholders of £1,639 million (2000 – £1,741 million). The underlying earnings per Ordinary Share are based upon Group profit attributable to Ordinary Shareholders (before exceptional items, Intelligent Finance and goodwill amortisation but after tax) of £2,003 million (2000 – £1,941 million). For the basic and underlying earnings per Ordinary Share the weighted average number of 25p Ordinary Shares of 3,536 million (2000 – 3,488 million) is used and for the diluted earnings per Ordinary Share the weighted average number of actual and potential 25p Ordinary Shares of 3,568 million (2000 – 3,505 million) is used. Group profit attributable to Ordinary Shareholders equals profit attributable to shareholders of £1,676 million (2000 – £1,778 million) less preference dividends of £37 million (2000 – £37 million). The weighted average number of actual and potential Ordinary Shares in issue is detailed below:

	2001 Number million	2000 Number million
Actual weighted average number of shares in issue	3,536	3,488
Adjustment for weighted average number of shares on which options have been granted but not yet exercised	32	17
Potential weighted average number of shares in issue	3,568	3,505

Notes on the Accounts

Continued

13. Earnings per Ordinary Share continued

The calculation of the underlying basic earnings per 25p Ordinary Share, noted below, has been included to enable shareholders to assess the underlying trading performance.

	2001 pence	2000 pence
Basic earnings per share	46.4	49.9
Exceptional items		
Exceptional merger costs, administrative expenses and income	5.1	2.7
Exceptional charge in respect of Lex Vehicle Leasing		1.0
Exceptional tax credit		(1.1)
Intelligent Finance	3.0	1.8
Goodwill amortisation	2.1	1.3
Underlying earnings per share	56.6	55.6

14. Treasury Bills and Other Eligible Bills

	2001		Group	
	Book Value £ million	Market Value £ million	Book Value £ million	Market Value £ million
<i>Investment securities</i>				
Treasury bills and similar securities	2,602	2,600	1,158	1,161
Other eligible bills	448	451	2,038	2,038
	3,050	3,051	3,196	3,199
<i>Other securities</i>				
Treasury bills and similar securities	57	57		
Other eligible bills	964	964		
	1,021	1,021		
	4,071	4,072	3,196	3,199

The movement on treasury bills and other eligible bills held for investment purposes was as follows:

	£ million
At 1 January 2001	3,196
Exchange translation	(22)
Additions	14,800
Disposals	(14,928)
Amortisation	4
At 31 December 2001	3,050
Aggregate unamortised discounts net of premiums at 31 December 2001	16

15. Loans and Advances to Banks

	2001		Group	
	£ million	£ million	£ million	£ million
Repayable on demand	1,625		2,400	
Other loans and advances repayable				
in 3 months or less	9,191		10,099	
between 3 months and 1 year	1,741		4,826	
between 1 year and 5 years	185		642	
after 5 years	187		150	
	12,929		18,117	

16. Loans and Advances to Customers

	Group	
	2001 £ million	2000 £ million
Repayable on demand or at short notice	16,679	11,468
Other loans and advances repayable		
in 3 months or less	18,296	17,260
between 3 months and 1 year	10,057	8,961
between 1 year and 5 years	27,582	24,810
after 5 years	127,171	109,063
Gross loans and advances to customers	199,785	171,562
Provisions for bad and doubtful debts (Note 18)	(1,769)	(1,578)
Interest in suspense	(123)	(96)
Loans and advances to customers	197,893	169,888

At 31 December 2001, there were gross loans and advances to customers of £3,280 million (2000 – £2,080 million) outstanding from associated undertakings and joint ventures.

Loans and advances to customers include finance lease receivables of £3,900 million (2000 – £3,692 million). Assets acquired in the year for letting under finance leases amounted to £1,005 million (2000 – £1,662 million).

The Group's gross lending exposure is analysed below.

	2001 £ million	2000 £ million
Agriculture, forestry and fishing	1,038	974
Energy	1,598	1,610
Manufacturing industry	5,654	5,426
Construction and property	15,053	10,051
Hotels, restaurants and wholesale and retail trade	5,930	5,126
Transport, storage and communication	4,736	2,925
Financial	6,716	7,225
Other services	9,850	9,900
Individuals		
Home mortgages	127,636	110,412
Other personal lending	13,874	11,421
Overseas residents	7,700	6,492
Gross loans and advances to customers	199,785	171,562

Loans and advances to customers which have been securitised are shown below. These meet the criteria set out in FRS 5 "Reporting the Substance of Transactions", for a linked presentation format.

	At 31 December 2001		At 31 December 2000	
	Assets securitised	Gross assets securitised £ million	Gross assets securitised £ million	Non- returnable finance £ million
SWAN Trust	Mortgages	204	204	337
Mound Financing (No 1) PLC	Mortgages	750	748	750
Mound Financing (No 2) PLC	Mortgages	750	748	
Melrose Financing No 1 plc	Corporate Loans	1,500	1,441	
Birmingham Midshires Mortgage Asset No 1 Ltd	Mortgages			37
		3,204	3,141	1,124
				1,121

These special purpose companies, all of which are ultimately beneficially owned by charitable trusts, have been funded primarily through the issue of floating rate notes. Neither the Company nor its subsidiary undertakings will support any losses that may be suffered by the noteholders in accordance with the terms of the notes. When all liabilities to the noteholders have been discharged any remaining surpluses in the securitisation companies accrue to the Company or its subsidiary undertakings.

Notes on the Accounts

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16. Loans and Advances to Customers continued

Neither the Company nor its subsidiary undertakings have the right or obligation to repurchase any securitised advance unless it has been in breach of warranty.

The HBOS Group undertakings and third parties have entered into a number of interest rate swaps with the securitisation undertakings, the intention of which is to swap all or part of the interest flows from customers into variable rate interest flows to match the variable rate interest payable to the noteholders.

In February 2001, £750 million of mortgages and £1,500 million of corporate loans were securitised through Mound Financing (No 2) PLC and Melrose Financing No 1 plc respectively.

In aggregate the securitisation undertakings had net interest income of £3.7 million (2000 – £1.6 million); operating expenses of £1.5 million (2000 – £0.2 million); provisions for bad and doubtful debts of £0.2 million (2000 – £0.2 million); resulting in a profit for the period of £2.0 million (2000 – £1.2 million).

17. Non-performing Assets

The aggregate gross non-performing loans and advances is £4,072 million (2000 – £3,666 million) including £1,125 million (2000 – £903 million) of advances on which interest is being held in suspense. Net of provisions and interest in suspense, non-performing loans and advances amount to £2,180 million (2000 – £1,992 million).

18. Provisions for Bad and Doubtful Debts

	Group		
	Specific £ million	General £ million	Total £million
At 1 January 2001	971	607	1,578
Exchange translation	(2)	(3)	(5)
Acquisitions	16	11	27
New provisions less releases	595	52	647
Amounts written off	(478)		(478)
Cumulative provisions as at 31 December 2001	1,102	667	1,769
New provisions less releases	595	52	647
Recoveries of amounts previously written off	(39)		(39)
Net charge to profit and loss account	556	52	608

19. Operating Lease Assets

Assets leased to customers include the following amounts in respect of operating leased assets:

	Group £ million
Cost	
At 1 January 2001	1,956
Additions	1,305
Disposals	(775)
At 31 December 2001	2,486
Aggregate depreciation	(444)
Net Book Value at 31 December 2001	2,042
Net Book Value at 31 December 2000	1,519

20. Debt Securities

Group	2001								2000
	Issued by Public Bodies £ million	Issued by Others £ million	Total £ million	Market Value £ million	Issued by Public Bodies £ million	Issued by Others £ million	Total £ million	Market Value £ million	
Investment securities									
Listed									
British Government Securities	378		378	384	2,313		2,313	2,337	
Others	2,096	10,992	13,088	13,144	1,739	9,393	11,132	11,154	
Unlisted									
Certificates of deposit issued by banks and building societies		5,138	5,138	5,152		8,902	8,902	8,920	
Others	1,221	9,395	10,616	10,623	1,238	5,431	6,669	6,693	
Total investment securities	3,695	25,525	29,220	29,303	5,290	23,726	29,016	29,104	
Other securities									
Listed	1,454	397	1,851	1,851	3		3	3	
Unlisted	229	11,149	11,378	11,378	142	382	524	524	
	5,378	37,071	42,449	42,532	5,435	24,108	29,543	29,631	
of which:									
maturing within 1 year			22,189				12,919		
in more than 1 year			20,260				16,624		
			42,449				29,543		

The movement on debt securities held as investment securities is as follows:

	Group		
	Amortised Cost £ million	Aggregate amount written off £ million	Book Value £ million
At 1 January 2001	29,026	(10)	29,016
Exchange translation	189		189
Acquisitions	212		212
Additions	64,094		64,094
Amortisation	(51)		(51)
Disposals	(64,227)	2	(64,225)
Amount written off		(15)	(15)
At 31 December 2001	29,243	(23)	29,220
Aggregate unamortised premium at 31 December 2001	(45)		(45)

Debt securities include securities with a market value of £1,077 million (2000 – £1,058 million) for the Group sold subject to agreement to repurchase.

Debt securities include asset backed securities of £7,670 million (2000 – £1,332 million) which have been sold by the Company's subsidiary, Halifax plc, to bankruptcy remote special purpose vehicles funded by the issue of commercial paper on terms whereby the rewards and some of the risks of the portfolio have been retained by Halifax plc. The securitisation does not qualify for linked presentation under FRS 5 and the asset backed securities have therefore been retained on the Group balance sheet with commercial paper being included within debt securities in issue (Note 32).

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21. Equity Shares

	Listed			Unlisted			Total Book Value £ million
	Cost £ million	Aggregate amount written off £ million	Book Value £ million	Cost £ million	Aggregate amount written off £ million	Book Value £ million	
Group							
At 1 January 2001	19		19	135	(7)	128	147
Exchange translation				1		1	1
Acquisitions	25		25	35		35	60
Additions	23		23	52		52	75
Disposals	(3)		(3)	(52)	2	(50)	(53)
Amounts written off					(6)	(6)	(6)
At 31 December 2001	64		64	171	(11)	160	224

The total value of investments as at 31 December 2001 for the Group was £285 million (2000 – £301 million) including £114 million (2000 – £156 million) in respect of listed equity shares.

22. Interests in Joint Ventures and Associated Undertakings

(i) Joint Ventures

	Group				
	Acquired Book Value £ million	Equity Adjustments £ million	Share of Net Tangible Assets £ million	Goodwill £ million	Book Value £ million
At 1 January 2001	112	(44)	68	116	184
Acquisitions and subscriptions of capital	39		39		39
Disposals		(1)	(1)		(1)
Equity accounting adjustments				(6)	(6)
At 31 December 2001	151	(45)	106	110	216

(ii) Associated Undertakings

	Group				
	Acquired Book Value £ million	Equity Adjustments £ million	Share of Net Tangible Assets £ million	Goodwill £ million	Book Value £ million
At 1 January 2001	115	9	124	(1)	123
Acquisitions and subscriptions of capital	30		30		30
Disposals	(18)	(13)	(31)	1	(30)
Equity accounting adjustments		11	11		11
At 31 December 2001	127	7	134		134

All the investments are unlisted.

The main joint ventures and associated undertakings are listed in Note 54 on page 106.

23. Shares in Group Undertakings

	Banks £ million	Others £ million	Total £ million
Acquisitions and subscriptions of capital	734	567	1,301
At cost at 31 December 2001	734	567	1,301

The main subsidiary undertakings of the Group are listed in Note 55 on page 107.

On 10 September 2001, the merger of Bank of Scotland Group and Halifax Group by way of Schemes of Arrangement under Section 425 of the Companies Act 1985 was completed. HBOS plc became established as the parent company of Bank of Scotland and Halifax Group plc. On 7 September 2001 the Company acquired 100% of the Ordinary Stock and Preference Stock of Bank of Scotland. On 10 September 2001, the Company acquired 100% of the Ordinary Share capital of Halifax Group plc.

24. Intangible Fixed Assets

	Goodwill £ million
Cost	
At 1 January 2001	1,106
Exchange translation	(2)
Fair value adjustments (Note 50)	27
Additions (Note 50)	241
At 31 December 2001	1,372
Amortisation and provisions for impairment	
At 1 January 2001	59
Amortisation charged in year	68
At 31 December 2001	127
Net Book Value	
At 31 December 2001	1,245
At 31 December 2000	1,047

Goodwill on acquisitions is capitalised and amortised by equal instalments over its estimated useful life, normally 20 years.

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25. Tangible Fixed Assets

	Group		
	Cost £ million	Depreciation £ million	Book Value £ million
Property			
At 1 January 2001	1,274	(387)	887
Exchange translation	(2)		(2)
Additions and transfers	76	1	77
Disposals	(45)	15	(30)
Depreciation for year		(47)	(47)
At 31 December 2001	1,303	(418)	885
of which:			
Freehold			700
Long leasehold			85
Short leasehold			100
			885
Occupied for own activities			745
Equipment			
At 1 January 2001	1,521	(832)	689
Exchange translation	(4)	3	(1)
Additions and transfers	313		313
Acquisitions	20	(4)	16
Disposals	(124)	62	(62)
Depreciation for year		(213)	(213)
At 31 December 2001	1,726	(984)	742
Total tangible fixed assets 2001	3,029	(1,402)	1,627
Total tangible fixed assets 2000	2,795	(1,219)	1,576
Equipment includes amounts acquired under finance leases	32	(28)	4

Included within Group tangible fixed assets are assets in the course of construction amounting to £89 million (2000 – £89 million) which are not depreciated until the assets are brought into use.

26. Other Assets

	Group	
	2001 £ million	2000 £ million
Own shares (Note 27)	5	6
Positive market values of trading derivative contracts	2,813	1,195
Other assets	1,387	1,502
	4,205	2,703

27. Own Shares

Included in other assets are own shares held as follows:

(a) No. 1 Employee Share Ownership Trust (formerly Halifax Group plc Employee Share Ownership Plan)

The No. 1 Employee Share Ownership Trust administers shares conditionally granted to Halifax Executive Directors and other Executives under the Halifax Group plc Short Term Executive Bonus Scheme and the Halifax Group plc Long Term Executive Bonus Scheme, and shares which have been conditionally granted to employees under the Halifax Group plc Annual Bonus Plan.

Interest free loans have been provided by Halifax Group plc to the trust to allow shares to be purchased in the market to satisfy these share grants. The cost of the shares conditionally awarded is being charged to the profit and loss account on a straight line basis over the performance period.

On 10 September 2001, HBOS plc replaced Halifax Group plc as the principal company, the name of the trust was amended, and the Halifax Group plc shares held in the trust were replaced by HBOS plc shares on a one-for-one basis.

As a consequence of the merger, 0.6 million shares conditionally awarded under the Halifax Group plc Short Term Executive Scheme were released early from the trust.

At 31 December 2001, 2.1 million HBOS plc ordinary shares (2000 – 2.0 million Halifax Group plc ordinary shares) were held by the trustee and included in the balance sheet of HBOS plc. The shares, with a nominal value of 25p each, had a total market value at that date of £17 million (2000 – £13 million). Under the terms of the trust, dividends on these shares are waived. At 31 December 2001 all these shares had been conditionally granted.

(b) Halifax plc Qualifying Employee Share Ownership Trust (the "QUEST")

A QUEST has been operated by the Company's subsidiary, Halifax plc, in conjunction with an employee saving-related share option scheme (Halifax plc Sharesave Scheme 1997).

Contributions to the QUEST prior to the merger were used to subscribe for ordinary shares in Halifax plc at market value. These Halifax plc shares were exchanged for Halifax Group plc shares under a scheme of arrangement in June 1999, and these shares have been exchanged subsequently for HBOS plc shares under the terms of the scheme of arrangement effecting the merger in September 2001. The ordinary shares held by the QUEST are included within own shares in the balance sheet at nil value.

At 31 December 2001, the QUEST held 14.6 million HBOS plc ordinary shares (2000 – 14.6 million Halifax Group plc ordinary shares) with a market value of £116 million (2000 – £97 million).

Under the terms of the trust deed, dividends are required to be waived on the shares held by the QUEST.

Participants in the Halifax plc Sharesave Scheme 1997 and Halifax Group plc Sharesave Scheme 1999 have been given the opportunity to exchange their existing rights over Halifax Group plc ordinary shares for new rights over HBOS plc ordinary shares, on a one-for-one basis. The new rights are identical to the existing rights, including the option price, and will continue to be governed by the existing rules of the Sharesave Scheme.

28. Capital and Other Commitments

	Group	
	2001	2000
	£ million	£ million
There are commitments in respect of capital expenditure on fixed assets, authorised but not provided for in the accounts for which contracts have been entered into	25	49
Included in deposits by banks and in customer accounts are net obligations under finance leases payable as follows:		
within 1 year	8	9
between 2 and 5 years	14	21

Commitments for which contracts have been placed in relation to operating lease assets were £251 million (2000 – £22 million).

Notes on the Accounts

Continued

29. Long-Term Assurance Business

The value of long-term assurance business is actuarially assessed and comprises the surplus attributable to the Group, including minority interests, together with the net present value of in-force business. This method of calculating the net worth of the business to the Group is known as the embedded value approach. The principal economic assumptions behind the embedded value calculation are reviewed regularly and are as follows:

	2001 %	2000 %
Risk discount rate (net of tax) for traditional with profits business	8.5	8.5
Risk discount rate (net of tax) for other business	9.5	10.0
Return on equities (net of tax credits)	7.5	7.0
Return on Gilts (gross of tax)	5.0	5.0
Expense inflation	3.0	3.0

In-force business is defined as all live policies where the first premium has been paid. The Group's entitlement is equivalent to one ninth of the value of traditional with profits business bonuses declared in any particular year. The level of assumed future bonuses is calculated by projecting the portfolio of with profits business forward and applying reversionary and terminal bonus rates at such a level as to exhaust the projected surplus of assets attributable to with profit policyholders over liabilities. For all other business the entire surplus is attributable to the Group.

The income from long-term assurance business which is included within other operating income in the consolidated profit and loss account is calculated as follows:

	2001 £ million	2000 £ million
Closing value of Group's interest in long-term assurance business including minority interests	3,265	2,400
Opening value of Group's interest in long-term assurance business including minority interests	(2,400)	(1,762)
Increase in value of long-term assurance business	865	638
Transfer to long-term assurance business	(254)	(81)
Transfer of long-term assurance business of The Equitable (Note 50(b))	(277)	
Transfer of long-term assurance business of St. James's Place Capital plc (Note 50(c))	21	(336)
Income after tax from long-term assurance business	355	221
Taxation relating to long-term assurance business (Note 10)	115	67
Income before tax from long-term assurance business (Note 1)	470	288

The assets and liabilities attributable to policyholders are presented separately from those arising from other Group activities to reflect the different nature of the policyholders' interest.

The long-term assurance assets attributable to policyholders comprise:

	2001 £ million	2000 £ million
Investments	37,591	31,464
Value of in-force policies	2,993	2,107
Net current assets/(liabilities)	282	(113)
Long-term assurance business attributable to shareholders	40,866	33,458
Long-term assurance assets attributable to policyholders	(3,265)	(2,400)
Long-term assurance assets attributable to policyholders	37,601	31,058
Long-term assurance liabilities attributable to policyholders	37,601	31,058

Derivatives (options and futures) are used for efficient portfolio management of the long-term assurance business and to match obligations to policyholders. These derivatives are included in investments at market value.

30. Deposits by Banks

	Group	
	2001 £ million	2000 £ million
Repayable on demand	8,440	6,653
Repayable		
in 3 months or less	16,267	15,793
between 3 months and 1 year	5,632	2,877
between 1 and 5 years	44	5
after 5 years	66	
	30,449	25,328
Amounts above include:		
Associated undertakings	444	386

31. Customer Accounts

	Group	
	2001 £ million	2000 £ million
Repayable on demand	116,715	103,603
Repayable		
in 3 months or less	18,961	18,679
between 3 months and 1 year	3,917	3,345
between 1 and 5 years	876	1,282
after 5 years	47	103
	140,516	127,012
Amounts above include:		
Associated undertakings	9	13
Joint ventures	29	3

32. Debt Securities in Issue

	Group	
	2001 £ million	2000 £ million
Bonds and Medium Term Notes		
Repayable		
within 1 year	8,668	3,628
between 1 and 2 years	3,552	6,088
between 2 and 5 years	3,699	4,526
after 5 years	2,546	2,437
	18,465	16,679
Other Debt Securities		
Repayable		
in 3 months or less	38,584	30,126
between 3 months and 1 year	12,202	6,600
between 1 and 2 years	206	98
between 2 and 5 years	67	171
after 5 years	4	4
	51,063	36,999
Total Debt Securities in Issue	69,528	53,678

Bonds and Medium Term Notes includes £320 million (2000 – £336 million) secured on advances to customers and certain other assets of the Group.

Other Debt Securities includes £7,711 million (2000 – £1,341 million) in respect of commercial paper issued to fund the purchase of asset backed securities by special purpose vehicles (Note 20).

Notes on the Accounts

Continued

33. Other Liabilities

	Group	
	2001 £ million	2000 £ million
Negative market values of trading derivative contracts	2,580	1,046
Unclaimed shares	286	
Short positions in government debt securities	615	
Other liabilities	1,672	1,791
	5,153	2,837

Unclaimed shares comprises the net sale proceeds of certain Halifax Group plc ordinary shares which, following the Halifax Group restructuring which took effect on 1 June 1999, represented Halifax plc ordinary shares. These shares were issued to meet claims for Halifax plc ordinary shares from qualifying members of Halifax Building Society and others following the transfer of business from Halifax Building Society to Halifax plc in 1997. This liability also includes the related unclaimed dividends up to the date of sale and the unclaimed capital payments arising from the Halifax Group restructuring in 1999. These amounts are being held on behalf of the persons who would have been entitled to claim the shares before they were sold.

34. Provisions for Liabilities and Charges

	Group 2001 £ million
(i) Deferred Taxation	
At 1 January 2001	497
Charge in year (Note 10)	121
Other movements	10
At 31 December 2001	628

	2001		2000	
	Provided for in Accounts £ million	Full Potential Liability £ million	Provided for in Accounts £ million	Full Potential Liability £ million
Deferred taxation comprises:				
Group				
Capital allowances:				
on assets leased to customers	574	574	446	446
on other assets	37	37	36	36
Other timing differences	17	(103)	15	(106)
	628	508	497	376

	Group				
	Pensions Review Provision £ million	Pensions and Other similar Obligations £ million	HBOS Integration Provision £ million	Other Provisions £ million	Total £ million
(ii) Other Provisions					
At 1 January 2001	37	109		17	163
Exchange translation				(1)	(1)
Arising on acquisition				12	12
Charge for year	(5)	42	132	2	171
Utilised in year	(9)	(13)	(67)	(4)	(93)
At 31 December 2001	23	138	65	26	252

The pensions review provision has been established to cover estimated administrative costs and compensation payable in connection with Phases 1 and 2 of the Pensions Review and the FSAVC Review. A further provision of £41 million (2000 – £51 million) to cover direct and indirect costs arising from the pensions review is included in the long-term assurance business liabilities attributable to policyholders.

Of the provision for pensions and similar obligations, £33 million relates to post-retirement benefits (2000 – £31 million).

Other provisions include property related costs on surplus leased space.

35. Subordinated Liabilities

	Group	
	2001	2000
	£ million	£ million
Dated Loan Capital		
DFL7 million 9.72% Registered Loans 2000/2001		2
€51.1 million 8.30% Notes 2002	31	
US\$300 million 8.80% Notes 2004	207	201
£400 million 8.75% Subordinated Notes 2006	400	400
US\$150 million 8.85% Notes 2006	103	100
£75 million 9.125% Subordinated Notes 2006	75	75
£60 million 9.00% Instruments 2006	60	60
A\$100 million Callable Notes 2007	35	37
€650 million 4.75% Subordinated bonds 2009	397	405
US\$500 million Floating rate subordinated step-up callable notes 2009	345	335
€500 million 5.50% Instruments 2009	305	311
£75 million Floating rate subordinated notes 2009	75	75
US\$500 million Notes 2010	344	335
£75 million Floating Rate Instruments 2010	75	75
US\$150 million Notes 2011	103	100
€7 million Floating Rate Notes 2011	4	
£200 million Floating rate step-up callable subordinated notes 2012	200	200
€12.8 million 6.25% Instruments 2012	8	
€1,000 million Subordinated callable fixed/floating rate instruments 2013	611	
€325 million 6.125% Notes 2013	198	
£250 million 11% Subordinated bonds 2014	250	250
£150 million 10.5% Subordinated bonds 2018	150	150
£250 million 6.375% Instruments 2019	250	250
£500 million 9.375% Subordinated bonds 2021	500	500
€400 million 6.45% Eurodated Floating subordinated guaranteed bonds 2023	251	
Unamortised Premiums, Discounts and Issue Costs	(11)	(7)
	4,966	3,854
Repayable:		
within 1 year	31	2
between 2 and 5 years	845	201
after 5 years	4,090	3,651
	4,966	3,854

No repayment, for whatever reason, of dated subordinated debt prior to its stated maturity and no purchase by the relevant subsidiary undertaking of its subordinated debt may be made without the consent of the Financial Services Authority. On a winding up of the relevant company, the claims of the holders of dated subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of that company other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the dated subordinated debt.

Interest on the floating rate subordinated US dollar step-up callable note 2009 is payable three months in arrear at US dollar LIBOR plus a margin of 0.35% per annum for years 1 to 5 and 0.85% per annum thereafter.

Interest on the £200 million floating rate step-up callable note dated 2012 is payable three months in arrear at LIBOR plus a margin of 0.25% per annum for years 1 to 10 and 1.25% per annum thereafter.

The €1,000 million Instruments bear interest at a fixed rate of 5.125% until 5 December 2008 at which time the interest rate becomes 3 month €EUR-EURIBOR-Telerate plus 1.00% until maturity. These instruments may, at the option of the Bank of Scotland, be redeemed at par on 5 December 2008, or any interest payment date thereafter.

Notes on the Accounts

Continued

35. Subordinated Liabilities continued

	2001	Group	Company
	£ million	2000 £ million	2001 £ million
Undated Loan Capital			
£600 million Fixed to Floating Rate Undated Subordinated Notes			600
€500 million Fixed to Floating Rate Undated Subordinated Notes	305		305
£300 million 7.5% Subordinated Step-Up Notes	300	300	
US\$300 million Reset Notes	207	201	
£200 million Perpetual Notes	200	200	
£200 million 7.375% Subordinated Guaranteed Bonds	200	200	
€300 million Floating Rate Subordinated Step-Up Notes	183	187	
US\$250 million Floating Rate Primary Capital Notes	172	167	
£150 million Instruments	150	150	
£150 million Instruments	150	150	
JPY 17 billion Instruments	110	107	
£100 million Instruments	100	100	
£100 million 12% Perpetual Subordinated Bonds	100	100	
£100 million 8.75% Perpetual Subordinated Bonds	100	100	
£75 million 13.625% Perpetual Subordinated Bonds	75	75	
JPY 9 billion Instruments	47	53	
£50 million 9.375% Perpetual Subordinated Bonds	50	50	
JPY 42.5 million 3.50% Subordinated Yen Step-Up Notes	223		
Unamortised Premiums, Discounts and Issue Costs	(12)	(9)	(3)
	2,660	2,131	902

No exercise of any redemption option or purchase by the relevant company of any of its undated subordinated debt may be made without the consent of the Financial Services Authority. On a winding up of the Company or subsidiary undertaking the claims of the holders of perpetual subordinated debt shall be subordinated in right of payment to the claims of all depositors and creditors of the Company or subsidiary undertaking other than creditors whose claims are expressed to rank pari passu with or junior to the claims of the holders of the perpetual subordinated bonds. The perpetual subordinated bonds are junior in point of subordination to the dated subordinated debt referred to above.

The £600 million Fixed to Floating Rate Undated Subordinated Notes were issued to HBOS Capital Funding LP by the Company. HBOS Capital Funding LP has issued preferred securities of equivalent amount. These are included in minority and other interests (non-equity) in the Consolidated Balance Sheet (Note 37).

On 23 November 2001 HBOS plc issued €500 million Fixed to Floating Rate Undated Subordinated Notes at an issue price of 99.67% of their principal amount. The Notes will bear interest at 6.05% per annum payable annually in arrears to 23 November 2011 and thereafter at 3 month EUR-EURIBOR-Telorate plus 2.25% per annum paid quarterly in arrears.

The undated loan capital has no final date of maturity. All or some of the Capital Notes may be redeemed at the option of the relevant company at par on any interest payment date. The £200 million Perpetual Notes may, at the option of Bank of Scotland on 4 November 2013, be redeemed at par or exchanged for new notes. The new notes (and any further new notes issued) may be similarly redeemed or exchanged for further new notes at the option of Bank of Scotland on the fifth anniversary of their respective date(s) of issue.

The Instruments may, at the option of the relevant subsidiary undertaking on giving 30 days notice, be redeemed at par or exchanged for new Instruments on 10 August 2015 (£100 million); 9 February 2016 (JPY 17 billion); 30 May 2016 (JPY 9 billion); 30 October 2006 (£150 million) and 10 February 2023 (£150 million). The new Instruments (and any further new Instruments issued) may be similarly redeemed or exchanged for further new notes at the option of Bank of Scotland on the fifth anniversary of their respective date(s) of issue. The JPY 17 billion Instruments have been converted into an obligation of US\$160 million, bearing interest at US\$ LIBOR plus 1.01% by means of swap arrangements. The Reset Notes may be redeemed at the option of Bank of Scotland at par on 20 November 2007, at which time the interest rate becomes US\$ LIBOR plus 1.625%, or any interest payment date thereafter.

Halifax Group plc has the option, in the case of the 12% Perpetual Subordinated Bonds, at any time after 30 January 2022 and, in the case of the 8.75% Perpetual Subordinated Bonds, 14 September 2023, to redeem some or all of the Bonds at their principal value plus any accrued and unpaid interest. The 13.625% Perpetual Subordinated Bonds and the 9.375% Perpetual Subordinated Bonds carry no optional redemption clauses.

Interest on the undated Sterling 7.5% Subordinated Step-Up Notes is payable annually in arrears on 26 May from 26 May 2001 to 26 May 2016 at the rate of 7.5% per annum and, for each period of five years thereafter, annually in arrears on 26 May at the rate per annum equal to the sum of the five year benchmark Gilt rate plus 3.45%. Halifax Group plc has the option to redeem these Notes on 26 May 2016 and on each fifth anniversary thereafter.

35. Subordinated Liabilities continued

Interest on the undated Euro Floating Rate Subordinated Step-Up Notes is payable on 26 May, 26 August, 26 November and 26 February each year until 26 August 2010 at the rate of 3 month EURIBOR plus a margin of 1.20% per annum and from and including 26 August 2010 at the rate of 3 month EURIBOR plus a margin of 2.30% per annum. Halifax Group plc has the option to redeem these notes on 26 August 2010 and on each interest payment date thereafter.

On 28 February 2001 Halifax Group plc issued 3.50% undated Subordinated Yen Step-Up Notes at an issue price of 100% of their principal amount. Interest on the 3.50% undated Subordinated Yen Step-Up Notes is payable half yearly in arrears on 28 February and 28 August until 28 February 2031 at the rate of 3.50% per annum and from and including 28 August 2031 at the rate of 6 month JPY LIBOR plus a margin of 2.09% per annum. Halifax Group plc has the option to redeem these notes on 28 February 2011, on 28 February 2031 and on each coupon payment date thereafter.

36. Share Capital

	Ordinary Shares £ million	9¼% Non- Cumulative Irredeemable Preference Shares £ million	9¾% Non- Cumulative Irredeemable Preference Shares £ million	Other Preference Shares	
				Sterling £ million	Euro £ million
Authorised					
Created in year	1,185	375	125	1,204	1,500
At 31 December 2001	1,185	375	125	1,204	1,500
Allotted, called up and fully paid					
Issued to former shareholders of:					
Bank of Scotland – Preference shares £1		300	100		
Bank of Scotland – Ordinary shares 25p	317				
Halifax Group plc – Ordinary shares 20p	449				
Merger adjustment	112				
At 1 January 2001	878	300	100		
Issued under employee Stock Schemes, in lieu of dividends and acquisitions	14				
At 31 December 2001	892	300	100		

The merger adjustment represents the difference between the nominal value of 25 pence of the shares issued to former Halifax Group plc shareholders and the nominal value of 20 pence of the Halifax Group plc shares acquired.

Other sterling preference shares include £200 million 6.125 per cent. Non-Cumulative Redeemable Preference Shares, £1,000 million Sterling Preference Shares, £2.5 million 8.117 per cent. Non-Cumulative Perpetual Preference Shares Class A and £1.5 million 7.754 per cent. Non-Cumulative Perpetual Preference Shares Class B.

Euro preference shares include €1,500 million Euro preference shares.

The initial authorised share capital was £50,000 divided into 50,000 shares of £1 each. At an Extraordinary General Meeting on 12 June 2001, the shares were sub-divided into 200,000 ordinary shares of 25p each. On 7 September 2001, upon the Bank of Scotland Scheme of Arrangement becoming effective the authorised share capital of HBOS plc increased to £904,000,000 by the creation of a further 1,599,800,000 Ordinary Shares, 375,000,000 9¼ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each, 125,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares of £1 each, 250,000 HBOS Class A Perpetual Preference Shares of £10 each and 150,000 HBOS Class B Perpetual Preference Shares of £10 each.

On 10 September 2001, upon the Halifax Scheme of Arrangement becoming effective the authorised share capital increased to £2,889,000,000 and €1,500,000,000 by the creation of a further 3,140,000,000 Ordinary Shares, 200,000,000 6.125 per cent. Non-Cumulative Redeemable Preference Shares of £1 each, 1,000,000,000 Sterling Preference Shares of £1 each and 1,500,000,000 Euro Preference Shares.

On 7 September 2001, the Company issued 1,311,553,989 Ordinary Shares, 300,000,000 9¼ per cent. Non-Cumulative Irredeemable Preference Shares and 100,000,000 9¾ per cent. Non-Cumulative Irredeemable Preference Shares as consideration for the acquisition of Bank of Scotland pursuant to the Bank of Scotland Scheme of Arrangement. On 10 September 2001, the Company issued 2,250,439,819 Ordinary Shares as consideration for the acquisition of Halifax Group plc pursuant to the Halifax Group Scheme of Arrangement.

On 12 September 2001, the Company issued 18,526 Ordinary Shares under the terms of the Halifax Group plc Share Ownership Plans.

Notes on the Accounts

Continued

36. Share Capital continued

The Group operates a number of share option schemes for executives and savings-related share option schemes for employees. In connection with the merger, the rules of the executive share option schemes and savings-related share option schemes required that participants either exercise their existing options under the previous schemes or exchange their rights existing under the previous schemes at the date of the merger for new rights over HBOS plc ordinary shares, on a one-for-one basis. Rights which are neither exercised nor exchanged will lapse by 10 March 2002.

At 31 December 2001, options to acquire 7.9 million ordinary shares were outstanding under the former Bank of Scotland executive stock option schemes. These options are exercisable at a range of prices from £1.10 to £7.13 at various dates up to 16 October 2010. Of these, options in respect of 0.6 million shares were outstanding where the scheme participants have not yet elected to either exchange their rights under these schemes for rights over HBOS plc ordinary shares or exercise their options under these former schemes.

At 31 December 2001, options to acquire 52.6 million ordinary shares were outstanding under savings-related share option schemes. These options are exercisable at a range of prices from £1.64 to £5.79 at various dates up to 31 December 2009. Of these, options in respect of 20.3 million shares were outstanding where the scheme participants have not yet elected to exchange their rights under these schemes for rights over HBOS plc ordinary shares or exercise their options under these former schemes.

The Group also operates a number of other Inland Revenue approved and unapproved employee share option schemes. At 31 December 2001, options to acquire 16.3 million ordinary shares were outstanding. These options are exercisable at a range of prices between £6.68 and £6.80 and at various dates up to 21 February 2006.

During the year, a total of 12 million shares were issued on the exercise of options for a consideration of £48 million.

37. Minority and Other Interests (Non-equity)

The principal minority and other interests (non-equity) are set out below.

	2001 £ million	2000 £ million
£600 million preferred securities ^o	600	
£300 million Perpetual Regulatory tier One securities [^]	300	
£250 million preferred securities [†]	250	250
£150 million preferred securities [†]	150	150
£245 million preferred securities [*]	245	245
£415 million preferred securities [*]	257	257
£198 million non-cumulative preference shares ^{**}	198	198
	2,000	1,100
Less: unamortised issue costs	(13)	(3)
At 31 December	1,987	1,097

^o On 28 November 2001, £600 million Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A were issued through HBOS Capital Funding LP (£594 million net of expenses). These qualify as Tier 1 regulatory capital. These are perpetual securities and are not subject to any mandatory redemption provisions. They are redeemable in 2018, or each fifth anniversary thereafter, at the option of the general partner. The securities have a fixed coupon of 6.461% to 2018. Thereafter, if not redeemed, the coupon will be reset.

[^] On 28 February 2001, £300 million Perpetual Regulatory tier One securities were issued through Bank of Scotland (£297 million net of expenses). These qualify as Tier 1 regulatory capital. A £150 million Series A Issue has a fixed coupon of 7.286% to 2016 and a Series B Issue of £150 million has a fixed coupon of 7.281% to 2026. Thereafter, if not redeemed on their respective dates, for each Issue the coupon will be reset and will be further reset at five yearly intervals. There is an option to settle the coupon payment through the issue of Ordinary Shares. Coupon payments may be deferred but the Bank of Scotland may not declare or pay dividends on any of its Ordinary Shares whilst any coupon payments are deferred.

[†] During 2000, the £250 million and £150 million preferred securities were issued by a subsidiary undertaking of the Bank of Scotland.

^{*} During 1999, the £245 million and £415 million guaranteed non-voting non-cumulative preferred securities were issued by subsidiary undertakings of the Halifax Group.

^{**} During 1999, non-cumulative preference shares were issued by a subsidiary undertaking, Halifax plc, as part of the consideration to acquire the business of the Birmingham Midshires Building Society.

38. Reserves

	Share Premium £ million	Other Reserves £ million	Profit and Loss Account £ million
Group			
At 1 January 2001		209	9,051
Reserve arising on sale of unallocated shares		21	2
Premium arising on the issue of new shares prior to the merger		268	
Premium arising on the issue of new shares	13		
Dividends retained on account of stock dividends			24
Exchange translation		(6)	
Contribution to Employee Share Trust prior to the merger			(20)
Contribution to Employee Share Trust	14		(10)
Cost of employee options granted under company share ownership plans			(36)
Retained profit			646
At 31 December 2001	27	492	9,657
Company			
Premium arising on the issue of new shares	13		
Contribution to Employee Share Trust	14		(10)
Retained profit			43
At 31 December 2001	27		33

Other reserves arising on the sale of unallocated shares of £21 million represent the proceeds received during the year on the sale of certain Halifax Group plc ordinary shares. The £2 million adjustment to the profit and loss account reserve represents a revision to reserves created on the Halifax Group plc reconstruction in 1999. These shares, which, following the Halifax Group restructuring that took effect on 1 June 1999, represented Halifax plc ordinary shares issued to meet claims for Halifax plc ordinary shares from qualifying members of Halifax Building Society and others following the transfer of business from Halifax Building Society to Halifax plc in 1997, and which were no longer considered necessary to meet such claims.

The Group profit and loss account reserve at 31 December 2001 includes £756 million (2000 – £362 million) not presently available for distribution. This represents the excess of retained profits on an embedded value basis over those available for distribution.

The cumulative amount of positive goodwill on acquisitions of subsidiary undertakings written off in the Group reserves is £574 million (2000 – £574 million) and in respect of joint ventures and associated undertakings £nil (2000 – £1 million).

The Ordinary Dividend Stock Alternative Scheme, which was offered as an alternative to the cash dividend to Bank of Scotland stockholders, resulted in £24 million relating to the February 2001 final dividend (2000 – £70 million) being retained by Bank of Scotland and added to reserves.

Notes on the Accounts

Continued

39. Reconciliation of Shareholders' Funds

	2001	Group	Company
	£ million	2000 £ million	2001 £ million
Profit attributable to shareholders	1,676	1,778	1,073
Dividends	(1,030)	(826)	(1,030)
Other recognised gains and losses	(6)	(7)	
Dividends retained on account of stock dividends	24	70	
Contribution to Employee Share Trust	(30)	(21)	(10)
Cost of employee options granted under company share ownership plans	(36)		
Ordinary capital subscribed	309	53	919
Preference capital subscribed			400
Reserve arising on sale of unallocated shares	23		
	930	1,047	1,352
Shareholders' Funds at 1 January	10,538	9,491	
Shareholders' Funds at 31 December	11,468	10,538	1,352
of which:			
Attributable to non-equity interests	400	400	400
Attributable to equity interests	11,068	10,138	952
	11,468	10,538	1,352

40. Memorandum Items

The contract amounts noted below indicate the volume of business outstanding at the balance sheet date in respect of contingent liabilities and commitments undertaken for customers. They do not reflect the underlying credit and other risks, which are significantly lower.

Group	2001	2000
	Contract	Contract
	Amount	Amount
	£ million	£ million
Contingent Liabilities		
Acceptances and endorsements	202	160
Guarantees and assets pledged as collateral security		
Guarantees and irrevocable letters of credit	2,133	1,713
	2,335	1,873
Commitments		
Other commitments		
Short-term trade related transactions	202	104
Undrawn formal standby facilities, credit lines and other commitments to lend		
up to and including 1 year	26,298	19,229
over 1 year	10,772	8,199
	37,272	27,532

41. Derivatives

The Group uses interest rate swaps, forward foreign exchange contracts and other derivative instruments to hedge and reduce the interest rate and currency exposures that are inherent in any banking business. Trading transactions are either customer driven and generally matched or are carried out for proprietary trading purposes within limits approved by the Board.

The Group has entered into derivative contracts as noted below. The notional principal amounts and fair values of these derivatives (excluding internal trades) are analysed between non-trading and trading activity. "Fair value" is the amount at which instruments could be exchanged in an arm's-length transaction.

	2001			2000		
	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Year End Fair Value Liability £ million	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Year End Fair Value Liability £ million
Group						
Non-Trading						
Exchange Rate Related Contracts						
Forward foreign exchange	1,653	24	12	16,888	114	503
Cross currency swaps	13,264	450	513	10,723	430	538
	14,917	474	525	27,611	544	1,041
Interest Rate Related Contracts						
Interest rate swaps	62,447	1,076	987	77,148	1,263	834
Forward rate agreements	734		1	3,119	10	7
Options	183	6	3	2		
Futures	2,838		4	13,017		
	66,202	1,082	995	93,286	1,273	841
Equity and Commodity Related Contracts						
Options and swaps	520	21	14	614	88	66
Total Non-Trading Derivatives	81,639	1,577	1,534	121,511	1,905	1,948
	2001			2000		
	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Year End Fair Value Liability £ million	Notional Principal Amount £ million	Year End Fair Value Asset £ million	Year End Fair Value Liability £ million
Trading						
Exchange Rate Related Contracts						
Forward foreign exchange	49,887	327	441	14,393	247	278
Cross currency swaps	78	1	1	49		2
Options	483	3	3	285	7	4
	50,448	331	445	14,727	254	284
Interest Rate Related Contracts						
Interest rate swaps	184,125	1,415	1,508	110,950	675	607
Forward rate agreements	6,323	3	3	4,911	6	5
Options	31,364	89	61	14,252	88	5
Futures	80,591	22	60	32,019	5	2
	302,403	1,529	1,632	162,132	774	619
Equity and Commodity Related Contracts						
Options and swaps	323	11	5	349	11	12
Total Trading Derivatives	353,174	1,871	2,082	177,208	1,039	915
Total Group Derivatives	434,813	3,448	3,616	298,719	2,944	2,863

Notes on the Accounts

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41. Derivatives continued

The residual maturity of 'over the counter' (OTC) and non-margined exchange traded contracts was as follows:

	2001		2000	
	Notional Principal Amount £ million	Replace- ment Cost £ million	Notional Principal Amount £ million	Replace- ment Cost £ million
Group				
Contracts maturing within 1 year	223,122	1,724	150,419	1,243
between 1 and 5 years	91,187	782	83,988	1,028
after 5 years	37,075	920	19,276	668
	351,384	3,426	253,683	2,939

Credit Risk Analyses

Counterparties of the Group's derivative transactions are primarily financial institutions. An institutional and geographical analysis of replacement cost, based on the location of the office writing the business, is shown below:

	Group	
	2001 £ million	2000 £ million
Institutional		
Financial Institutions	3,094	2,598
Non-financial Institutions	332	341
	3,426	2,939
Geographical		
UK	3,190	2,698
Rest of World	236	241
	3,426	2,939

The Group's objectives and policies in managing the risks that arise in connection with the use of financial instruments are set out on pages 41 to 43 of the Financial Review and Risk Management.

42. Fair Value of Financial Assets and Financial Liabilities

Fair values of financial assets and financial liabilities are based on market prices where available, or are estimated using other valuation techniques. Where they are short-term in nature or reprice frequently fair value approximates to carrying value.

Derivatives held for trading purposes as disclosed in Note 41 are carried at fair values. Derivatives held for non-trading purposes are accounted for in the same way as the underlying transaction being hedged. Fair values are based on market prices where available, or are estimated using other valuation techniques.

The following table shows the carrying amount and the fair value of financial assets and liabilities analysed between trading and non-trading:

Group	2001								2000	
	Assets		Liabilities		Assets		Liabilities		Carrying Amount £ million	Fair Value £ million
	Carrying Amount £ million	Fair Value £ million								
Non-Trading										
Treasury bills and other eligible bills	3,050	3,051			3,196	3,199				
Debt securities	29,220	29,303			29,016	29,104				
Equity shares	224	285			147	301				
Debt securities in issue			69,162	66,961					53,507	53,528
Dated loan capital			4,966	5,709					3,854	4,243
Undated loan capital			2,660	2,705					2,131	2,194
Preference stocks			400	577					400	522
Minority and other interests (non-equity)			1,987	2,224					1,097	1,129
Derivatives	1,298	1,577	979	1,534	1,651	1,905	1,309	1,309	1,309	1,948
Total Non-Trading	33,792	34,216	80,154	79,710	34,010	34,509	62,298	62,298	62,298	63,564
Trading										
Treasury bills and other eligible bills	1,021	1,021								
Loans and advances to banks	463	463			282	282				
Loans and advances to customers	480	480			8	8				
Debt securities	13,229	13,229			527	527				
Other assets	165	165								
Debt securities in issue			366	366					171	171
Deposits by banks			6,649	6,649					173	173
Customer accounts			1,991	1,991					50	50
Other liabilities			946	946						
Derivatives	1,871	1,871	2,082	2,082	1,039	1,039	915	915	915	915
Total Trading	17,229	17,229	12,034	12,034	1,856	1,856	1,309	1,309	1,309	1,309

Fair values in respect of non-trading financial assets and liabilities are disclosed only where there is a liquid and active market.

Fair value information is not provided for items that do not meet the definition of a financial instrument or for certain other financial instruments, including short-term debtors and creditors. The fair value information presented does not therefore represent the fair value of the Group as a going concern at 31 December 2001.

Notes on the Accounts

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43. Hedges

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	2001		
	Gains £ million	Losses £ million	Total Net Gains/(Losses) £ million
Group			
Unrecognised gains and losses on hedges at 1 January 2001	877	1,262	(385)
Gains and losses arising in previous years that were recognised in the year ended 31 December 2001	421	771	(350)
Gains and losses arising before 1 January 2001 that were not recognised in the year ended 31 December 2001	456	491	(35)
Gains and losses arising in the year ended 31 December 2001 that were not recognised in that year	369	610	(241)
Unrecognised gains and losses on hedges at 31 December 2001	825	1,101	(276)
of which:			
Gains and losses expected to be recognised in the year ended 31 December 2002	233	663	(430)
Gains and losses expected to be recognised after 31 December 2002	592	438	154
			2000
	Gains £ million	Losses £ million	Total Net Gains/(Losses) £ million
Group			
Unrecognised gains and losses on hedges at 1 January 2000	735	542	193
Gains and losses arising in previous years that were recognised in the year ended 31 December 2000	313	367	(54)
Gains and losses arising before 1 January 2000 that were not recognised in the year ended 31 December 2000	422	175	247
Gains and losses arising in the year ended 31 December 2000 that were not recognised in that year	455	1,087	(632)
Unrecognised gains and losses on hedges at 31 December 2000	877	1,262	(385)
of which:			
Gains and losses expected to be recognised in the year ended 31 December 2001	381	784	(403)
Gains and losses expected to be recognised after 31 December 2001	496	478	18

44. Interest Rate Sensitivity Gap

The tables below summarise the repricing profiles of the Group's assets and liabilities.

As at 31 December 2001

	Not more than 3 months £ million	Over 3 months but not over 6 months £ million	Over 6 months but not over 1 year £ million	Over 1 year but not over 5 years £ million	Over 5 years £ million	Non-interest bearing £ million	Trading £ million	Total £ million
Assets								
Treasury bills and other eligible bills	2,001	948	9	92			1,021	4,071
Loans and advances to banks	9,772	1,542	462	169	26	495	463	12,929
Loans and advances to customers	150,282	5,732	4,110	27,040	9,893	356	480	197,893
Debt securities and equity shares	19,550	5,023	1,589	2,102	729	451	13,229	42,673
Other assets	224	221	215	589	684	12,197	2,978	17,108
	181,829	13,466	6,385	29,992	11,332	13,499	18,171	274,674
Liabilities								
Deposits by banks	19,943	1,951	1,196	27	18	665	6,649	30,449
Customer accounts	127,404	2,465	2,840	3,779	150	1,887	1,991	140,516
Debt securities in issue	52,011	9,435	4,317	1,441	1,952	6	366	69,528
Other liabilities			1	20		9,138	3,526	12,685
Subordinated liabilities	1,268	203		785	5,370			7,626
Minority interests and shareholders' funds						13,870		13,870
Internal funding of trading business	(5,639)						5,639	
	194,987	14,054	8,354	6,052	7,490	25,566	18,171	274,674
On-balance sheet gap	(13,158)	(588)	(1,969)	23,940	3,842	(12,067)		
Non-trading derivatives	6,598	(746)	(1,372)	(9,305)	4,825			
Net interest rate repricing gap 2001	(6,560)	(1,334)	(3,341)	14,635	8,667	(12,067)		
Cumulative gap 2001	(6,560)	(7,894)	(11,235)	3,400	12,067			

Notes on the Accounts

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44. Interest Rate Sensitivity Gap continued

As at 31 December 2000

	Not more than 3 months £ million	Over 3 months but not over 6 months £ million	Over 6 months but not over 1 year £ million	Over 1 year but not over 5 years £ million	Over 5 years £ million	Non-interest bearing £ million	Trading £ million	Total £ million
Assets								
Treasury bills and other eligible bills	2,919	185	19	73				3,196
Loans and advances to banks	14,493	2,253	618	87	24	360	282	18,117
Loans and advances to customers	118,657	5,241	3,499	29,737	12,211	535	8	169,888
Debt securities and equity shares	18,888	2,504	3,355	3,237	652	527	527	29,690
Other assets	5			1,277	247	11,470	1,195	14,194
	154,962	10,183	7,491	34,411	13,134	12,892	2,012	235,085
Liabilities								
Deposits by banks	21,664	1,820	1,256	4		411	173	25,328
Customer accounts	115,015	2,433	3,341	4,322	48	1,803	50	127,012
Debt securities in issue	40,334	4,253	3,526	3,398	1,996		171	53,678
Other liabilities				24	3	9,997	1,046	11,070
Subordinated liabilities	904	167		201	4,713			5,985
Minority interests and shareholders' funds						12,012		12,012
Internal funding of trading business	(572)						572	
	177,345	8,673	8,123	7,949	6,760	24,223	2,012	235,085
On-balance sheet gap	(22,383)	1,510	(632)	26,462	6,374	(11,331)		
Non-trading derivatives	14,501	(8,775)	(1,144)	(8,331)	3,749			
Net interest rate repricing gap 2000	(7,882)	(7,265)	(1,776)	18,131	10,123	(11,331)		
Cumulative gap 2000	(7,882)	(15,147)	(16,923)	1,208	11,331			

All derivative instruments which alter the interest bases of the non-trading portfolio of assets and liabilities are reflected in the above tables.

45. Trading Value at Risk

The Group's Value at Risk (VaR) methodology of estimating potential losses arising from the Group's exposure to market risk is explained on page 43 of the Financial Review and Risk Management. The Group's trading market risk exposure for the year ended 31 December 2001 is analysed below.

	Exposure							
	As at 31 December 2001 £ million	As at 31 December 2000 £ million	Average		Highest		Lowest	
			2001 £ million	2000 £ million	2001 £ million	2000 £ million	2001 £ million	2000 £ million
Total Value at Risk	13.8	3.1	8.0	1.7	21.4	4.5	0.8	0.2

For all significant exposures VaR has been calculated on a daily basis.

46. Non-trading Currency Exposure

Structural currency exposures arise from the Group's investments in overseas subsidiaries, branches and other investments and are noted in the table below.

Functional currency of the operation	2001			2000		
	Net investments in overseas operations £ million	Borrowing taken out to hedge the net investments £ million	Remaining structural currency exposure £ million	Net investments in overseas operations £ million	Borrowing taken out to hedge the net investments £ million	Remaining structural currency exposure £ million
US Dollar	114	85	29	36	12	24
Euro	212	56	156	65	55	10
Australian Dollar	307	281	26	267	232	35
Other	2	2		2	2	
Total	635	424	211	370	301	69

As at 31 December 2001 and 31 December 2000 there are no material net currency exposures in the non-trading book relating to transactional (or non-structural) positions that would give rise to net currency gains or losses for the reason set out on page 43 of the Financial Review and Risk Management.

47. Assets and Liabilities in Foreign Currencies

	Group	
	2001 £ million	2000 £ million
The aggregate amounts of assets and liabilities denominated in currencies other than sterling were:		
Assets	59,932	49,361
Liabilities	82,912	59,388

The above figures do not reflect the Group exposure to foreign exchange, which is significantly lower as it is hedged by off-balance sheet instruments.

48. Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities

	2001 £ million	2000 £ million
Group operating profit	2,670	2,683
Decrease/(increase) in accrued income and prepayments	395	(642)
(Decrease)/increase in accruals and deferred income	(840)	1,561
Provision for bad and doubtful debts	608	471
Depreciation and goodwill amortisation	538	490
Amortisation of debt securities	51	21
Increase in the income from long-term assurance business	(470)	(288)
Interest on subordinated loans	467	422
Profits on sale of investment securities	(92)	(116)
Profits on sale of fixed assets	(7)	(19)
Provisions for liabilities and charges	171	17
Provisions utilised	(93)	(19)
Provision against debt securities and equity shares	21	9
Exchange differences	(194)	(102)
Other non-cash movements	14	
Net cash inflow from trading activities	3,239	4,488
Net increase in notes in circulation	84	108
Net (increase)/decrease in items in course of collection	(229)	121
Net (increase)/decrease in treasury and other eligible bills	(875)	255
Net increase in loans and advances to banks and customers	(21,979)	(21,286)
Net increase in deposits by banks and customer accounts	16,370	15,441
Net increase in debt securities in issue	15,850	5,960
Net increase in other assets	(1,320)	(1,117)
Net increase in other liabilities	2,233	678
Net (increase)/decrease in debt securities	(12,702)	133
Net cash inflow from operating activities	671	4,781

Notes on the Accounts

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49. Gross Cash Flows

	Notes	2001 £ million	2000 £ million
(i) Returns on investments and servicing of finance			
Interest paid on loan capital		(456)	(395)
Preference dividends paid		(37)	(37)
Dividends paid to minority shareholders in subsidiary undertakings		(145)	(102)
		(638)	(534)
(ii) Capital expenditure and financial investment			
Transfers to long-term assurance business		(254)	(81)
Purchase of investment securities		(64,169)	(72,709)
Sale and maturity of investment securities		64,370	72,282
Purchase of property and equipment		(390)	(452)
Sale of property and equipment		99	130
Movement in own shares		1	6
Purchase of operating lease assets		(1,305)	(1,328)
Sale of operating lease assets		572	598
		(1,076)	(1,554)
(iii) Acquisitions and disposals			
Investment in subsidiary undertakings		(700)	(932)
Investment in associated undertakings, joint ventures and business interests		(69)	(54)
Disposal of associated undertakings, joint ventures and business interests		31	
Minority interest acquired		4	
Minority interest disposed		(5)	
		(739)	(986)
(iv) Financing			
Issue of ordinary stock	52	275	53
Issue of subordinated loan capital	52	1,595	935
Issue of Perpetual Regulatory tier One securities		297	
Issue of preferred securities		594	400
Repayments of subordinated loan capital	52	(33)	(185)
Contribution to Employee Share Trust		(30)	(21)
Cost of employee options granted under company share ownership plans		(36)	
Other movements	52		2
		2,662	1,184

50. Acquisitions and Disposals

(a) On 16 February 2001, Bank of Scotland acquired 99.99% of the share capital of ICC Bank plc, which is based in Ireland. The remaining equity has been acquired during the year. The consideration of £227 million inclusive of fees and expenses was satisfied partly in cash raised from the proceeds of a placing of Bank of Scotland stock and partly by stock issued.

The summarised profit and loss account for ICC Bank plc included in the results of the Group from 16 February 2001 to 31 December 2001 is as follows:

	2001 £ million
Interest receivable	128
Interest payable	(78)
Net interest income	50
Fees and commissions receivable	9
Fees and commissions payable	(1)
Other operating income	7
Net operating income	65
Administrative expenses	(19)
Depreciation	(1)
Operating expenses	(20)
Provisions for bad and doubtful debts	(4)
Operating profit	41

The net assets at the date of acquisition are shown in the table below.

	Acquired book value £ million	Revaluation adjustments £ million	Accounting policy adjustments £ million	Total fair value adjustments £ million	Fair value to the Group £ million
Loans and advances to banks and customers	2,239	(4)		(4)	2,235
Debt securities and equity shares	233	39		39	272
Other assets, prepayments and accrued income	41		(1)	(1)	40
Total assets	2,513	35	(1)	34	2,547
Deposits by banks, customer accounts and debt securities in issue	2,255				2,255
Other liabilities, accruals and deferred income and other provisions	48				48
Subordinated liabilities	78	1		1	79
Minority interests	2				2
Total liabilities	2,383	1		1	2,384
Net assets	130	34	(1)	33	163
Goodwill					64
Consideration					227
Satisfied by:					
Cash					193
Shares issued at fair value					34
					227

In accordance with FRS 7 "Fair Values in Acquisition Accounting", the principal fair value adjustment reflects the revaluation of debt securities and equity shares to market value. The other accounting policy and revaluation adjustments are not individually material.

Notes on the Accounts

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50. Acquisitions and Disposals continued

(b) Equitable Life Assurance Society ("The Equitable")

On 1 March 2001, the Halifax Group acquired the operating assets, salesforce and unit linked and non-profit business of The Equitable for £507 million (including costs of acquisition). Net assets with a fair value of £341 million were acquired, creating a balance of goodwill on the acquisition of £166 million.

The acquisition method of accounting has been adopted and the results of the acquired operation have been consolidated in full from that date.

On 11 January 2002, The Equitable's guaranteed annuity rate and non-guaranteed annuity rate policyholders voted in favour of a scheme of arrangement to compromise their respective claims against the with-profits fund. The scheme became effective on 8 February 2002.

As a result of this, in accordance with the terms of the acquisition, in addition to the consideration paid of £507 million, Halifax plc (a subsidiary undertaking of HBOS plc) agreed to pay a further £250 million which it has done by unconditionally waiving the repayment of £250 million of loans advanced by it to The Equitable under a fully collateralised loan facility of £251 million, which was granted in 2001.

This waiver will be dealt with as an adjustment to goodwill, although this has not been recognised in the balance sheet as at 31 December 2001 as the scheme only became effective after the balance sheet date.

In addition, Halifax Group is obliged to pay up to a further £250 million depending on the extent to which certain new business sales and profitability targets are achieved in 2003 and 2004 by the distribution channel acquired from The Equitable. Any amounts to be paid will only be ascertained in 2005. Under the terms of the acquisition, any obligation arising was to have been met by Halifax plc advancing a further loan of £250 million under the £251 million fully collateralised loan facility and waiving its repayment to the extent The Equitable became entitled to a further payment. It has now been agreed that in the event that a further amount becomes payable to The Equitable, a cash payment will be made by Halifax Group plc. This will be dealt with, in the accounts of Halifax Group plc, as an adjustment to the value of goodwill arising on the acquisition of The Equitable's business.

The following table summarises the effects of this acquisition:

	Acquired book value £ million	Revaluation adjustments £ million	Accounting policy adjustments £ million	Total fair value adjustments £ million	Fair value to the Group £ million
Long-term assurance business attributable to shareholders			277	277	277
Long-term assurance assets attributable to policyholders	4,106				4,106
Other assets	149		10	10	159
Total assets	4,255		287	287	4,542
Long-term assurance liabilities attributable to policyholders	4,106				4,106
Other liabilities	84	12	(1)	11	95
Total liabilities	4,190	12	(1)	11	4,201
Net assets	65	(12)	288	276	341
Goodwill					166
Consideration					507
Satisfied by:					
Cash					500
Acquisition costs					7
					507

In accordance with FRS 7, preliminary fair value adjustments have been made. The principal adjustment required reflects the fact that as a mutual life assurance society, The Equitable did not prepare accounts on an embedded value basis. A fair value adjustment for £277 million has therefore been made, being an estimate of the value of acquired in-force business. The other accounting policy and revaluation adjustments are not individually material.

The goodwill arising on the acquisition is being amortised over a period of 20 years to reflect the strategic rationale of the acquisition and the period over which the economic benefits associated with the goodwill are expected to arise.

50. Acquisitions and Disposals continued

The summarised profit and loss account for The Equitable's acquired operating business included in the results of the Group from 1 March 2001 to 31 December 2001 is as follows:

	£ million
Fees and commissions receivable	62
Other operating income	
Income from long-term assurance business	46
Total income	108
Administrative expenses	(42)
Depreciation	(1)
Operating profit	65

In addition, exceptional integration costs of £42 million have been incurred in respect of this acquisition.

It has not been practicable to disclose the turnover, operating profit or profit after taxation for the acquired operating assets, salesforce and unit-linked and non-profit business for the periods prior to the acquisition as they were integrated within The Equitable's operations and thus did not form a separately identifiable business.

(c) St. James's Place Capital plc (SJPC)

On 1 June 2000, the Halifax Group acquired 60% of the issued share capital of SJPC for a total cost of £810 million.

The preliminary fair value adjustments applied as at 31 December 2000 have been reviewed, resulting in a £12 million increase in the value of goodwill acquired net of minority interests of £9 million. The revaluation adjustments relate to SJPC's participating interest in LAHC. LAHC has changed its accounting to reflect the latest ABI guidance (in particular the way DSS payments are accounted for) resulting in a reduction to the embedded value of £43 million. This is offset by the renegotiation of various agreements relating to certain indemnities which amounted to £22 million post tax. As a result net assets with a fair value of £437 million were acquired which, after deduction of the minority interest of £187 million, creates goodwill on acquisition of £560 million.

(d) During the year a further £26 million of goodwill arose from the acquisition of minorities and from fair value adjustments to previous acquisitions. During 2000, £24 million of goodwill arose from the combination of an acquisition of a portfolio of motor finance receivables and motor dealer funding, acquisitions of minorities and from fair value adjustments to previous acquisitions.

(e) UK credit card operation of Bank One Corporation ("Bank One International")

On 21 June 2000, the Group's subsidiary, Halifax plc, acquired Bank One International for a total consideration of £228 million. Net assets with a fair value of £207 million were acquired creating goodwill on acquisition of £21 million.

(f) There were no material disposals in the year to 31 December 2001.

51. Analysis of the Balances of Cash as shown in the Balance Sheet

	As at 1 January 2001 £ million	Cashflow £ million	As at 31 December 2001 £ million	As at 1 January 2000 £ million	Cashflow £ million	As at 31 December 2000 £ million
Cash and balances at central banks	1,252	(102)	1,150	944	308	1,252
Loans and advances to other banks repayable on demand	2,400	(775)	1,625	1,261	1,139	2,400
	3,652	(877)	2,775	2,205	1,447	3,652

The Group maintains balances with the Bank of England which, at 31 December 2001, amounted to £732 million (2000 – £636 million).

Notes on the Accounts

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52. Analysis of the Changes in Financing During the Year

	2001		2000	
	Share Capital (including Premium) £ million	Loan Capital £ million	Share Capital (including Premium) £ million	Loan Capital £ million
At 1 January	1,278	5,985	1,270	5,133
Effect of foreign exchange differences				100
Acquisitions		79		
Shares issued as part payment for the acquisition of ICC Bank plc	34			
Proceeds of capital issues (including premium) – ordinary shares	275		53	
Issue of subordinated loan capital		1,595		935
Repayments of loan capital		(33)		(185)
Non cash movement				
Transfer of share premium to other reserves	(268)		(45)	
Other movements				2
At 31 December	1,319	7,626	1,278	5,985

53. Related Party Transactions

In the year ended 31 December 2001, Bank of Scotland Group provided both administration and processing services to Sainsbury's Bank plc. The amounts in respect of administration and processing services payable to Bank of Scotland Group during the year were £19 million (2000 – £20 million), of which £6 million was outstanding at the year end (2000 – £5 million).

During the year, IBM United Kingdom (Systems Operations) Limited, a non consolidated subsidiary, provided to Bank of Scotland Group systems operations services. The amounts in respect of these services payable from Bank of Scotland Group during the year were £116 million (2000 – £36 million), of which £11 million was outstanding at the year end (2000 – £2 million).

54. Main Joint Ventures and Associated Undertakings

	Nature of Business	Issued Share and Loan Capital		Group's Interest	Accounts Made up to	Principal Area of Operations
Incorporated in the UK						
Joint Ventures:						
Centrica Personal Finance Limited	Finance	ordinary	£3,000,000	50.0%	December 2001	UK
RFS Limited	Finance	loan	£4,500,000	50.0%	December 2001	UK
Lex Vehicle Leasing (Holdings) Ltd and its subsidiaries	Finance	ordinary	£6,000,006	50.0%	December 2001	UK
Halifax Cetelem Credit Ltd	Vehicle Leasing	ordinary	£66,300,000	50.0%	December 2001	UK
esure Holdings Ltd and its subsidiaries	Consumer Credit	ordinary	£12,000,000	50.0%	December 2001	UK
	Insurance	ordinary	£3,330,000	70.0%	December 2001	UK
Associated Undertaking:						
Sainsbury's Bank plc	Banking	ordinary	£130,000,000	45.0%	February 2001	UK

All the above are held by subsidiary undertakings.

The Group also holds 100% of the preference shares issued by esure Holdings Ltd.

55. Main Subsidiary Undertakings

	Company's Interest in Ordinary Share Capital and Voting Rights	Principal Business	Incorporated
The Governor and Company of Bank of Scotland and subsidiaries, including	100%†	Banking, financial and related services	UK
Bank of Scotland Treasury Services PLC	100%	Banking	UK
Bank of Western Australia Ltd	56.3%	Retail and commercial banking	Australia
CAPITAL BANK plc	100%*	Banking and personal finance	UK
Halifax Group plc and subsidiaries, including	100%	Retail financial services	UK
Halifax plc	100% ^o	Banking	UK
Halifax General Insurance Services Ltd	100%	General insurance brokerage	UK
Halifax Share Dealing Ltd	100%	Execution only stockbroking	UK
Clerical Medical Investment Group Ltd	100%	Life assurance	UK
Halifax Financial Services Ltd	100%	Financial services	UK
Halifax Unit Trust Management Ltd	100%	Unit trust management	UK
St. James's Place Capital plc	60%	Financial services	UK

† HBOS plc holds 100% of the issued preference share capital.

* Bank of Scotland also holds 100% of the issued preference share capital.

^o Halifax Group plc also holds 75% of the issued preference share capital.

56. Transactions with Directors, Officers and Connected Persons

The aggregate amounts outstanding at 31 December 2001 in respect of loans and credit cards which were made available by the Group for persons who are, or were during the year, Directors and officers of HBOS plc and their connected persons were:

	Number	Aggregate amount outstanding £000
Loans	7	1,248
Credit card accounts	12	33

57. Segmental Analysis

Business Sector

The Group reports through five divisions: Retail, Business, Corporate, Treasury, Insurance & Investment, plus BankWest and Group Items.

	Profit before Tax £ million	Exceptional items and Intelligent Finance £ million	2001 Total £ million	Profit before Tax £ million	Exceptional items and Intelligent Finance £ million	2000 Total £ million
Retail	1,403	(179)	1,224	1,567	(141)	1,426
Business	308	(9)	299	290	(62)	228
Corporate	515	(1)	514	376	(2)	374
Treasury	169	(2)	167	210		210
Insurance & Investment	772	(22)	750	593	(7)	586
BankWest	80		80	73		73
Group Items	(240)	(164)	(404)	(184)	(45)	(229)
	3,007	(377)	2,630	2,925	(257)	2,668

Notes on the Accounts

Continued

57. Segmental Analysis continued

	Net Assets		Total Assets	
	2001 £ million	2000 £ million	2001 £ million	2000 £ million
Retail	3,953	3,886	139,499	121,230
Business	1,046	1,153	21,954	18,448
Corporate	2,100	1,790	38,211	29,007
Treasury	643	870	61,866	55,277
Insurance & Investment	3,352	2,487	42,963	34,969
BankWest	374	352	7,782	7,212
	11,468	10,538	312,275	266,143

Geographical

The table below analyses the Group results and assets by the geographical area in which the business is generated. The geographical analysis is prepared in accordance with the location of the relevant company or branch.

	2001			2000		
	UK £ million	Rest of World £ million	Group Total £ million	UK £ million	Rest of World £ million	Group Total £ million
Interest receivable	14,961	1,154	16,115	14,154	957	15,111
Fees and commissions receivable	1,789	132	1,921	1,575	136	1,711
Dealing profits	77	5	82	61	5	66
Other operating income	974	239	1,213	815	28	843
Gross income	17,801	1,530	19,331	16,605	1,126	17,731
Operating profit before exceptional items and Intelligent Finance	2,663	308	2,971	2,720	175	2,895
Share of operating profits of joint ventures	25	(5)	20	10		10
Share of operating profits of associated undertakings	13	3	16	18	2	20
Exceptional items and Intelligent Finance	(377)		(377)	(245)	(12)	(257)
Group profit before taxation	2,324	306	2,630	2,503	165	2,668
Total assets	289,423	22,502	311,925	248,932	16,904	265,836
Joint ventures			216			184
Associated undertakings			134			123
Group total assets			312,275			266,143
Net assets (excluding minority interests)	10,370	1,098	11,468	9,871	667	10,538

58. Business Merger

The merger of the Bank of Scotland Group and Halifax Group was completed on 10 September 2001. The book value of net assets at the time of the merger together with adjustments arising from the alignment of accounting policies were:

	£ million
Bank of Scotland Group	
Book value of net assets at time of merger	3,925
Accounting adjustments relating to merger alignment (Note 59)	(53)
Restated net assets at time of merger	3,872
Halifax Group	
Book value of net assets at time of merger	7,587
Accounting adjustments relating to merger alignment (Note 59)	(7)
Restated net assets at time of merger	7,580

58. Business Merger continued

An analysis of contribution to the profit attributable to shareholders made by the combining groups in the period prior to the merger date of 10 September 2001, together with the contribution from the combined Group in the period subsequent to the merger, is as follows:

Profit & Loss Account	Bank of Scotland Group Pre merger £ million	Halifax Group Pre merger £ million	Combined Post merger £ million	Total £ million
Net interest income	1,426	1,491	1,256	4,173
Non-interest income	623	964	1,112	2,699
Net operating income	2,049	2,455	2,368	6,872
Administrative expenses	(872)	(1,038)	(1,057)	(2,967)
Depreciation and goodwill amortisation	(59)	(146)	(333)	(538)
Provisions for bad and doubtful debts	(328)	(87)	(193)	(608)
General insurance claims	(12)	(34)	(22)	(68)
Amounts written off fixed asset investments	(4)		(17)	(21)
Operating profit	774	1,150	746	2,670
Before exceptional items and Intelligent Finance	774	1,269	928	2,971
Exceptional items		(9)	(138)	(147)
Intelligent Finance		(110)	(44)	(154)
Share of operating profits/(losses) of joint ventures and associated undertakings	30	(2)	8	36
Merger costs – exceptional	(40)	(36)		(76)
Profit on ordinary activities before taxation	764	1,112	754	2,630
Before exceptional items and Intelligent Finance	804	1,267	936	3,007
Exceptional items	(40)	(45)	(138)	(223)
Intelligent Finance		(110)	(44)	(154)
Taxation	(272)	(331)	(162)	(765)
Profit on ordinary activities after taxation	492	781	592	1,865
Before exceptional items and Intelligent Finance	532	901	722	2,155
Exceptional items	(40)	(43)	(99)	(182)
Intelligent Finance		(77)	(31)	(108)
Minority interests	(59)	(76)	(54)	(189)
Profit for the period attributable to shareholders	433	705	538	1,676

Pre merger results are adjusted for the effect of alignments of accounting policies and practices, which are not material.

Notes on the Accounts

Continued

58. Business Merger continued

The equivalent analysis for the year ended 31 December 2000 is as follows:

Profit & Loss Account	Bank of Scotland Group Pre merger £ million	Halifax Group Pre merger £ million	Total £ million
Net interest income	1,645	2,386	4,031
Non-interest income	1,151	1,062	2,213
Net operating income	2,796	3,448	6,244
Administrative expenses	(1,174)	(1,406)	(2,580)
Depreciation and goodwill amortisation	(299)	(191)	(490)
Provisions for bad and doubtful debts	(381)	(90)	(471)
General insurance claims	(11)		(11)
Amounts written off fixed asset investments	(9)		(9)
Operating profit	922	1,761	2,683
Before exceptional items and Intelligent Finance	1,002	1,893	2,895
Exceptional items	(80)	(44)	(124)
Intelligent Finance		(88)	(88)
Share of operating profits/(losses) of joint ventures and associated undertakings	41	(56)	(15)
Profit on ordinary activities before taxation	963	1,705	2,668
Before exceptional items and Intelligent Finance	1,043	1,882	2,925
Exceptional items	(80)	(89)	(169)
Intelligent Finance		(88)	(88)
Taxation	(286)	(471)	(757)
Profit on ordinary activities after taxation	677	1,234	1,911
Before exceptional items and Intelligent Finance	739	1,323	2,062
Exceptional items	(62)	(27)	(89)
Intelligent Finance		(62)	(62)
Minority interests	(60)	(73)	(133)
Profit for the year attributable to shareholders	617	1,161	1,778

Pre merger results are adjusted for the effect of alignments of accounting policies and practices, which are not material.

59. Accounting Policy Alignment

The Group's accounting policies are set out on pages 65 and 66. These harmonise the policies used within Bank of Scotland Group and Halifax Group prior to the merger of the two groups on 10 September 2001.

The Group has adopted a consistent approach to the transitional implementation arrangements of FRS 15 "Tangible Fixed Assets". This has resulted in Bank of Scotland Group restating the carrying value of its tangible fixed assets to a historical cost basis. The effect of this merger adjustment at 31 December 2000 was to decrease the Group's tangible fixed assets by £47 million, with a corresponding decrease to the Group's profit and loss account reserves. The impact of this merger adjustment on profit on ordinary activities before taxation in 2001 and 2000 is not material to the Group.

General provision policy has been standardised based on an expected loss methodology. The loan loss estimate makes use of, inter alia, historical loan loss experience and economic and other business climate conditions. Specific loan loss provision methodology has also been standardised within all Divisions of HBOS. The impact on 2001 results of aligning general and specific provisioning policy methodologies is not significant.

While a number of accounting policies and practices have now been aligned across the Group, none of these are material to the Group.

60. Post Balance Sheet Events

As described in Note 50, on 1 March 2001, the Halifax Group acquired the operating assets, sales force and unit linked and non-profit business of The Equitable. On 11 January 2002, The Equitable's guaranteed annuity rate and non-guaranteed annuity rate policyholders voted in favour of a scheme of arrangement to compromise their respective claims against the with-profits fund. The scheme became effective on 8 February 2002. As a result of this, in accordance with the terms of the acquisition, in addition to the consideration paid of £507 million, Halifax plc (a subsidiary of HBOS plc) agreed to pay a further £250 million which it has done by unconditionally waiving the repayment of £250 million of loans advanced by it to The Equitable under a fully collateralised loan facility of £251 million, which was granted in 2001. The accounting implications arising from this are set out in Note 50.

Accounts in US Dollars

at \$1.4517 to the £ (2000 – \$1.4929 to the £)

Summary of Consolidated Balance Sheet

As at 31 December 2001

	2001 US\$ million	2000 US\$ million
Assets		
Cash and balances at central banks	1,669	1,869
Items in course of collection	1,427	1,126
Bills, debt securities and equity shares	67,858	49,096
Loans, advances and other accounts	318,374	290,911
Interest in associated undertakings and joint ventures	508	458
Intangible and tangible fixed assets	4,170	3,916
Long-term assurance business attributable to shareholders	4,740	3,582
Long-term assurance assets attributable to policyholders	54,584	46,367
Total Assets	453,330	397,325
Liabilities		
Deposits by banks, customers and debt securities in issue	349,125	307,564
Notes in circulation	1,070	975
Proposed dividends	986	817
Deferred taxation	911	742
Other liabilities and provisions	15,448	13,993
Subordinated liabilities – Dated loan capital	7,210	5,754
– Undated loan capital	3,861	3,181
Long-term assurance liabilities attributable to policyholders	54,584	46,367
	433,195	379,393
Capital and Reserves		
Called up share capital		
Preference stocks	581	596
Ordinary shares	1,294	1,311
Reserves	14,773	13,824
Minority interests	3,487	2,201
	20,135	17,932
Total Liabilities	453,330	397,325

Summary of Consolidated Profit and Loss Account

For the year ended 31 December 2001

	2001 US\$ million	2000 US\$ million
Operating profit before provisions	4,759	4,709
Provisions for bad and doubtful debts	(883)	(703)
Operating profit	3,876	4,006
Profit on ordinary activities before taxation	3,817	3,983
Profit attributable to shareholders	2,432	2,654
Dividends:		
Preference	53	55
Ordinary	1,441	1,178
Retained profit	938	1,421
Underlying earnings per share	82.2c	83.0c
Dividends per 25p Ordinary Share	40.6c	33.4c

Accounts in Euros

at €1.6380 to the £ (2000 – €1.6052 to the £)

Summary of Consolidated Balance Sheet

As at 31 December 2001

	2001 € million	2000 € million
Assets		
Cash and balances at central banks	1,881	2,010
Items in course of collection	1,611	1,210
Bills, debt securities and equity shares	76,566	52,789
Loans, advances and other accounts	359,231	312,794
Interest in associated undertakings and joint ventures	573	493
Intangible and tangible fixed assets	4,705	4,210
Long-term assurance business attributable to shareholders	5,349	3,853
Long-term assurance assets attributable to policyholders	61,590	49,854
Total Assets	511,506	427,213
Liabilities		
Deposits by banks, customers and debt securities in issue	393,930	330,701
Notes in circulation	1,207	1,047
Proposed dividends	1,113	878
Deferred taxation	1,028	798
Other liabilities and provisions	17,426	15,046
Subordinated liabilities – Dated loan capital	8,135	6,186
– Undated loan capital	4,357	3,421
Long-term assurance liabilities attributable to policyholders	61,590	49,854
	488,786	407,931
Capital and Reserves		
Called up share capital		
Preference shares	655	642
Ordinary shares	1,461	1,409
Reserves	16,669	14,865
Minority interests	3,935	2,366
	22,720	19,282
Total Liabilities	511,506	427,213

Summary of Consolidated Profit and Loss Account

For the year ended 31 December 2001

	2001 € million	2000 € million
Operating profit before provisions	5,369	5,063
Provisions for bad and doubtful debts	(996)	(756)
Operating profit	4,373	4,307
Profit on ordinary activities before taxation	4,307	4,283
Profit attributable to shareholders	2,744	2,854
Dividends:		
Preference	60	59
Ordinary	1,626	1,267
Retained profit	1,058	1,528
Underlying earnings per share	92.7c	89.2c
Dividends per 25p Ordinary Share	45.9c	36.0c

The New Force in Banking

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Notice of
Annual General Meeting
2002



Notice of Annual General Meeting

The Annual General Meeting of HBOS plc (the 'Company') will be held at the Edinburgh International Conference Centre, The Exchange, Morrison Street, Edinburgh EH3 3EE at 11.00 a.m. on Wednesday 15th May 2002 to consider the following business:

Resolutions 22, 23 and 25 will be proposed as special resolutions. All other resolutions will be proposed as ordinary resolutions.

Resolution 1:

THAT the accounts and reports of the Directors and the Auditors for the period ended 31st December 2001 be received.

Resolution 2:

THAT a final dividend of 18.7 pence per ordinary share for the period ended 31st December 2001 be declared and paid on 31st May 2002 to holders of ordinary shares on the register on 15th March 2002 in respect of each ordinary share, other than those ordinary shares on which a valid election has been made to receive new ordinary shares in lieu of the final dividend.

Resolution 3:

THAT Dennis Stevenson be elected as a director.

Resolution 4:

THAT Peter Burt be elected as a director.

Resolution 5:

THAT James Crosby be elected as a director.

Resolution 6:

THAT Charles Dunstone be elected as a director.

Resolution 7:

THAT Mike Ellis be elected as a director.

Resolution 8:

THAT Sir Ronald Garrick be elected as a director.

Resolution 9:

THAT Tony Hobson be elected as a director.

Resolution 10:

THAT Phil Hodgkinson be elected as a director.

Resolution 11:

THAT Andy Hornby be elected as a director.

Resolution 12:

THAT Brian Ivory be elected as a director.

Resolution 13:

THAT John Maclean be elected as a director.

Resolution 14:

THAT Colin Matthew be elected as a director.

Resolution 15:

THAT Coline McConville be elected as a director.

Resolution 16:

THAT Gordon McQueen be elected as a director.

Resolution 17:

THAT George Mitchell be elected as a director.

Resolution 18:

THAT Sir Bob Reid be elected as a director.

Resolution 19:

THAT Louis Sherwood be elected as a director.

Resolution 20:

THAT Philip Yea be elected as a director.

Resolution 21:

THAT KPMG Audit Plc be re-appointed as auditors of the Company from the conclusion of this meeting until the conclusion of the next general meeting at which accounts are laid before the shareholders in accordance with the provisions of the Companies Act 1985 and that their remuneration be determined by the Board.

Resolution 22:

THAT:

- (a) pursuant to the authority under section 80 of the Companies Act 1985 (the 'Act') contained in Article 21.2 of the Articles of Association of the Company, the Directors be empowered to allot equity securities (as defined in section 94 of the Act), entirely paid for in cash:
- (i) of an unlimited amount in connection with a rights issue (as defined in Article 21.7); and
- (ii) in addition, of an amount up to £44,582,088;
- free of the restrictions in section 89(1) of the Act.

- (b) this power shall expire on the date of the Annual General Meeting in 2003 or, if earlier, on 15th August 2003 and is in substitution for all previous such powers, which shall cease to have

effect from the date of this resolution, without affecting the validity of any allotment of securities already made under them;

- (c) during that period the Directors can make offers and enter into agreements which would, or might, require equity securities to be allotted after that period; and
- (d) in working out the maximum amount of equity securities for the purposes of paragraph (a) (ii) of this resolution, the nominal value of rights to subscribe for shares or to convert any securities into shares will be taken as the nominal value of the shares which would be allotted if the subscription or conversion takes place.

Resolution 23:

THAT the Company be and is hereby unconditionally and generally authorised for the purposes of section 166 of the Companies Act 1985 to make market purchases (as defined in section 163 of the Act) of ordinary shares of the Company provided that:

- (a) the maximum number of shares which may be purchased is 356,656,709;
- (b) the minimum price which may be paid is the 25p nominal value of each share;
- (c) the maximum price which may be paid for a share is an amount equal to 105 per cent of the average of the middle market quotations of the Company's ordinary shares as derived from the Stock Exchange Daily Official List for the five business days immediately preceding the day on which such share is contracted to be purchased;
- (d) this authority shall expire at the conclusion of the Annual General Meeting of the Company held in 2003 or, if earlier, 15th August 2003 (except in relation to the purchase of shares the contract for which was concluded before the expiry of such authority and which might be executed wholly or partly after such expiry) unless such authority is renewed prior to such time.

Notice of Annual General Meeting

Resolution 24:

THAT approval be and is hereby given for the Directors to offer to ordinary shareholders the right to elect to receive an allotment of additional ordinary shares credited as fully paid in lieu of any dividend (or any part thereof) declared or proposed at any time after the date of the passing of this resolution and prior to or on the date of the Annual General Meeting of the Company occurring in 2007.

Resolution 25:

THAT the terms of a proposed contract between (a) the Company, (b) Halifax QUEST Trustees Limited and (c) HBOS QUEST Limited providing for the purchase by the Company of an aggregate of 14,626,075 ordinary shares of 25p each in the capital of the Company (a draft of which has been produced to this meeting and initialled for identification by the Chairman) be and are hereby approved and authorised for the purposes of section 164 of the Companies Act 1985 but so that such approval and authority shall expire 18 months after the date on which this resolution is passed.

Resolution 26:

That the Rules of the HBOS plc Long Term Executive Bonus Plan (the principal features of which are summarised on pages 5 and 6 of the document of which this Notice forms a part and a copy of which is produced to the meeting and initialled by the Chairman for the purposes of identification) be approved and the Directors be authorised to do all acts and things as they may consider necessary or expedient to adopt and implement the HBOS plc Long Term Executive Bonus Plan.

Resolution 27:

THAT the Rules of the HBOS plc Special Long Term Bonus Plan (the principal features of which are summarised on page 6 of the document of which this Notice forms a part and a copy of which is produced to the meeting and initialled by the Chairman for the purposes of identification) be approved and the Directors be authorised to do all acts and things as they may consider necessary or expedient to adopt and implement the HBOS plc Special Long Term Bonus Plan.

Resolution 28:

THAT:

- (a) the HBOS plc Inland Revenue Approved Employee Share Option Plan 2002 and the HBOS plc (Unapproved) Employee Share Option Plan 2002 (together the 'Employee Plans') (the principal features of which are summarised on pages 6 and 7 of the document of which this Notice forms a part and which are constituted by the rules produced to the meeting and initialled by the Chairman for the purposes of identification) be approved and the Directors be authorised to do all acts and things as they may consider necessary or expedient to operate the Employee Plans including making such modifications as the Directors consider appropriate to maintain the approval of the Inland Revenue (where appropriate); and
- (b) the Directors be authorised to establish such further plans for the benefit of overseas employees based on the Employee Plans subject to such modifications as may be necessary or desirable to take account of overseas tax, exchange controls or securities laws provided that any shares made available under such plans are treated as counting against any limits on individual participation, or overall participation, in the Employee Plans.

Resolution 29:

THAT the Rules of the HBOS plc Annual Bonus Plan (the principal features of which are summarised on page 7 of the document of which this Notice forms a part and a copy of which is produced to the meeting and initialled by the Chairman for the purposes of identification) be approved and the Directors be authorised to do all acts and things as they may consider necessary or expedient to adopt and implement the HBOS plc Annual Bonus Plan.

Resolution 30:

THAT:

- (a) the HBOS plc Share Incentive Plan (the 'Share Incentive Plan') (the principal features of which are summarised on pages 7 and 8 of the document of which this Notice forms a part and which are constituted by the trust deed and rules produced in draft to this meeting and initialled by the Chairman for the purposes of identification) be approved and the Directors be authorised to do all acts and things as they may consider necessary or expedient to operate it

including making such modifications as the Directors consider appropriate to obtain and maintain the approval of the Inland Revenue; and

- (b) the Directors be authorised to establish such further plans for the benefit of overseas employees based on the Share Incentive Plan, subject to such modifications as may be necessary or desirable to take account of overseas tax, exchange controls or securities laws provided that any shares made available under such further plans are treated as counting against any limits on individual participation, or overall participation, in the Share Incentive Plan.

Resolution 31:

THAT the Company be and is hereby authorised to:

- (a) make Donations to EU Political Organisations; and
- (b) incur EU Political Expenditure in an aggregate amount not exceeding £200,000 during the period commencing on the date of this resolution and ending on the date of the Annual General Meeting in 2003. For the purposes of this resolution, the terms 'Donations', 'EU Political Organisations' and 'EU Political Expenditure' shall have the meanings given to them in section 347A of the Companies Act 1985 (as amended by the Political Parties, Elections and Referendums Act 2000).

Resolution 32:

THAT in addition to, and without prejudice to, the existing powers of the Directors to allot relevant securities, the Directors be generally and unconditionally authorised pursuant to and in accordance with section 80 of the Companies Act 1985 to exercise for the period beginning on the date of this resolution and ending on the date of the Company's Annual General Meeting in 2006 or, if earlier, on 12th June 2006, all the powers of the Company to allot relevant securities (as defined in that Act) up to the aggregate nominal amount of EUR 1,500,000,000.

By order of the Board

Harry Baines
Company Secretary
The Mound
Edinburgh
EH1 1YZ

28th February 2002

Resolution 1: Reports and Accounts

The Directors are required by law to present to the meeting the accounts and the Directors' and Auditors' reports for the period ended 31st December 2001.

Resolution 2: Declaration of Dividend including Share Dividend Alternative

The Directors are authorised to pay interim dividends. Under this authority, the Directors paid an interim dividend of 9.3 pence per ordinary share on 31st October 2001. Final dividends must be declared by shareholders but must not exceed the amount recommended by Directors. If the meeting approves resolution 2 the final dividend in respect of 2001 of 18.7 pence per share will be paid on 31st May 2002 to shareholders who are on the register of members on 15th March 2002 in respect of each ordinary share, other than those ordinary shares on which a valid election has been made to receive new ordinary shares in lieu of the final dividend.

Resolutions 3 to 20: Election of Directors

As this is the first AGM of HBOS plc all of the continuing Directors, who were appointed during 2001, will stand for election by the shareholders. Information about the Directors is shown on pages 9 and 10.

Resolution 21: Reappointment and Remuneration of Auditors

The Company is required to appoint auditors at each general meeting at which accounts are presented, to hold office until the end of the next such meeting. The resolution, which is recommended by the Audit Committee, proposes the reappointment of the Company's existing auditors, KPMG Audit Plc, and follows standard practice in giving authority to the Board to determine their remuneration.

Resolution 22: Authority to Allot Shares for Cash

The effect of this resolution is to renew the authority conferred on the Directors to allot equity securities for cash, without the need first to offer such shares to existing shareholders.

Following the placing of up to 172,500,000 new ordinary shares announced on 27th February 2002, the existing authority to allot equity securities for cash on a non pre-emptive basis, contained in the Company's Articles of Association, has largely been used up. The Directors think it appropriate that it should be renewed.

The renewed authority, which disapplies the statutory pre-emption provisions of the Companies Act 1985, would remain in force until the Annual General Meeting in 2003 or 15th August 2003, whichever is

the earlier. The proposed limit on the nominal value of ordinary shares that may be allotted for cash is £44,582,088 which represents 5% of the issued ordinary share capital as at 31st December 2001 is in line with the guidelines issued by the Investment Committees of the Association of British Insurers and the National Association of Pension Funds.

Resolution 23: Authority to Repurchase Ordinary Shares

The effect of this resolution is to renew the authority granted to the Company to purchase its own ordinary shares, up to a maximum of 356,656,709 ordinary shares, until the Annual General Meeting in 2003 or 15th August 2003 whichever is the earlier. This represents 10% of the ordinary shares in issue as at 31st December 2001 subject to stated upper and lower limits on the price payable which reflects the requirements of the UK Listing Authority. Shares will only be repurchased if earnings per share are expected to be enhanced as a result.

As at 22nd February 2002 (being the latest practicable date prior to the publication of this Notice), there were 75,261,694 outstanding options granted under all share option schemes operated by the Company which, if exercised, would represent 2.11 per cent of the issued ordinary share capital of the Company. If this authority were exercised in full, such options if exercised would represent 2.34 per cent of the issued share capital of the Company.

Resolution 24: Authority to offer Share Dividend Alternative in future

The Directors have decided to offer ordinary shareholders a Share Dividend Plan (the 'Plan') under which they can elect to receive the whole of their dividends in new fully paid ordinary shares of the Company instead of cash (a 'Share Dividend Alternative') in respect of the proposed final dividend for the period ended 31st December 2001 and for future dividends.

The Directors are already authorised under the Company's Articles of Association to offer a Share Dividend Alternative (or scrip dividend as it is commonly known) for the proposed final dividend for the period ended 31st December 2001.

Resolution 24, to be proposed as an ordinary resolution, will authorise the Directors to offer a Share Dividend Alternative in relation to future dividends. This authority will be renewable on a five-yearly basis.

Resolution 25: Authority to make off-market purchases of shares currently held by Halifax QUEST Limited – Share Purchase and Subscription Agreement

This resolution is to approve the terms of a share purchase and subscription agreement (the 'Agreement') between the Company, Halifax QUEST Trustees Limited ('Trustee 1') and HBOS QUEST Limited ('Trustee 2').

The Agreement is required to resolve an outstanding matter arising from the corporate restructuring of Halifax plc ('Halifax') in 1999 (the 'Restructuring') under which shareholders exchanged their Halifax plc shares for shares in a new company, Halifax Group plc, and from the subsequent merger between Bank of Scotland and Halifax Group plc in 2001 to create HBOS plc (the 'Merger') under which shareholders exchanged their Halifax Group plc shares for shares in the Company. Prior to the Restructuring and the Merger, Trustee 1 held shares in order to satisfy entitlements arising upon the exercise of share options granted by Halifax to participating employees under an Inland Revenue approved savings-related share option scheme ('Sharesave Scheme'). Existing tax legislation prevents Trustee 1 from subscribing for additional shares in the Company and so restricts the ability of Trustee 1 to satisfy the exercise of present and future options granted under the Sharesave Scheme. Therefore, if approved by shareholders, the Agreement will in effect result in Trustee 2 being able to satisfy the exercise of options granted under the Sharesave Schemes now operated by HBOS plc.

The Agreement, if entered into, will authorise the Company to acquire the 14,626,075 ordinary shares of 25p each in the capital of the Company from Trustee 1 for a consideration of £1,000. The Agreement also provides that, the Company will allot and issue for cash at par 14,626,075 ordinary shares of 25p each in the capital of the Company to Trustee 2. Trustee 2 will receive a loan from the Company for this purpose.

As at 22nd February 2002 (being the latest practicable date prior to the publication of this Notice), there were 75,261,694 outstanding options granted under all share option schemes operated by the Company which, if exercised, would represent 2.11 per cent of the issued share capital of the Company. Immediately following the acquisition and allotment and issue of 14,626,075 ordinary shares under the Agreement as described above, such options if exercised will continue to represent 2.11 per cent of the issued share capital of the Company.

New HBOS plc Share Plans

Following the merger of Halifax Group plc and Bank of Scotland, the Remuneration Committee (the 'Committee') has considered which employee incentive arrangements would be appropriate for the HBOS Group. The Committee concluded that the Company should operate similar share incentive plans to those operated by Halifax Group plc prior to the merger, at both the executive level and at the all-employee level. In addition, it is proposed that the Company should approve an Inland Revenue Approved Share Incentive Plan at the same time. While there are no immediate intentions to implement the Share Incentive Plan, delivery of shares to employees through an Inland Revenue approved plan, such as the Share Incentive Plan, can provide tax efficiencies to both the Company and its employees. These plans are:

- The HBOS plc Long Term Executive Bonus Plan (the 'Long Term Plan')
- The HBOS plc Special Long Term Bonus Plan (the 'Special Plan')
- The HBOS plc Inland Revenue Approved Employee Share Option Plan 2002 (the 'Approved Plan')
- The HBOS plc (Unapproved) Employee Share Option Plan 2002 (the 'Unapproved Plan')
- The HBOS plc Annual Bonus Plan (the 'Annual Bonus Plan'); and
- The HBOS plc Share Incentive Plan (the 'SIP')

(together known as the 'New Plans'). The New Plans would complement the HBOS plc Sharesave Plan 2001 which was adopted at the time of the merger.

The following are the common principal terms of each of the New Plans. The principal terms specific to each plan are set out in the description of the resolution proposing the adoption of the relevant plan.

Plan Limits

These limits apply to the New Plans other than the Special Plan. In any 10 year period, not more than 10% of the issued ordinary share capital of the Company may be issued or be issuable under the New Plans and all other employee share plans adopted by the Company. In addition, in any 10 year period, not more than 5% of the issued ordinary share capital of the Company may be issued or be issuable under the Long Term Plan and all other executive share plans adopted by the Company (other than the Special Plan). These limits do not include rights to shares which have lapsed or been surrendered.

Operation of the New Plans

The New Plans, other than the SIP and the Annual Bonus Plan, will normally be operated within 42 days of:

1. adoption of the relevant plan;
2. an announcement of results to the London Stock Exchange; and
3. in other exceptional circumstances.

The Approved and Unapproved Plans will be operated within 42 days of approval of the Approved Plan by the Inland Revenue.

Amendments to the New Plan Rules

The Board or the Committee, as appropriate, may amend the New Plans as they consider appropriate. However, alterations to the Approved Plan and the SIP are generally subject to the prior approval of the Inland Revenue. In addition, shareholder approval will be required to amend certain provisions of the New Plans to the advantage of participants. These provisions relate to: eligibility; individual and plan limits; option price (where relevant); rights attaching to the options, awards or shares; adjustment of options or awards on variation in the Company's share capital and the amendment powers.

The Board or the Committee, as appropriate, can without shareholder approval:

- make minor amendments to benefit the administration of the New Plans or which relate to any changes in legislation or which will obtain or maintain favourable tax, exchange control or regulatory treatment for any participating company or any participant; and
- in the case of the Approved Plan and the SIP, make amendments to maintain Inland Revenue approval.

General

- Any shares issued under the New Plans will rank equally with shares of the same class in issue on the date of allotment except in respect of rights arising by reference to a prior record date.
- Options or awards may be adjusted following any variation in the share capital of the Company.
- Options and awards granted under the New Plans are not transferable.
- Benefits under the New Plans are not pensionable.

Resolution 26: The HBOS plc Long Term Executive Bonus Plan

The principal terms of the Long Term Plan are as follows:

Eligibility

Employees and executive directors of the Company and any designated subsidiaries and associated companies of the Company are eligible to participate in the Long Term Plan. Participants will be selected by the Committee at its discretion. It is currently intended that the Long Term Plan will be used primarily for executives.

The Long Term Plan will first be operated within 42 days after its adoption by the Committee.

Performance Shares

Each time the Long Term Plan is operated, a participant will receive a conditional award of shares in the Company (the 'Performance Shares'), provided a performance condition (the 'Performance Condition') is satisfied during a lock-up period. The number of Performance Shares in an award is based on a percentage of the participant's salary, determined by the Committee each time the Long Term Plan is operated. The percentages in respect of the 2002 operation of the Long Term Plan are:

Level 8 Executive	100%
Level 8 Senior Management	66 $\frac{2}{3}$ %
Level 7 Senior Management	33 $\frac{1}{3}$ %

It is intended that Performance Shares will be held in the No. 1 Employee Share Ownership Trust during the lock-up period.

Lock-up Period

The lock-up period will be determined by the Committee in respect of each operation of the Long Term Plan. The lock-up period for the operation of the Long Term Plan in 2002 will be between three and five years. It will initially be the three financial years of the Company from 2002 to 2004. However, at the end of that period, participants will be given the opportunity to elect to extend the lock-up period for a further two financial years (to 2006).

Performance Condition

The extent to which conditional awards of Performance Shares vest at the end of the lock-up period will depend on the satisfaction of the Performance Condition. The Performance Condition will be determined by the Committee each time the Long Term Plan is operated. For the 2002 operation of the Long Term Plan, the Performance Condition will be the total shareholder return ('TSR') of the Company measured against the weighted average TSR of a comparator group of eight companies, comprising four retail banks and four insurance companies. The Committee may change the composition of the comparator group in such manner as it considers appropriate if any member of the comparator group is subject to a takeover, merger or other major corporate transaction.

For the 2002 operation, the Long Term Plan will:

- make no payment if HBOS TSR performance matches or is below that of the comparator group;
- release 100% of the conditional award if HBOS TSR performance exceeds that of the comparator group by 3% p.a.;
- release 200% of the conditional award if HBOS TSR performance exceeds that of the comparator group by at least 6% p.a.

A pro-rata payment will be made for intermediate performance on a straight-line basis. The Committee may decide that instead of shares, the participants will receive an equivalent value in cash. If a participant elects, at the end of the original three year lock-up period, to extend the lock-up period for an additional two years, then any payment at the end of the fifth year will be based on the better of:

- performance during the first three years; or
- the performance during the five year lock-up period.

The extent to which the Performance Condition has been satisfied will be determined as soon as is practicable after the lock-up period ends. If the Committee reasonably believes that the underlying financial performance of the HBOS Group during the lock-up period was not satisfactory, it may determine that the conditional award will not vest in whole or part as it reasonably considers appropriate in the circumstances.

Grant of Rights

The Committee may decide to grant a nil-cost option to a participant in respect of his vested Performance Shares. This option will be exercisable by the participant up to the seventh anniversary of the date of the original award or, if earlier, shortly following his cessation of employment or a takeover of the Company.

Cessation of Employment During the Lock-up Period

If a participant ceases to be an employee or executive director of the Company or of any other participating company in certain circumstances such as ill-health, retirement or redundancy, he will retain any conditional award of Performance Shares made before leaving employment. If a participant is dismissed or ceases to be an employee or executive director for any other reason, his conditional award of Performance Shares will lapse, unless the Committee decides otherwise. In these cases, the extent to which the Performance Condition has been satisfied will be determined in the usual way at the end of the lock-up period but the

Committee may pro-rate the number of Performance Shares in respect of which the conditional award vests. The participant may not be entitled to elect to extend the lock-up period.

Takeovers During the Lock-up Period

In the event of a change of control of the Company or a corporate reorganisation which results in a significant change in the identity of the shareholders, conditional awards of Performance Shares will vest early. The lock-up period will end immediately and the number of Performance Shares to which a participant is entitled will be determined as though the Performance Condition had been satisfied at the level determined by the Committee on the date of the award. The extent to which the Performance Condition has been satisfied will not be taken into account unless the Committee decides otherwise.

Participants' Rights Before Acquiring the Performance Shares

A participant will not be entitled to any rights relating to the Performance Shares comprised in his conditional award. However, at the time of transfer of the Performance Shares, a participant will receive additional shares equivalent in value to the amount of dividends he would have received during the elected lock-up period had he been entitled to dividends in respect of the Performance Shares.

Individual Limits

The maximum conditional award made in any financial year to a participant will be over Performance Shares having a market value equal to 100% of the participant's annual salary at that time. Market value will be taken immediately before the start of the relevant lock-up period.

Termination

The Committee may terminate the Long Term Plan at any time but any termination will not affect subsisting rights. The Long Term Plan will, in any event, terminate ten years after its adoption by the Committee following its approval by the Company in general meeting.

Resolution 27: The HBOS plc Special Long Term Bonus Plan

The principal terms of the Special Plan are as follows:

Eligibility

The Chairman is not eligible to participate in the Long Term Plan. However, the Committee believes that he should be incentivised in a similar way to the executive directors. The Company is proposing to establish the Special Plan under which it will make conditional awards of shares in favour of the Chairman. Under the Special Plan, any director of a participating company or his

service company would be eligible to participate.

The Special Plan will first be operated within 42 days after its adoption by the Committee.

Vesting

The rules of the Special Plan are substantially the same as the rules of the Long Term Plan. However, when an award vests, if at all, the Chairman will, for technical reasons, become entitled to the value of the relevant shares. This value will, subject to any withholdings for tax or National Insurance, be applied in acquiring shares in the Company on behalf of the Chairman.

Performance Condition

The award will be subject to the same Performance Condition as will apply to awards to be made in 2002 under the Long Term Plan, which is described above. For the 2002 award, a performance conditional award of shares will be made having a value up to 100% of the Chairman's annual fee, as at 31st December 2001.

Resolution 28: The HBOS plc Inland Revenue Approved Employee Share Option Plan 2002 and The HBOS plc (Unapproved) Employee Share Option Plan 2002

The Approved Plan

The principal terms of the Approved Plan are as follows:

Eligibility

Employees and executive directors of the Company and any participating subsidiaries are eligible to participate in the Approved Plan. Subject to Inland Revenue limits (see below), options will be granted under the Approved Plan to eligible employees (except senior executives) in April 2002 over shares of a value up to 20% of each optionholder's gross basic salary.

Performance Condition

The exercise of options may be made subject to satisfaction of a Performance Condition. It is not currently intended that any such condition will be imposed because the Approved Plan is operated on an all-employee basis.

Option Price

The option price must not be less than either the market value of the shares on the business day before the date of grant or, if the Directors so decide, the average market value of the shares over the three business days before the date of grant. However, if shares are to be subscribed then the option price must not be less than nominal value.

Individual Limits

The aggregate price payable by each employee for shares under option at any one time, under the Approved Plan and any other discretionary approved plans of the Company must not exceed £30,000, or such higher limit which the UK Inland Revenue may determine. The aggregate exercise price of options granted to an employee under the Approved Plan and any other discretionary share option plan operated by the Company in any financial year will not normally exceed his earnings for that year. However, this limit may be exceeded in exceptional circumstances.

Exercise of Options

Options will normally be exercisable, subject to any Performance Condition being satisfied, between the third and sixth anniversary of grant. However, options may be exercised early in certain circumstances, subject to the satisfaction or waiver of any Performance Conditions. These circumstances include an employee leaving because of retirement, death, redundancy or where the company or business for which he works leaves the HBOS Group. Unless the Directors decide otherwise, options will lapse on cessation of employment for other reasons. Options will lapse on the sixth anniversary of their grant. No options may be granted under the Approved Plan after the tenth anniversary of its approval by the Inland Revenue.

Change of Control, Merger or other Reorganisations

On a takeover, scheme of arrangement, merger or certain other corporate reorganisations options may generally be exercised early. Alternatively, participants may be allowed or required to exchange their options for options over shares in the acquiring company.

Termination

The Directors may terminate the Approved Plan at any time but termination will not affect subsisting rights. The Approved Plan will, in any event, terminate ten years after its approval by the Inland Revenue.

The Unapproved Plan

The Unapproved Plan is broadly the same as the Approved Plan, subject to the following principal differences:

- The approval of the Inland Revenue is not required in relation to the Unapproved Plan
- Options may where appropriate be satisfied by the delivery of shares or cash to the value of the difference between the aggregate option price and the aggregate market value of the shares subject to the option at the time of exercise.

Resolution 29: The HBOS plc Annual Bonus Plan

The principal terms of the Annual Bonus Plan are as follows:

Eligibility and Operation

The plan operates in connection with the payment of annual bonuses to employees of the Company and any participating HBOS Group companies.

Bonus Shares

The Directors may decide following the end of any financial year to offer participants the opportunity to use part of the net annual cash bonus they would receive to purchase shares in the Company ('Bonus Shares') and receive a conditional award of free matching shares at the same time. It is currently intended that a participant may use up to 100% of his net annual bonus to purchase Bonus Shares. The basis on which matching shares are awarded will be determined by the Directors but it is currently intended that the maximum match will be one matching share for every two Bonus Shares purchased. The Bonus Shares will be held in trust. A participant will be entitled to any dividends paid on his Bonus Shares and to instruct the trustee holding his Bonus Shares how to vote those shares.

Matching Shares

A participant will normally receive his matching shares if he is an employee at the end of a pre-determined lock-up period and his Bonus Shares are still held in trust. A participant will also normally receive his matching shares if he leaves before the pre-determined lock-up period due to death, retirement, redundancy, injury or disability, or his employing company or business being sold out of the HBOS Group. The Directors may exercise their discretion to allow a participant to receive matching shares in other circumstances. It is currently intended that the lock-up period will be three years from the date a participant receives an award of matching shares. If the matching shares cannot be transferred to participants due to legislative or administrative reasons then participants may receive a cash equivalent instead.

Reconstruction, Takeover, Merger or other Reorganisations

On a takeover, scheme of arrangement, merger or other corporate reorganisation, Bonus Shares will be transferred to the participants and the Directors may decide that matching shares will be transferred as well. Alternatively, participants may be required to exchange their shares for shares in the acquiring company.

Termination

The Directors may terminate the Annual Bonus Plan at any time, but termination will not affect subsisting rights. The Annual Bonus Plan, in any event, will terminate ten years after its adoption by the Directors following its approval by the Company in general meeting.

Resolution 30: The HBOS plc Share Incentive Plan

The principal terms of the SIP are as follows:

Eligibility

All UK employees and executive directors of the Company and any participating subsidiary or deadlock joint venture company may participate in the SIP. The Directors may set a qualifying period of continuous employment (which cannot exceed 18 months) for eligibility. When the SIP is operated, all eligible employees must be invited to participate. In addition, the Directors may offer participation to any other employees.

Operation

Employees may be offered free, partnership and/or matching shares (see below), as the Directors decide, each time they operate the SIP. The SIP may also offer dividend reinvestment. This will allow the Directors to implement the SIP in the way they consider most appropriate for the Company.

The SIP operates in conjunction with a trust, which will hold ordinary shares on behalf of participants.

The Directors can only operate the SIP between its approval by the Company in general meeting and the 10th anniversary of that date.

Free Shares

Participants can be given free ordinary shares ('free shares') with a market value of up to £3,000 each year or such other amount as provided for by the relevant legislation from time to time. The free shares must be offered to all eligible employees on similar terms but the number of free shares can vary by reference to the participant's remuneration, length of service or hours worked. The Directors may make the awards of free shares subject to performance targets.

Free shares must generally be held in trust for between three and five years. The Directors may require free shares to be forfeit if a participant leaves employment within three years of their award other than through death, retirement, redundancy, injury or disability, or his employing company or business being sold out of the HBOS Group.

Partnership Shares

Employees may be offered the opportunity to buy ordinary shares ('partnership shares') by deduction from their pre-tax salary. Under current legislation, they can buy up to £1,500 worth of partnership shares in each tax year (£125 a month) or, if less, 10% of salary.

The trustee may use the deductions from participants' salary to buy partnership shares on their behalf immediately. Alternatively, it may accumulate them for a period of up to one year and then use them to buy partnership shares at the end of the period. If this happens, participants will be allocated partnership shares by reference to the lower of their market value at the beginning or end of that period.

Participants can stop their salary deductions at any time. Any sums repaid will be subject to tax. Participants can also withdraw their partnership shares from the SIP at any time, although there are tax advantages if the partnership shares are retained in the SIP.

Matching Shares

The Directors may award additional free ordinary shares ('matching shares') on a matching basis to participants who buy partnership shares. Under current legislation, up to a maximum of two matching shares can be offered for each partnership share. Matching shares must be offered on the same basis to each participant purchasing partnership shares on that occasion.

Matching shares must generally be held in trust for a holding period of between three and five years. The Directors may require matching shares to be forfeit if, within three years of a participants' award, he takes his corresponding partnership shares out of the SIP or leaves employment other than through death, retirement, redundancy, injury or disability, or his employing company or business being sold out of the HBOS Group.

Leaving Employment

If a participant leaves employment for any reason, his shares will cease to be subject to the SIP. His free shares and matching shares may also be forfeit as described above.

Dividends

Cash dividends paid on ordinary shares held in the SIP may be reinvested in ordinary shares up to certain limits set out in the legislation.

Voting Rights

The trustees can only vote shares held in the SIP in accordance with participants' instructions.

General Offers

If a general offer is made to the shareholders of the Company, participants may direct the trustees how to act in respect of any shares held on their behalf.

Resolution 31: Authority to make Donations to EU Political Organisations and incur Political Expenditure

HBOS plc (and its subsidiaries) does **not**, and will **not**, make donations to political parties. This policy will continue whether or not resolution 31 is passed.

The background to this resolution is that the law regulating political donations has recently changed and as a result payments and activities which would not previously have been prohibited may now be regulated. The meaning and implications of this new legislation are unclear and could extend to routine activities undertaken by the Company, such as its quarterly briefings for MPs on house prices in the UK and its funding of research on issues affecting the Company's business activities. Any expenditure which is regulated by the new law must be approved by shareholders in advance. Accordingly, in order to avoid inadvertent infringement of the new law, the Board is seeking shareholders' authority to make 'Donations' and incur 'EU Political Expenditure' (as widely defined in the new law) up to an amount of £200,000.

Under the new law companies can request authority from shareholders for a period of up to four years. The Board believes that it would be appropriate to request an authority from shareholders for one year only on this occasion and, if approved, the authority will therefore expire at the 2003 Annual General Meeting.

Resolution 32: Authority to issue Euro Preference Shares

This resolution will authorise the Directors to issue Euro-denominated preference shares which form part of its authorised share capital. The Directors of Halifax Group plc have authority to issue Euro-denominated preference shares in Halifax Group plc, but an equivalent authority has not yet been granted for the Company. The Directors believe that it would be appropriate for them to have that authority to give them increased flexibility to manage the capital requirements of the Group.

The Directors consider that each of the resolutions is in the best interests of the Company and the shareholders as a whole and recommend all shareholders to vote in favour of all resolutions, as the Directors intend to do so in respect of their own shares.

Directors proposed by the Board for election

Dennis Stevenson

Age 56 Chairman

Dennis's main business activities are as Chairman of Pearson plc and HBOS plc, having been Chairman of Halifax. He is also a Non-Executive Director of Manpower Inc.

Peter Burt

Age 57 Executive Deputy Chairman

In 1975, Peter joined Bank of Scotland and in 1979 he became Assistant General Manager in the International Division responsible for the Oil and Energy Department, Project Finance and Planning. Following his appointment as Head of the International Division in 1985, Peter was appointed Treasurer and Chief General Manager in 1988, became a Director in 1995 and Group Chief Executive in 1996. Upon the successful completion of the merger of Halifax and Bank of Scotland he became Executive Deputy Chairman of HBOS plc.

James Crosby

Age 45 Chief Executive

James spent 17 years with Scottish Amicable which included 10 years as a fund manager followed by senior positions in IT, marketing, finance and corporate development. James led the establishment of the joint venture with J Rothschild Assurance (1991) of which he was a director until 1994. In 1994 he joined Halifax Building Society to set up a new bancassurance business and in 1996 led the acquisition of Clerical Medical. On 1 January 1999 James was appointed Chief Executive of Halifax and upon successful completion of the merger of Halifax and Bank of Scotland he became Chief Executive of HBOS plc.

Charles Dunstone

Age 37 Non-Executive Director

Charles was appointed as a Non-Executive Director to the Board of Halifax in February 2000 and subsequently appointed to the Board of HBOS plc in 2001. He is Chairman and Chief Executive Officer of Carphone Warehouse plc, Europe's largest independent retailer of mobile communications equipment, which he founded in 1989.

Mike Ellis

Age 51 Group Finance Director

Mike joined Halifax Building Society in June 1987 as Treasurer, became Group Treasurer in June 1989, General Manager, Treasury and European Operations in August 1992 and Managing Director, Treasury and Overseas Operations in August 1995. In December 1996, he became Banking and Savings Director and in January 1999, became Retail Financial Services Director with responsibility for Mortgages and Savings, Banking and Consumer Credit, General Insurance, Long Term Savings and Marketing, with additional Board responsibility for Distribution. On 1st October 1999, Mike was appointed Chief Operating Officer of Halifax and became Group Finance Director of HBOS plc in 2001.

Sir Ronald Garrick

Age 61 Non-Executive Director

Sir Ronald was appointed as a Non-Executive Director to the Board of Bank of Scotland in March 2000 and subsequently to the Board of HBOS plc in 2001. He is Chairman of The Weir Group PLC having previously been Chief Executive for over 16 years. Sir Ronald was appointed CBE in 1986 and knighted in 1994 for services to industry and public life in Scotland.

Tony Hobson

Age 54 Non-Executive Director

Tony joined the Board of Halifax in May 2001 as a Non-Executive Director and subsequently was appointed to the Board of HBOS plc in 2001. He is Chairman of the Audit Committee. He was formerly Group Finance Director at Legal and General from 1987, retiring from the Board on 28th February 2001. He was previously with Sperry Corporation, SG Warburg and Arthur Andersen, and was the senior independent director of Thames Water PLC until November 2000. He is a Non-Executive Director of Glas Cymru and Jardine Lloyd Thomson Group.

Phil Hodkinson

Age 43 Chief Executive, Insurance and Investments

Phil has worked in the life and pensions industry throughout his career. He joined Allied Dunbar in 1984 and rose to Managing Director before moving to Eagle Star Life as Chief Executive. More recently he has run the UK life business of Zurich Financial Services and immediately prior to joining HBOS plc was the founder of Zurich's UK Enterprise portfolio of new insurance, banking and e-commerce operations. He was appointed Chief Executive, Insurance and Investments of HBOS plc in September 2001.

Andy Hornby

Age 35 Chief Executive, Retail Banking

At ASDA, Andy worked closely on the strategic development of the business. As Retail Managing Director, he had responsibility for 36 stores and 14,000 employees and was most recently Managing Director of George, ASDA. In November 1999 Andy joined Halifax as Chief Executive, Halifax Retail and was appointed to the Halifax Board. He was subsequently appointed to the HBOS plc Board as Chief Executive, Retail Banking and is responsible for all the retail banking activities of Halifax and Bank of Scotland, which extend to some 1,500 retail banking and estate agency outlets.

Brian Ivory

Age 52 Non-Executive Director

Brian was appointed to the Board of Bank of Scotland in 1998 as a Non-Executive Director and subsequently appointed to the Board of HBOS plc in 2001. He is Chairman of The Scottish American Investment Company PLC, a director of Remy Cointreau SA and Chairman of the National Galleries of Scotland. He was Chairman and Chief Executive of Highland Distillers plc until 1999 and he was appointed CBE in 1999 for services to Scotch Whisky and The Arts. Brian is Chairman of the Remuneration Committee.

John Maclean

Age 58 Non-Executive Director

John was appointed to the Board of Bank of Scotland in 1995 as a Non-Executive Director and subsequently appointed to the Board of HBOS plc in 2001. He is a Non-Executive Director of Scottish Value Trust PLC and a number of listed and unlisted companies and was a founder and Director of Kelvin Shipholdings Limited.

Colin Matthew

Age 51 Chief Executive, Business Banking

Colin has a wealth of experience gained from the wide range of responsibilities he has held. He was Assistant and also Divisional General Manager UK Banking – England in 1991 and had responsibilities as General Manager for both Bank of Scotland Treasury Services PLC and UK Banking – England within Bank of Scotland. In 1999 he joined the Group Management Board of Bank of Scotland, became Chief Executive of the division of Business Banking and was appointed as an Executive Director of Bank of Scotland in 2000. Colin was subsequently appointed to the Board of HBOS plc in 2001 as Chief Executive, Business Banking.

Coline McConville

Age 37 Non-Executive Director

Coline was appointed to the Board of Halifax in February 2000 as a Non-Executive Director and subsequently appointed to the Board of HBOS plc in 2001. She is Chief Operating Officer of Clear Channel International Ltd, a media group with operations in 56 countries. Previously she was with management consultants McKinsey and Co in London and the LEK Partnership in Munich.

Gordon McQueen

Age 55 Chief Executive, Treasury

Gordon's career with Bank of Scotland commenced in 1976 when he joined the International Division, after which he was appointed its General Manager and became a member of Bank of Scotland's Group Management Board in 1989. In 1990 he was appointed General Manager of Treasury Division and Executive Vice Chairman of Bank of Scotland Treasury Services PLC, then became General Manager, UK Banking – England and subsequently General Manager, Accounting and Finance. In April 1999, Gordon became Divisional Chief Executive, Group Treasury and Finance and Chief Executive of Bank of Scotland Treasury Services PLC. In May 2000 he was appointed to the Board of Bank of Scotland as an Executive Director and subsequently appointed to the Board of HBOS plc as Chief Executive, Treasury in 2001.

George Mitchell

Age 51 Chief Executive, Corporate Banking

George joined Bank of Scotland straight from school in 1966 and has worked in a wide range of business areas and a number of locations including London, New York and Hong Kong. He was appointed to Bank of Scotland's Group Management Board in 1994 and the Board of Bank of Scotland in May 2000. He was appointed Chief Executive of Bank of Scotland's Corporate Banking Division prior to the merger of Halifax and Bank of Scotland and was subsequently appointed to the Board of HBOS plc in 2001 as Chief Executive, Corporate Banking.

Sir Bob Reid

Age 67 Non-Executive Director

Sir Bob was appointed to the Board of Bank of Scotland in 1987 and was appointed as Deputy Governor in 1997. He was subsequently appointed to the Board of HBOS plc in 2001 as the Senior Independent Director. He was Chairman and Chief Executive of Shell UK Limited until 1990 and Chairman of British Railways Board between 1990 and 1995. Sir Bob is Chairman of the International Petroleum Exchange of London and of Sondex Limited. He is a Non-Executive Director of Avis Europe plc, The Merchants Trust plc, Siemens Holdings plc and the Sun Life Assurance Company of Canada Inc. He is Chancellor of the Robert Gordon University, Chairman of each of Kings Cross Partnership, Foundation for Management Education, Edinburgh Business School and Learning through Landscapes.

Louis Sherwood

Age 60 Non-Executive Director

Louis joined the Board of Halifax in January 1997 as a Non-Executive Director and was subsequently appointed to the HBOS plc Board in 2001. He is Chairman of Govett European Technology and Income Trust PLC. He was formerly Chairman of HTV Group plc between 1991 and 1997. He is Non-Executive Director of ASW Holdings PLC, ROK Property Solutions plc and Wessex Water Services Ltd.

Philip Yea

Age 47 Non-Executive Director

Philip joined the Board of Halifax in October 1999 as a Non-Executive Director and was subsequently appointed to the Board of HBOS plc in 2001. He was formerly Finance Director of Guinness PLC and subsequently Diageo plc before joining Investcorp in 1999. He is a Non-Executive Director of Manchester United PLC.

Shareholders

Only those shareholders on the register of members as at close of business on 13th May 2002 are entitled to attend and vote. Such a shareholder is entitled to appoint a proxy or proxies to attend and, on a poll, to vote instead of him or her. A proxy need not be a shareholder of the Company. Forms of Proxy and/or Direction must reach our Registrars, Computershare Investor Services PLC, PO Box 1912, The Pavilions, Bridgwater Road, Bristol BS99 2HF by 11 a.m. on 13th May 2002.

If you propose to attend the meeting, please detach and bring the attendance slip with you.

Shareholders who return completed proxy voting forms may still attend the meeting instead of their proxies and vote in person if they wish. In the event of a poll in which the shareholder votes in person, his/her proxy votes lodged with the Company will be excluded.

Documents

The following information is available for inspection during business hours at the registered office of the Company (weekends and public holidays excluded). It will also be available for inspection at the place of the Annual General Meeting from 10.00 a.m. on the day of the meeting until the conclusion of the meeting:

- (a) the register of interests of Directors and their connected persons in the share capital of the Company;
- (b) copies of the Directors' service contracts;
- (c) a statement containing particulars of loans and quasi-loans made by the Company in favour of the Directors and connected persons;
- (d) the Memorandum and Articles of Association of the Company;
- (e) The following documents relating to share plan related resolutions:
 - The HBOS plc Long Term Executive Bonus Plan
 - The HBOS plc Special Long Term Bonus Plan
 - The HBOS plc Inland Revenue Approved Employee Share Option Plan 2002
 - The HBOS plc (Unapproved) Employee Share Option Plan 2002
 - The HBOS plc Annual Bonus Plan
 - The HBOS plc Share Incentive Plan
 (These are also available for inspection during normal business hours at the offices of Linklaters & Alliance, One Silk Street, London EC2Y 8HQ).
- (f) The draft Share Purchase and Subscription Agreement between HBOS plc and Halifax Quest Trustees Limited and HBOS QUEST Limited.

Report and Accounts Election

The Company publishes two documents: the full report and accounts (Annual Report and Accounts 2001) and a separate annual review (Shareholders' Annual Review and Summary Financial Statement 2001). This latter document is designed to meet the requirements of the majority of shareholders.

You have been sent the Shareholders' Annual Review and Summary Financial Statement 2001 in this mailing. You will not receive a full report and accounts unless you have previously notified the Company in writing. Shareholders and participants who only receive a Shareholders' Annual Review and Summary Financial Statement 2001 may request a copy of the full report and accounts for the period ended 31st December 2001 by telephoning our Registrars on 0870 702 0102.

If you would like to receive the full Annual Report & Accounts in future years, please write to our Registrars, Computershare Investor Services PLC PO Box 1909 The Pavilions Bridgwater Road Bristol BS99 7DS.

If in the past you have elected to receive the full report and accounts and now wish to cancel that instruction, please notify our Registrars at the above address.

Voting Results

You can obtain the result of the voting at the AGM by telephoning our Registrars on 0870 702 0102 on or after 16th May 2002.

The highlights of the Annual General Meeting will also be available to view from 16th May 2002 on www.hbosplc.com/annualgeneralmeeting/on-linehighlights.

If you are attending the Meeting

The Meeting

10.00am

Doors open to shareholders and the reception area.

11.00am

The Annual General Meeting begins.

- Shareholders will be asked to vote on a number of the resolutions set out in this Notice of Annual General Meeting.
- Shareholders will have an opportunity to ask questions at the meeting.

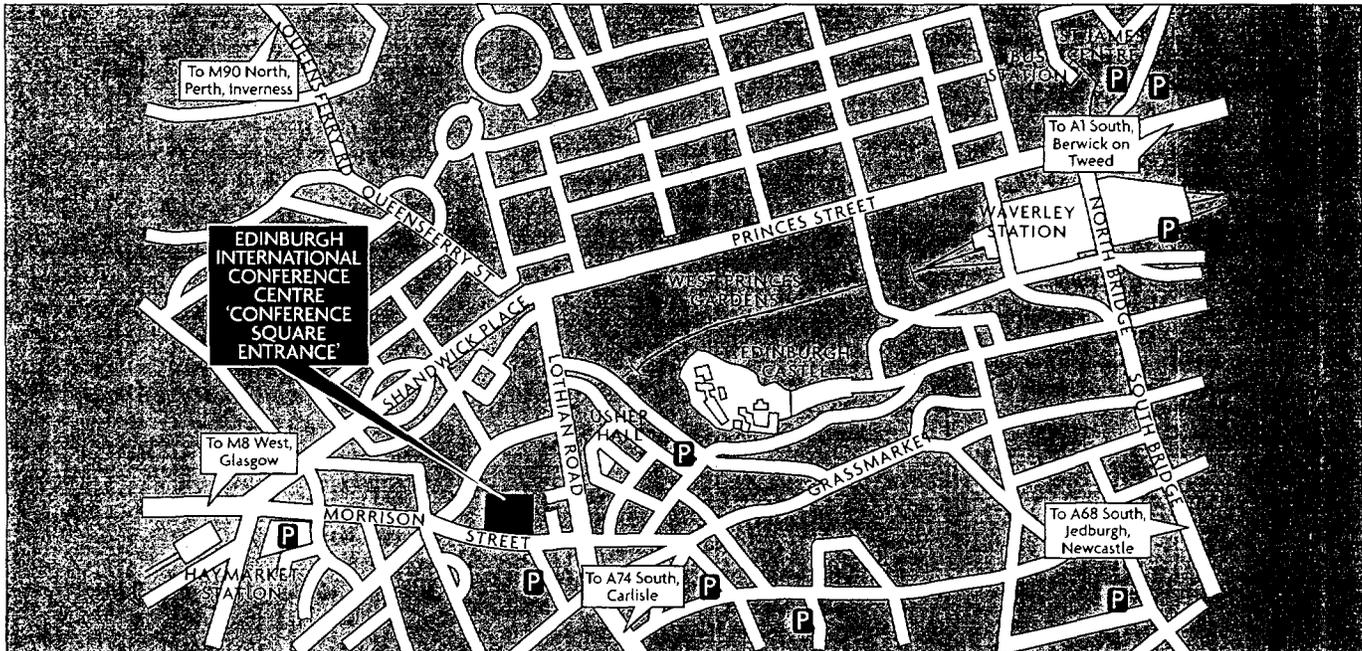
Who may attend?

Only shareholders and certain 'participants' (i.e. holders of HBOS Shareholder Accounts or HBOS Share PEPs) are entitled to attend the meeting. Non-shareholders who are accompanying shareholders or participants will be admitted at the discretion of the Company. Holders of HBOS shares through the (Dealing Service – HSDL) and HBOS Preference Shareholders may attend the meeting as observers. They are not permitted to speak or vote.

How to get there if you travel by train:

The Edinburgh International Conference Centre (EICC) is situated on Morrison Street. There are two stations in Edinburgh – Waverley and Haymarket. Taxis are available from both stations. If you prefer to walk, Haymarket station is about 15 minutes' walk and Waverley is about 25 minutes' walk.

Further details can be obtained by telephoning National Rail Enquiries on 08457 48 49 50 or at www.thetrainline.com



Admission

Please bring the attendance slip attached to your Form of Proxy/Form of Direction. You will be asked to show it at the entrance and not having it available could delay your admission. On the reverse of the attendance slip is a poll card which you will also need to bring with you, in case a poll is called. Shareholders and participants may also be required to provide proof of identity. If you have been appointed as a shareholder proxy, please make this fact known to the admission staff who will direct you to a proxy helpdesk.

Additional Needs

Facilities will be available for our shareholders and participants who have additional needs. An Induction Loop and Sign Language Interpreters will be available in the auditorium. Facilities are also available for wheelchair users. Anyone wishing to use any of these facilities should contact one of our HBOS stewards. Information contained in this pack is available in alternative formats on request.

Medical Care

If you need medical attention, please contact an HBOS steward who will obtain medical assistance.

Smoking

Smoking will not be permitted in the auditorium.

Security

Please leave briefcases, cameras, tape recorders, video recorders and laptop computers in the cloakroom. Arrangements will be made for their safe keeping. Please turn off mobile telephones before entering the auditorium.

Safety

In the event of a fire or other emergency, an alarm will sound and an announcement will be made. If asked to evacuate the building, please follow the instructions of staff from the Edinburgh International Conference Centre.

Refreshments

Tea and coffee will be available before the meeting and light refreshments will be served after the meeting has concluded.

On-line Voting

You can vote online at www.hbosplc.com/annualgeneralmeeting/on-linevoting from 9:00am on 11th March 2002 until 11:00am on 13th May 2002. You will need your unique PIN number provided on your Form of Direction/Form of Proxy for security verification.

Register your Email address

By registering your email address at www.hbosplc.com/annualgeneralmeeting/email registration you may be eligible to receive key shareholder information electronically.

How to vote at the meeting

At the meeting you will be asked to vote on the resolutions which are set out in this Notice of Meeting. Explanatory notes are also provided. You will therefore find it helpful to bring this document with you with the attendance slip attached to the Form of Proxy/Form of Direction.

Asking questions at the meeting

During the meeting the Chairman will give shareholders and eligible participants the opportunity to ask questions. Those who wish to ask questions should contact one of the HBOS stewards prior to the meeting commencing.

On-line Highlights

The highlights of the Annual General Meeting will be available to view from 16th May 2002 at www.hbosplc.com/annualgeneralmeeting/on-linehighlights

Enquiries

If you have any questions about the meeting our Registrars will be pleased to help

Telephone: 0870 702 0102

Textphone: 0845 60 50 013

(for hearing impaired/speech impaired customers only).

Always giving you EXTRA

the new force in banking
extra benefits
extra value and choice
extra service and simplicity
extra performance
the new force in the community



 **HBOS**plc

Annual Review and Summary
Financial Statement 2001

In May 2001 Halifax and Bank of Scotland agreed to merge to create the HBOS Group. Within four months the merger became effective. James Crosby, Chief Executive of the new Group, answers some of your shareholder questions.

What did you first say when you merged?

Well, Bank of Scotland and Halifax had known each other for many years, and the interesting thing is, there was very little overlap in the products and services we both offered. But we did share a common philosophy – of growing by providing a first-class service to our customers. And we did have a common ambition – to seek out new opportunities.

“Rarely have two great brands and two great organisations combined to offer so much potential for extraordinary growth.”
James Crosby, Chief Executive



So, the two businesses fit very well, and together create one new business the size to take on the traditional banks. The merger's good news for our customers, our people and our shareholders, but as Peter Burt our Deputy Chairman likes to say, our competitors will come to hate it!

Is the merger going as planned?

Yes it is. There's still plenty to do, of course, but it really is very rewarding work and I can tell you these are exciting times at HBOS. We concluded merger discussions quickly, following the first meeting, demonstrating the shared vision of where our growth opportunities lie. On Day One, we had the top 50 senior appointments in place and we hit the ground running. Within three months, management were concentrating very much on business as usual. Also, I have to say, we

The New Force in Banking

Of course, almost all HBOS shareholders are customers also. So over the page we highlight some of the many products and services HBOS offers you. But here we answer more of your key shareholder questions.

Our philosophy is that providing better value and service to customers is the only way to create long-term growth in shareholder value – keep your customers happy and the profits will follow. So too will new customers. We draw great strength from being a low cost player in each of our diverse businesses, and we'll grow by systematically attacking our competitors in all our markets.

We will always be realistic on pricing and seek to achieve sustainable margins – the foundation of quality growth. Applying this strategy in the mortgage market last year led to our market share of net lending soaring to an extraordinary 31%. At the same time our strategy of exposing exploitative current account pricing led to a revolution in banking which is obviously in our favour.

With you all, we offer the best products and services.

We have some of the strongest and most recognised financial services brands around –



there are no plans to change that state of affairs. Except to keep improving our products and introducing new ones in response to what our customers tell us they want. And of course, by having Halifax products available to more people in Scotland, and more Bank of Scotland services available south of the border. While all our divisions will deliver growth, we will preserve the inherent balance of our business – with earnings of 50% from Retail, 25% from Insurance & Investment, and 25% from Corporate Business and Treasury.

With you all, we offer the best products and services.

We are already seeing a significant uplift in sales volumes by having more products and services available to more people, as described above. But we have also identified synergies – the savings we can make from eradicating duplication from our businesses and the revenue gained from increased sales – and we expect annual benefits to reach £690m a year by 2005.

The share price is not the most important decision we make. We will deliver long-term capital returns for our shareholders.

As a result of the merger, we are a stronger financial force.

While it is difficult to assess the impact of the recession at the time of writing, all our businesses had an excellent year and are continuing to perform well. But in times of economic slowdown, the importance of asset quality comes to the fore, and for us this is a source of comparative advantage. Our well diversified balance sheet centres on residential mortgages, and while our consumer finance businesses are growing strongly, it is not at the expense of credit quality. In short, we are expansion-minded but in a realistic and responsible way, without over-stretching, and without unnecessary risk.

Our aim is to grow based on Bank of Scotland's traditional strengths in this area, and its sound philosophy of long-term customer partnerships. Helping customers through the difficult times is just as much a part of the deal as the initial loans themselves. You'll find our services to small business customers profiled over the page.

We'd like to think all the people who work for HBOS are shareholders and customers as well. The more who are, the more will act as advocates for our products and services, and do so where it matters most – in front of the customer. Listening to colleagues' views and acting on their feedback is very much part of how we build commitment to our company and its goals. We run local share and cash-based incentive schemes which link rewards to local performance. The bottom line is that we reward good performance, and we reward exceptional achievements exceptionally.

With you all, we offer the best products and services.

In Retail and Insurance & Investment our ambition is to grow our businesses to be the clear number one wherever possible, and offer our customers a wide choice of brands for them to access in whichever way they choose. In Business Banking we want to break the mould and achieve a major presence in England and Wales. In Corporate Banking we aim to extend our franchise to Europe and North America and capitalise on the growth opportunities arising from the merger. Our Treasury business will be looking to build on the strengths of Bank of Scotland and Halifax Treasury businesses and deliver improved customer services and greater product coverage.



enjoyed extraordinary support from our 60,000 colleagues throughout HBOS, and that's something I'm keen to preserve and enhance in the months ahead.

What are your aims for the new company, HBOS?

We have a strategy which clearly sets us apart from our competitors – to deliver outstanding outcomes for each of our three stakeholder groups: customers, investors, and the people who work for HBOS. That's how we'll grow.

We accept without question that to grow our relationships with customers we have to deliver value for money, high quality service and absolute transparency – by that I mean, no nasty small print and no hidden charges. In the financial services market of the 21st century, the real power lies with customers. Therefore our goal, quite simply, is to have customers rate HBOS as the best.

Are you pleased with the first annual results from HBOS?

I couldn't be more pleased. We've made tremendous progress in terms of the merger, but we've kept our eye firmly on the ball in terms of business. In 2001, we took 31% of the UK's net mortgage lending, we grew current account sales by 77% and credit card sales by 98%. Our insurance sales topped the £1bn mark, and so did our investment sales. We had a really strong performance in Corporate Banking where profits increased 37%. Business Banking grew assets by 11% – and after adjusting for assets transferred to Corporate Banking by 20% – a real achievement as we prepare to roll out this Bank of Scotland service across Halifax branches in England and Wales. In Treasury the focus has been on merging the

Bank of Scotland and Halifax businesses – and we're well on with that task. Of course, I must also mention Intelligent Finance – their unique concept has really taken off in 2001 – for example they captured more than 9% of the UK mortgage market – quite an achievement.

What dividend have you decided to pay?

The proposed final dividend is 18.7p, bringing the total for the year to 28.0p. That's 6% higher than last year for Halifax shareholders and 83% higher for Bank of Scotland shareholders.

You can choose now to receive your HBOS plc ordinary share dividends in the form of additional shares rather than cash. This allows you to increase your holding without paying share dealing costs or stamp duty. You will be able to participate in the Share Dividend Plan for the 2001 final dividend and, if the shareholders approve the proposal at the AGM, for future dividends. Full details, including the terms and conditions of the Plan are contained in the circular also enclosed – please read them carefully and sign and return the enclosed mandate form if you want to take shares instead of cash. No action is required if you want to continue to receive cash.

It all sounds exciting – how do things look for the future?

The results show very clearly that our strategy is already delivering extraordinary growth in sales and balances, in Retail, Insurance & Investment, Corporate and Business Banking. Right from the start we believe we will be able to demonstrate underlying growth in each of our divisions; the real inspiration behind the creation of HBOS.

HBOS Results 2001

Profit*	£3.0bn
Earnings per share**	56.6p
Dividend per share	28.0p
<hr/>	
Divisional Profit*	
Retail Banking	£1,403m
Insurance & Investment	£772m
Business Banking	£308m
Corporate Banking	£515m
Treasury	£169m
BankWest	£80m
Group Items	(£240m)
<hr/>	
Customers	20m
Colleagues	60,000
Shareholders	2.8m

* before tax, exceptionals and Intelligent Finance
** underlying



		www.HBOSplc.com
Retail Banking	Mortgages, savings, banking, loans, credit cards and other consumer financial services.	
Business Banking	Banking services, for businesses whose turnover is less than £10 million a year and specialist asset financing services.	
Insurance & Investment	Long-term savings, personal, household and life assurance and personal asset management.	
Corporate Banking	Banking services and specialist financing for businesses whose turnover is more than £10 million a year.	
Treasury	Risk management, foreign exchange activities and investment portfolio management for HBOS Group and its customers.	



INTELLIGENT FINANCE™
is a division of HALIFAX plc



CLERICAL MEDICAL
The choice of the professional



St Andrew's
GROUP



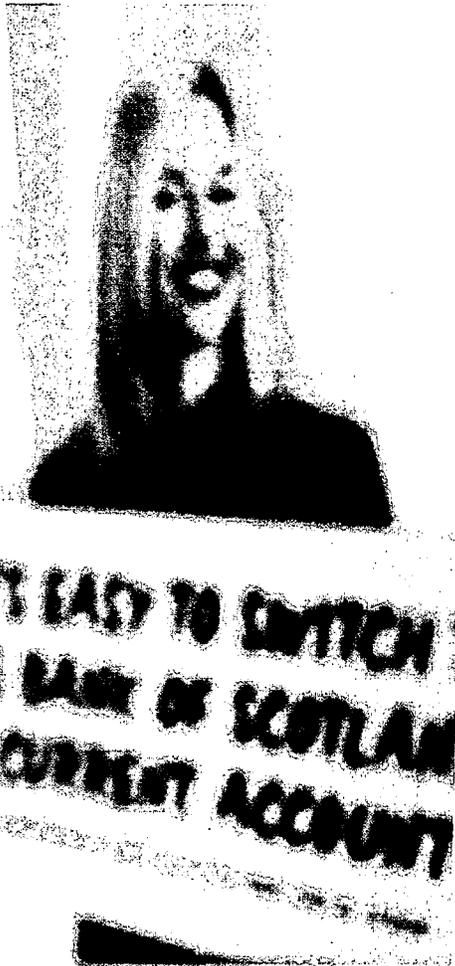
CAPITAL BANK



THE MORTGAGE
BUSINESS

The new HBOS at a glance

- A quarter of the people in the UK enjoy the benefits of being an HBOS customer
- 300 years of banking experience
- Number 1 in mortgages and savings
- Fastest growing banking and consumer credit brands
- Leading arranger of UK household insurance
- Innovative Corporate and Business Banking services



IT'S EASY TO SWITCH
A BANK OF SCOTLAND
CURRENT ACCOUNT

GET ONLINE

for @ the Halifax

Press any key to start

With the merger of Halifax
and Bank of Scotland our
customers can now enjoy
even greater services
on their local high streets

HALIFAX

HBOS serves an incredible 20 million personal customers – no other UK financial institution comes close. We believe we know why.

It's because HBOS offers the right financial services products, because they are easy to understand, and because they're available at good value prices. Not forgetting the fact that our customers can choose to deal with us in whichever way suits them best. Or that we're developing the friendliest and most motivated financial services workforce in the UK. OK, that's a lot of reasons. But it's such a simple principle you'd have thought the other banks would cotton on.

Mortgages

In 2001, we increased our market share of net lending to 31%, three times that of our nearest competitor, which is quite exceptional. Among key reasons were the transfer of around 350,000 of our customers to considerably cheaper long-term mortgage rates and a massive contribution from Intelligent Finance, our internet bank. It's also been a great year for our brands Birmingham, Midshires and The Mortgage Business, in specialist areas like buy-to-let mortgages and mortgages for self-employed customers. Our aim is to consolidate our position as far and away Britain's number one by keeping our market share at 25%.

Bank accounts

Last year we launched our high street account paying 20 times more interest than the traditional banks – and we charge approximately half the overdraft rate of our main competitors. Add our successful adverts starring colleagues Howard Brown and Angela Anderson, and we've really taken the high street by storm – the clear customer champion in current accounts, with over one in every five new or transferred current accounts opened last year.

"Value products with transparent prices. It's such a simple principle you'd have thought the other banks would cotton on."

Credit cards and loans

We will be the fastest-growing UK company in banking and consumer credit, establishing ourselves comfortably as the largest provider of new credit cards, issuing 1.1 million in 2001. We also achieved extraordinary growth in personal lending, with unsecured increasing 35% and secured 43%.

Savings

Easily the number one savings provider, our banking and savings balances increased £8.5 billion last year to a massive £102 billion.

Insurance

Increases in insurance business took us to over £1 billion in premiums, with household and repayment insurance growing through cross-selling from our increased mortgage, credit card and personal loan sales. In fact, we are now one of the main UK providers of home insurance and our motor insurance business also grew, particularly with the launch of our new business, esure. Future initiatives include our new range of travel insurance policies.

Investment

Sales grew well above predicted market growth and our calculated income from premiums, as in insurance, was also above £1 billion. Our sales in bancassurance grew strongly, so too in group pensions. Our initiatives include a stand-alone Asset Management business and the creation of a single customer service division for our life and pensions businesses.



Something Extra for the Small Business customer

The merger opens up huge opportunities both for ourselves and for small businesses across the country. We help one third of the small business market in Scotland and we now have the resources to spread our offer throughout the UK and further afield. We're looking to break the mould, to be the bank that dares to do things differently. This means superior banking arrangements, interest on current accounts as standard, a helping hand in switching accounts to us, competitive asset and motor finance and much more. In fact, we're looking to shake things up a bit. So if you run a small business or are thinking of starting one, you could make your own smart move – and talk to HBOS.

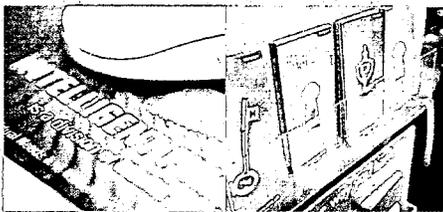
Over the next few years, HBOS will ensure that the cosy world of the so-called Big Four banks becomes a thing of the past. The new force in banking has truly arrived.

extra value and choice for customers



Alan Gibson, a customer with the Halifax for 16 years, enjoys the freedom provided by his flexible mortgage product.

extra service and simplicity for customers



Today's customers expect more from financial services organisations in terms of value for money, choice and service. They want to deal with people who advise them well, and they want services that suit the way they live.

At HBOS we make it our business to give customers what they want. Which is why we offer such a wide choice of brands and lots of different ways to do business with us. In short, we make financial services easy.

"We make it our business to give customers what they want. In short we make financial services easy."

Branches

Right across the UK under the Halifax and the Bank of Scotland brands, we have 1,100 bank branches. And we're represented in every single major town in the UK.

Agencies

We operate 700 Halifax agencies, usually within estate agents or solicitors offices, where customers can carry out basic transactions. This has proved particularly useful in the rural communities let down by other banks.

Estate Agencies

Under the Halifax Estate Agents brand, we operate nearly 400 of our own estate agencies, the second largest estate agency business in the country. As well as providing home buying services, these also arrange mortgages for our customers.

Telephone and Internet

We're leading the way with telephone and internet banking. We run 11 call centres across the UK with 5,000 colleagues offering customers a complete range of services over the phone. In addition, over a million Halifax and Bank of Scotland customers now choose to deal with us online, enjoying the convenience, and special online products such as our Web Saver account.

And our specialist online banking brand, Intelligent Finance, is the most successful new generation bank in the UK, attracting 155,000 customers in its first year of operation.

Intermediaries

Our five mortgage brands accounted for over 30% of mortgages sold through intermediaries in 2001, far more than any other provider of mortgages.

Leading Insurance and Investment brands

Under the **Halifax** brand we offer our retail and business banking customers straightforward, value for money products that enable them to invest for the future and protect their homes, offices, cars and mortgage repayments. We offer **Clerical Medical** pensions and investment products through leading Independent Financial Advisers, and through **St. James's Place Capital** we offer expert investment advice and a broad range of financial services to 'private clients'. **esure**, our '21st Century insurance' joint venture offers competitive motor and home insurance via the telephone and internet, while **The St. Andrew's Group** enables many partner organisations to offer 'own label' repayment insurance to their customers.

HBOS people make it happen

Look after your colleagues, and reward them fairly for their effort, and you'll look after your customers. A fairly straightforward maxim. In fact is there any other way? We recognise that to serve our customers in the way we want to, we must create the most highly motivated workforce wherever we do business.

We're aiming to do just this by listening to colleagues' opinions, rewarding their performance, and giving them an opportunity to share in the growth and prosperity of the business. On the back page, we show you how, and tell you a bit more about our role in the wider community.



Hilda Dewar, a SME customer, enjoys the benefits that Bank of Scotland's business banking experience provides.

extra performance for you

Following the merger of Bank of Scotland Group and Halifax Group, these results have been presented as if the new Group had been established throughout the current and comparative year.

Non interest income:
Net fees and commissions; long-term assurance and general insurance income; dealing profits and other operating income.

Provisions for bad and doubtful debts:
Amounts set aside to cover situations where customers fail to pay.

Operating profit:
Profit from all operations after deducting costs of running the businesses, including bad debts.

Minority interests:
The interests of other people who hold shares or other instruments in our subsidiary companies.

Earnings per share:
Underlying – Profit before exceptional items, Intelligent Finance and goodwill amortisation but after tax (less preference dividends) divided by the weighted average number of ordinary shares in issue during the year.
Basic – Profit for the year (less preference dividends) divided by the weighted average number of ordinary shares in issue during the year.

Diluted – As per basic but assuming the issue of new ordinary shares on exercise of all the share options which have been granted.

Recommended total dividend per share up 25% to 28p

Underlying earnings per share up 2% to 56.6p

Profits before tax* up 3% to £3,007m

Post tax return on equity* 18.2%, 19.5% the previous year

* Before exceptional items and Intelligent Finance

Summary Group Profit and Loss Account for the year ended 31 December 2001

	2001 £m	2000 £m
Interest receivable	16,115	15,111
Interest payable	(11,942)	(11,080)
Net interest income	4,173	4,031
Non interest income	2,699	2,213
Net operating income (all from continuing operations)	6,872	6,244
Operating expenses	(3,505)	(3,070)
General insurance claims	(68)	(11)
Provisions for bad and doubtful debts	(608)	(471)
Amounts written off fixed asset investments	(21)	(9)
Operating profit (all from continuing operations)	2,670	2,683
Before exceptional items and Intelligent Finance	2,971	2,895
Exceptional items	(147)	(124)
Intelligent Finance	(154)	(88)
Share of operating profits/(losses) of joint ventures and associated undertakings	36	(15)
Merger costs – exceptional	(76)	
Profit on ordinary activities before taxation	2,630	2,668
Before exceptional items and Intelligent Finance	3,007	2,925
Exceptional items	(223)	(169)
Intelligent Finance	(154)	(88)
Tax on profit on ordinary activities	(765)	(757)
Profit on ordinary activities after taxation	1,865	1,911
Before exceptional items and Intelligent Finance	2,155	2,062
Exceptional items	(182)	(89)
Intelligent Finance	(108)	(62)
Minority interests (equity)	(77)	(54)
(non-equity)	(112)	(79)
Profit attributable to shareholders	1,676	1,778
Dividends		
Preference	37	37
Ordinary	993	789
Retained profit of the year	646	952
Underlying earnings per share	56.6p	55.6p
Basic earnings per share	46.4p	49.9p
Diluted earnings per share	45.9p	49.7p
	2001	2000
Directors' emoluments	£000	£000
Total emoluments	6,515	3,830
Total potential pre-tax gains on stock options exercised	1,195	735
Highest paid Director – emoluments	994	682
– potential pre-tax gains on stock options exercised	1,195	735
– accrued pension entitlement per annum	296	216

Retirement benefits accrued to 8 Directors under pension schemes in the year to 31 December 2001. The figures for the years to 31 December 2000 and 2001 include the emoluments of the Directors of Bank of Scotland and Halifax Group plc who were appointed to the Board of HBOS plc. A detailed analysis of Directors' emoluments, pension entitlements, stock interests and stock options is given in the Remuneration Report in the full Report and Accounts.

Statement of the independent auditors to the members of HBOS plc (pursuant to section 231 of the Companies Act 1985)

We have examined the Summary Group Profit and Loss Account and Summary Group Balance Sheet set out on pages 10 to 14.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Review and Summary Group Profit and Loss Account in accordance with applicable law and practice. Our responsibility is to report to you on whether the consistency of the summary financial statements with the Annual Review and Summary Group Profit and Loss Account and Summary Group Balance Sheet

statements with the full annual financial statements and directors' report and accounts complies with the relevant requirements of section 231 of the Companies Act 1985 and the auditors' rules thereunder. We do not have the same information contained in the Annual Review and Summary Financial Statements and cannot be held responsible for our report if we become aware of any apparent misstatements or false information which does not appear in the summary financial statements.

Our opinion

We consider that we have been provided with sufficient information to enable us to make our summary financial statements and to be satisfied by the Accounting Practices Board for the United Kingdom. Our report on the full annual financial

statements describes the basis of our such opinion on these financial statements.

Opinion

In our opinion the summary financial statements are consistent with the full annual financial statements and directors' report of HBOS plc for the year ended 31 December 2001 and complies with the applicable requirements of section 231 of the Companies Act 1985 and the regulations made thereunder.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh, 25, Parliament Street

"Wherever we carry out our business, we support the local community, and are involved in a wide range of charitable activities"

We believe there's a right way to conduct business. We couldn't run our business without the support of our colleagues, customers, shareholders and the communities in which we operate. So we have responsibilities to all of them.

Quality at work

Our philosophy is to ensure every colleague can share in the success of the business, so we will link rewards directly to performance, loyalty and commitment, with bonus arrangements where colleagues may earn up to an additional 20% of basic salary. We encourage everyone to share in our prosperity and growth and believe the best way to achieve this is through attractive employee share ownership plans. In September 2001, we launched HBOS Sharesave and over 62% of the workforce now participate in our Group Save As You Earn plan. In addition, they will have the opportunity to invest some or all of their short-term cash bonus in HBOS shares, with one free share for every two purchased if they hold their shares for three years or more. We also aim to build on the Bank of Scotland's flexible benefits plan by giving all colleagues within HBOS the opportunity to design a benefits package to suit their own individual lifestyle.

We recognise that everyone has a voice, and annual opinion surveys give all employees the chance to air their views. We've developed this into a monthly programme of tracking opinion through questionnaires and interviews, with the results addressed at the highest level and

reported back to colleagues. Recognising the diversity of our workforce, we're also committed to remaining at the forefront of progressive forward-looking companies through our employment and work-life policies.

Social responsibility

We recognise the importance of the indirect environmental impact of our business activity, and make sure we keep our business customers and workforce up to date with both potential risks and opportunities to improve matters. The Group is a leading provider of finance to the renewable energy sector and Bank of Scotland is able to purchase renewable energy to meet 10% of its electricity consumption in Scotland. Halifax has also upgraded a total of 415 branches with the aim of reducing energy and water consumption. Last year Halifax produced an environmental report, and Bank of Scotland a corporate citizenship report, and both are available in internet and print versions. A great deal of work is underway in these areas and we will carry this forward in HBOS Group during 2002. Our full Report and Accounts carries a more detailed report on our sponsorship of external environmental initiatives and our ratings in various business indices.

Supporting the community

Wherever HBOS carries out its business, it supports the local community. The Group is involved in a wide range of activities across the UK and over the past five years Halifax and Bank of Scotland have donated over £23 million to literally thousands of charities

Since 1988 over £15m has been donated to British Heart Foundation, Imperial Cancer Research, Mencap and many other medical charities through our charity Visa cards.

In future, our activity will be organised by the HBOS Foundation and will focus on a number of themes:

- Debt counselling and money advice, supporting agencies such as Citizens Advice Bureaux and Money Advice Trust.
- Online technologies, developing sites for charities such as the National Asthma Association.
- Education and Life Long Learning, helping people with learning difficulties and those taking second chance learning opportunities.
- Community support, helping small community groups in locations where we have offices and branches.

All this activity makes HBOS Group one of the UK's largest corporate community investors. Once again, you can find a more detailed report in our full Report and Accounts.



HBOS's commitment to community issues is highlighted by the help they provide The Big Issue staff in opening Halifax accounts - although sadly this doesn't apply to Rocky, a much-loved member of The Big Issues Edinburgh salesforce.

The new force in the community

Summary Group Balance Sheet

as at 31 December 2001

	2001 £m	2000 £m
Assets		
Cash and balances at central banks	1,150	1,252
Items in course of collection	983	754
Treasury bills and other eligible bills	4,071	3,196
Loans and advances to banks	12,929	18,117
Loans and advances to customers	201,034	171,009
Less: non-returnable finance	(3,141)	(1,121)
	197,893	169,888
Operating lease assets	2,042	1,519
Debt securities	42,449	29,543
Equity shares	224	147
Interest in joint ventures and associated undertakings	350	307
Intangible fixed assets	1,245	1,047
Tangible fixed assets	1,627	1,576
Other assets	6,446	5,339
Long-term assurance business attributable to shareholders	3,265	2,400
	274,674	235,085
Long-term assurance assets attributable to policyholders	37,601	31,058
Total assets	312,275	266,143
Liabilities		
Deposits by banks	30,449	25,328
Customer accounts	140,516	127,012
Debt securities in issue	69,528	53,678
Other liabilities	12,685	11,070
Subordinated liabilities	7,626	5,985
	260,804	223,073
Capital and reserves		
Called up share capital		
Preference shares (non-equity)	400	400
Ordinary shares	892	878
	1,292	1,278
Share premium account	27	
Other reserves	492	209
Profit and loss account	9,657	9,051
Shareholders' funds (including non-equity interests)	11,468	10,538
Minority interests (equity)	415	377
Minority and other interests (non-equity)	1,987	1,097
	13,870	12,012
	274,674	235,085
Long-term assurance liabilities attributable to policyholders	37,601	31,058
Total liabilities	312,275	266,143
Memorandum items		
Contingent liabilities	2,335	1,873
Commitments	37,272	27,532

This Summary Financial Statement on pages 10 and 11 was approved by the Directors on 26 February 2002.

Lord Stevenson Chairman **A J Hobson** Chairman of Audit Committee **P A Burt** Executive Deputy Chairman
J R Crosby Chief Executive **M H Ellis** Group Finance Director

Summary Directors' Report

The information contained in the Summary Group Profit and Loss Account and Summary Group Balance Sheet is only a summary of the information which appears in the full Annual Report & Accounts.

Principal Activities

The principal activities of the Group are the provision of banking and other financial services in the UK and overseas.

Results and Dividends

Group profit before tax was £2,240 million (2000: £2,163 million). The Directors propose a final dividend of 14.7p per share to be paid on 31 May 2002 to shareholders on the register at the close of business on 15 March 2002. The final dividend brings the full year dividend to 26p, up 25.2% on 2000.

Business Review

Summarised extracts from the Business Review in the Annual Report & Accounts are included in other sections of this document.

Corporate Governance

The Group places a high degree of importance on corporate governance and on how the Group conducts its affairs. A detailed report on corporate governance including the UK Listing Authority's

Combined Code, is contained in the Annual Report & Accounts.

Directors

The names of the current Directors are:
Chairman - Lord Stevenson

Executive Directors

Executive Deputy Chairman - Peter Burt
James Crosby Gordon McQueen
Mike Ellis Colin Matthew
Phil Hodgkinson George Mitchell
Andy Hornby

Non-Executive Directors

Charles Dunstone Coline McConnell
Sir Ronald Carrar Sir Bob Reid
Tony Hobson Louis Sherwood
Brian Ivory Lord Simpson of Dunkeld
John McGeer Philip Yen

Auditors

The financial information set out in the summary financial statement does not constitute the Group's statutory accounts for the year ended 31 December 2001 but is derived from those accounts. Statutory accounts for 2001 will be delivered to the registrar of companies following the company's Annual General Meeting. The auditors have reported on

those accounts; their report was unqualified and did not contain statements under section 237(2) or (3) of the Companies Act 1985.

A resolution to reappoint KPMG Audit plc as auditors will be put to members at the Annual General Meeting.

HIBOS Board

The Board of Directors, which meets regularly, is legally responsible for running the Company on your behalf. There is a formal list of matters which must be decided at Board level. Executive Directors are full-time employees. Non-Executive Directors bring experience and advice from the outside business world.

The Board is supported by a clearly defined structure of sub-committees consisting of Board members. These include the Audit, Remuneration and Nominations Committees and the Special Committee (which makes urgent decisions that cannot wait for the next Board meeting). The roles of Chairman and Chief Executive are separate. All Executive Directors have contracts that provide for not less than one year's notice in the event of termination. Non-Executive Directors are appointed for three years and reappointment is not automatic.

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to the action that you should take, you are recommended to seek your own financial advice from your stockbroker, solicitor, accountant or other professional adviser authorised under the Financial Services and Markets Act 2000.

If you have sold or otherwise transferred all or some of your ordinary shares in HBOS plc prior to 13 March 2002 (the ex dividend date), please see paragraph 9 of the Rules of the Share Dividend Plan on page 7 of this document.



To Ordinary Shareholders/HBOS Shareholder Account holders/participants in the Bank of Scotland Profit Sharing Stock Ownership Scheme and in the Halifax Group plc Annual Bonus Plan 2001 ('Halifax Sharekicker').

Dear Shareholder/Participant

Share Dividend Plan (the 'Plan')

I am pleased to tell you that you can now choose to receive your dividends in the form of new fully paid ordinary shares of the Company ('new shares') instead of cash. You can choose to participate in the Share Dividend Plan in respect of the proposed final dividend of 18.7p per share for the period ended 31 December 2001 (the '2001 final dividend') and, subject to shareholder approval, for future dividends. This document contains the information you will need to decide whether you want to join the Plan, and for your convenience I have summarised below some of the key issues and questions.

Why should I choose shares instead of cash?

By choosing to take new shares instead of cash dividends you can increase your holding without paying dealing costs or stamp duty. You should bear in mind however, that the price of shares can go down as well as up. There are also tax implications which you should consider and these are summarised on pages 3 and 4.

How does the Plan work?

The Plan is based on a standing order arrangement (or mandate) in relation to the whole (and not part only) of your holding of ordinary shares at the record date for each dividend. If you hold ordinary shares on behalf of more than one beneficial owner then you may be able to elect for less than your entire holding to be subject to a mandate; please see paragraph 2 of the Rules of the Share Dividend Plan on page 6.

A mandate form is included in this pack. If you decide you wish to receive additional ordinary shares instead of cash for the 2001 final dividend, please sign, date and return the mandate form to our Registrars, in the envelope provided, to reach them by **13 May 2002**. Any mandate form received after this date will only take effect for future dividends.

We will include details of the operation of the Plan from time to time with your Summary Financial Statement (in relation to final dividends) and in a national newspaper and on our website (for interim dividends). If you wish to cancel your mandate then you should write to our Registrars.

A timetable of events is set out at the end of this letter.

How many new ordinary shares will I get?

We will use the formula below to calculate the number of new shares you will get if you choose to join the Plan.

$$\frac{\text{Number of shares held at record date x cash dividend per share (net of tax)}}{\text{Reference Price}}$$

(rounded down to the nearest whole number).

For the 2001 final dividend we will work this out using:

- A price for each new share which is calculated by taking the average of the middle market prices of the ordinary shares of the Company taken from the Daily Official List of the London Stock Exchange for the five business days starting on the date on which the ordinary shares are quoted ex dividend. This price is known as the 'Reference Price';
- The 2001 final dividend net of tax of 18.7p per share; and
- The number of shares you hold at 15 March 2002 (the 'Record Date')

The Reference Price will be available from Wednesday 20 March 2002 on our website (www.hbosplc.com) or by telephoning our Registrars (0870 702 0102).

As you can only receive whole new shares, we will carry forward any cash balance, which will never be more than the value of one share at the Reference Price, to the next dividend.

What do I do if I wish to continue to receive my dividends in cash?

Nothing! If you want to continue to receive your dividends in cash then you need take no further action. However, if in the future you change your mind and want to receive additional shares instead of cash, you can join the Plan for future dividends by contacting our Registrars and completing a mandate form.

Does the Plan need to be approved by shareholders?

The Directors are authorised to make this offer in respect of the 2001 final dividend under the Company's Articles of Association, although the offer is still subject to shareholder approval of the payment of the 2001 final dividend and listing of the new shares being granted by the United Kingdom Listing Authority. At the Annual General Meeting on 15 May 2002 we will also be asking shareholders to authorise the Directors to continue to operate the Share Dividend Plan in relation to future dividends up until the 2007 Annual General Meeting.

What do I do if I receive more than one mandate form?

Registered Ordinary Shareholders, HBOS Shareholder Account holders, participants in the Bank of Scotland Profit Sharing Stock Ownership Scheme and Halifax Sharekicker participants must fill in separate mandate forms. If you have an interest in ordinary shares under more than one of these categories and wish to join the Plan for each of them then you must fill in the relevant mandate form in respect of each of your interests. Please read paragraphs 12 and 13 of the Rules of the Share Dividend Plan carefully.

General Information

The continued operation of the Share Dividend Plan is subject to, among other things, the Directors not revoking their decision to offer new shares instead of the full cash dividend. If the price of the ordinary shares falls by 15% or more below the price used to determine the basis of the allotment on the return date in respect of any dividend, the Plan will be suspended automatically in respect of that particular dividend and the dividend will be paid in cash in the usual way.

If all shareholders were to decide to receive the 2001 final dividend in cash (ignoring any dividend waivers), the total cash dividend payable by the Company would be approximately £667,203,237. If all shareholders were to elect to receive new shares instead of cash, approximately 77,835,188 new shares would be issued, based on a Reference Price of 857.2p (calculated for illustrative purposes based on the five business days ending on 19 February 2002, the latest practicable date prior to printing this document and ignoring any dividend waivers and any reduction in respect of fractions), representing an increase of approximately 2.18 per cent in the ordinary share capital of the Company. As at 19 February 2002 the authorised ordinary share capital of the Company was 4,740,000,000 ordinary shares of 25p each, of which 3,567,931,749 were in issue.

In order to ensure your participation in the Plan is valid for the 2001 final dividend, mandate forms must be received by our Registrars no later than 13 May 2002.

Yours sincerely



Dennis Stevenson
Chairman
HBOS plc

Expected Timetable of Events

27 February 2002	Announcement of Annual Results
13 March 2002	Ordinary shares quoted ex dividend
13 – 19 March 2002	Period over which the Reference Price will be calculated
15 March 2002	Record Date for the proposed final dividend for 2001 (and for Share Dividend Alternative entitlements)
13 May 2002	Final date for receipt of Mandate Forms to receive the Share Dividend Alternative for the proposed final dividend for 2001 and for future dividends – the 'Return Date'
15 May 2002	Annual General Meeting
30 May 2002	New ordinary share certificates or CREST entitlement statements posted
31 May 2002	Dividend Payment Date. CREST accounts to be credited with new ordinary shares. Admission of the new shares to the Official List and to trading on the main market of the London Stock Exchange. First day of dealing in new ordinary shares

Further Information

Taxation

The taxation effect for a Shareholder making an election under the Share Dividend Plan will depend on the circumstances of that Shareholder. The directors have been advised that, under current UK legislation and Inland Revenue practice, the taxation consequences for Shareholders will be broadly as outlined below.

This summary of the taxation treatment is not exhaustive and does not consider the position of any Shareholder who is not resident, or not ordinarily resident in the United Kingdom, or who holds Ordinary Shares as trading stock. If you are not sure how you will be affected, you should consult your professional adviser before deciding whether or not to make an election under the Share Dividend Plan.

1. Individuals (including HBOS Shareholder Account holders and participants in the Bank of Scotland Profit Sharing Stock Ownership Scheme and in the Halifax Group plc Annual Bonus Plan 2001 ('Halifax Sharekicker')).

1.1 Income Tax

An individual who elects to take New Shares instead of the full cash dividend will be treated for tax purposes as having received gross income of an amount which, when reduced by income tax at the rate of 10 per cent, is equal to the cash dividend forgone. Income tax at the rate of 10 per cent is treated as having been paid on this gross income. For example, an individual who receives New Shares in respect of which the cash dividend forgone is £90 will be treated as having received gross income of £100 and as having paid income tax of £10 on that gross income. An individual who is liable to income tax at only the starting or basic rate will have no further tax to pay. An individual who is not liable to income tax will not be entitled to make a claim for repayment of the income tax treated as having been paid. However, non-taxpayers are no longer able to obtain refunds of the tax credit on a cash dividend. An individual liable to income tax at the higher rate will be subject to income tax at the rate of 32.5 per cent on the amount of gross income treated as having been received. The 10 per cent income tax deemed to have been paid can be set off against part of that liability, thereby reducing the liability to 22.5 per cent of the amount of the gross income treated as having been received (which is equal to 25 per cent of the cash dividend forgone). In the example above, this would mean further tax to pay of £22.50.

You should note that it is not possible to set any charges on income paid net of tax against the income treated as received in respect of the New Shares, as you can do with a cash dividend. This point should be considered if you make Gift Aid donations to charity or other payments net of tax, and normally rely on cash dividends (and other income) to cover such charges for tax purposes.

Income tax treated as paid on receipt of New Shares cannot be reclaimed in respect of existing Ordinary Shares held in personal equity plans ('PEPs') or individual savings accounts ('ISAs'). The tax credit on the full cash dividend paid in respect of existing Ordinary Shares held in PEPs or ISAs can be reclaimed. Shareholders who hold their shares in these products should therefore consider their position carefully before electing to participate in the Share Dividend Plan.

1.2 Capital Gains Tax

New Shares acquired following election under the Share Dividend Plan will not be aggregated with individuals' existing holdings for capital gains tax purposes, but will be treated instead as a new asset acquired on the date the shares are issued. The base cost of the new holding will be deemed to be the amount of the cash dividend forgone and taper relief will run from the date of issue of the New Shares.

2. Trustees

The same grossing up procedure as outlined in paragraph 1.1 above will apply to trustees liable to income tax at the rate applicable to trusts who elect to receive New Shares. So, for the purposes of charging income tax, if these trustees receive New Shares in respect of which the cash dividend forgone is £90 they will be treated as having received gross income of £100 and as having paid income tax of £10 on that grossed up amount. The trustees will be subject to tax on the gross income of £100 at the rate of 25 per cent although the £10 income tax deemed to have been paid can be set off against part of that liability. The result in this example would be that the trustees would be liable to pay an extra £15 income tax. So far as capital gains tax is concerned paragraph 1.2 above applies to these trustees.

Trustees not liable to income tax at the rate applicable to trusts will have no further income tax to pay. If the trustees treat the New Shares as income, an individual beneficiary will be treated as an individual who directly receives the New Shares (see paragraphs 1.1 and 1.2 above). If the trustees treat the New Shares as capital, neither the trustees nor the beneficiary will have any further income tax to pay. However, for the purposes of capital gains tax, no consideration is deemed to have been given for the New Shares. They will be added to the beneficiary's existing holding of shares in the Company and treated as though they had been acquired when the existing holding was acquired.

If your shares are held in a bare trust or in the name of a nominee, the trust or nominee will be disregarded for the purposes of both income tax and capital gains tax.

3. Corporate Shareholders

A corporate Shareholder who elects to receive New Shares will not be liable to corporation tax on the receipt of the New Shares. However, the shares will not be treated as franked investment income for the purposes of the shadow ACT rules. A cash dividend would be so treated, thereby reducing the notional ACT treated as having been paid by the corporate Shareholder on its own distributions. For the purposes of corporation tax on chargeable gains, no consideration is assumed to have been given for the New Shares. They will be added to the corporate Shareholder's existing holding of shares in the Company and treated as though they had been acquired when the existing holding was acquired.

4. Gross Funds

No claim for repayment of tax can be made in respect of the New Shares; nor could such a claim be made in respect of the full cash dividend.

5. Cash Dividend Forgone

If the amount of the full cash dividend differs substantially from the market value of the New Shares on the first day of their dealing on the London Stock Exchange, the Inland Revenue will take that market value rather than the cash dividend forgone as the amount which the shareholder is deemed to have received (before grossing up). References in the preceding paragraphs to the cash dividend forgone should then be read as references to that market value. According to current Inland Revenue practice, a substantial difference means a difference of 15 per cent or more from the market value of the shares received.

Overseas Shareholders

Making the Plan available to shareholders resident in certain jurisdictions other than in the UK would involve the Company in complying with local legal requirements which may be onerous and costly to do. Accordingly, the Directors have decided that the right to participate in the Plan will not be made available to shareholders with addresses in the province of Quebec in Canada or the state of California in the USA. In addition, the right to participate in the Plan is not available to any person in any other jurisdiction outside the UK where such an offer would require compliance by the Company with any governmental or regulatory procedures or any similar formalities. Please see paragraph 6 of the Rules of the Share Dividend Plan for more detail.

Halifax Share Dealing Account

The Halifax Share Dealing Account offers

- Low cost dealing
- Dealing online or via telephone
- Speedier settlement than certificated sales

For further information tick the box on the enclosed Share Dividend Plan mandate form and return in the envelope provided or contact Halifax Share Dealing on 0870 2411114 or visit www.halifax.co.uk/sharedealing

Halifax Share Dealing Limited is regulated by the Financial Services Authority and a member of the London Stock Exchange.

Halifax Nominees Limited. Registered in England No. 2791465.

Halifax Share Dealing Limited. Registered in England No. 3195646, is responsible for the safe custody activities of Halifax Nominees Limited, known as the HBOS Shareholder Account.

Registered Offices: Trinity Road, Halifax, West Yorkshire HX1 2RG.

Rules of the HBOS plc Share Dividend Plan

1. Definitions

The following definitions apply to terms used in these Rules and in the accompanying Mandate Form:

'the Company'	means HBOS plc and 'the Directors' refers to the Board of Directors of HBOS plc.
'CREST'	means the relevant system (as defined in the Uncertificated Securities Regulations 1995) in respect of which CRESTCo Limited is the operator.
'Halifax Sharekicker'	means the Halifax Group plc Annual Bonus Plan 2001.
'HBOS Shareholder Account Holder'	means the holder of an HBOS Shareholder Account on whose behalf Halifax Nominees Ltd holds Ordinary Shares.
'Mandate'	means an election to participate in the Share Dividend Plan and 'Mandate Form' means a form under which a Mandate is granted.
'New Shares'	means ordinary shares of HBOS plc allotted and issued credited as fully paid under the Plan.
'Ordinary Shares'	means ordinary shares of HBOS plc.
'Record Date'	in relation to a dividend on Ordinary Shares, the close of business on the date which determines entitlement to that dividend.
'Reference Price'	the price equal to the average of the middle market quotations of an Ordinary Share as derived from the Daily Official List of the UKLA for the five business days commencing on the date on which the Ordinary Shares were first quoted ex-dividend.
'Registrars'	means Computershare Investor Services PLC, PO Box 1910, The Pavilions, Bridgwater Road, Bristol, BS99 7DZ. Telephone 0870 702 0102.
'Return Date'	in relation to a dividend for which the Share Dividend Alternative is offered, the date by which a duly completed Mandate Form must be returned.
'Share Dividend Alternative'	means the right to receive fully paid new Ordinary Shares as an alternative to cash in respect of an interim or final dividend of the Company.
'Share Dividend Plan' or 'Plan'	means this plan under which Shareholders may elect to receive new Ordinary Shares under any offers of a Share Dividend Alternative.
'Shareholder'	means a holder or, in the case of joint holdings, the holders of Ordinary Shares on the register of members of the Company.
'Scheme'	means the Bank of Scotland Profit Sharing Stock Ownership Scheme established by Deed of Trust dated 19 February 1980 (as subsequently amended).
'UKLA'	means the United Kingdom Listing Authority.

2. Terms of Election

Subject to a Share Dividend Alternative being offered by the Directors in respect of a dividend, Shareholders on the register on a Record Date may elect to receive New Shares credited as fully paid instead of cash in respect of that dividend on the whole (and not part only) of their holding of Ordinary Shares at the Record Date. This right is governed by these Rules and the Company's Memorandum and Articles of Association. Shareholders who hold Ordinary Shares on behalf of more than one beneficial owner may, on application, at the discretion of the Company and subject to such terms and conditions as it may require, be permitted to elect for less than their entire relevant holding to be subject to a Mandate. Any such application should be addressed to the Registrars. Unless the Directors otherwise resolve, the Share Dividend Alternative will be offered subject to the conditions which apply to the corresponding cash dividend, such as the approval by shareholders of a final dividend and any other applicable legal or regulatory requirement.

3. How to make the election

If you wish to instruct the Company to treat you as having elected to take the maximum whole number of New Shares available instead of cash in respect of the dividend currently proposed and all future dividends for which a Share Dividend Alternative is offered then you should sign, date and send the Mandate Form to the Registrars so as to be received no later than the Return Date. The Mandate will apply to your entire holding of Ordinary Shares on the Record Date. If the Mandate Form is not received by the close of business on the Return Date, the dividend will be paid in cash in the normal way and the Mandate will be effective for future dividends only.

4. Cancellation of the Mandate

Your Mandate may be cancelled by the Company at any time, or by you giving written notice to the Registrars so as to be received before the Return Date in respect of the next dividend, failing which the cancellation will take effect from the following dividend. Your Mandate will automatically be cancelled if the Company registers a transfer of all of your Ordinary Shares (e.g. following a sale of your entire holding) or if the Company receives notice of your death. If further Ordinary Shares are acquired or Ordinary Shares are disposed of in respect of a shareholding, the Mandate will continue to apply (until cancelled) to such increased or decreased shareholding. Any accumulated residual cash entitlement will become payable to you in Sterling (without interest) if, at any time, you dispose of your entire holding, cancel your Mandate or so request in writing to the Registrars. Such a payment will also be made to a duly appointed representative following the receipt of proper notice of the death of a sole shareholder. The accumulated residual cash balance in Sterling will be paid within 28 days after receipt by the Registrars of written notice of any such event.

5. Basis of allotment

Provided a valid Mandate is in force at the Return Date, the number of New Shares that you are entitled to receive shall be calculated on the basis of the following formula and rounded down to the nearest whole number:

$$\frac{\text{Number of Ordinary Shares held at the Record Date} \times \text{cash dividend per Ordinary Share (net of tax)}}{\text{Reference Price}}$$

No fraction of a New Share will be allotted and the residual cash entitlement will be carried forward in Sterling in a non-interest bearing account, and will be applied in payment upon the allotment of further New Shares when a Share Dividend Alternative is next offered if sufficient funds are available in the account. It should be noted that all New Shares allotted on each election will automatically increase the shareholding on which future entitlement to New Shares will be calculated.

6. Eligibility

You can elect to receive New Shares instead of cash in respect of dividends unless you are subject to the restrictions referred to below on persons outside the United Kingdom.

The right to receive New Shares instead of cash in respect of dividends will not be available to any person in any jurisdiction outside the United Kingdom where such an offer would require compliance by the Company with any governmental or regulatory procedures or any similar formalities. The right to receive New Shares is also not available to Shareholders who hold shares as a nominee or trustee for any person in such a jurisdiction in respect of that holding. No person receiving a copy of this document or the Mandate Form in any such country or jurisdiction may treat such documents as an invitation to receive New Shares unless such an invitation could lawfully be made without such compliance. It is the responsibility of any person resident outside the UK wishing to elect to receive New Shares under this Plan to be satisfied as to full observance of the laws of the relevant territory, including obtaining any governmental or other consents which may be required and observing any other formalities in such territories. Individuals electing to take New Shares under the Plan will not be charged UK stamp duty on the New Shares.

Shareholders who no longer meet the eligibility criteria noted above are responsible for cancelling their Mandates in accordance with paragraph 4 of these Rules.

In addition, the Company may at any time determine that the right to elect to receive New Shares under the Plan is subject to such exclusions, restrictions or other arrangements as it deems necessary or expedient in relation to legal or practical problems under the laws of, or requirements of any recognised regulatory body or any stock exchange in, any territory or in the light of the level of costs which would otherwise be incurred if the Company were to offer such a right in any territory. The Company may decide not to send Mandate Forms to Shareholders in or otherwise subject to the laws of any such territory.

7. Details of Share Dividend Alternative offers

Details of any Share Dividend Alternative offer will be provided with each annual Summary Financial Statement or Annual Report in respect of final dividends and, in respect of interim dividends, will be provided at the same time as the announcement of the Company's interim results in at least one national newspaper and on the Company's website (www.hbosplc.com). These details will include the ex-dividend date, the period over which the Reference Price will be calculated, the Record Date, the Return Date, the date when new share certificates and CREST entitlement statements will be posted, the dividend payment date and the date on which CREST accounts will be credited with New Shares and the date when dealings in the New Shares are expected to commence. If you have a current valid Mandate, you will not be sent any notice of entitlement to a Share Dividend Alternative in advance of any dividend payment date.

8. If you have more than one registered holding

If for any reason your shares are registered in more than one holding and as a result you have received more than one Mandate Form then, unless you are able to make arrangements with the Registrars to have your holdings consolidated before the Return Date, they will be treated for all purposes as separate and you should complete separate Mandate Forms accordingly.

9. If you have recently sold any of your Ordinary Shares

If you have sold any of your Ordinary Shares prior to the first day the Ordinary Shares are quoted ex-dividend for any particular dividend then you may not be entitled to the dividend on those shares and are advised to contact your stockbroker or agent through whom the sale was made without delay. If you have sold all your Ordinary Shares prior to such day then you should pass on this document and any other relevant documents to such stockbroker or agent.

10. CREST

Where practicable, New Shares allotted to you in respect of a holding in CREST will be allotted in uncertificated form and credited electronically to the same CREST member account as that holding, unless the Company is unable to do so under the provisions of the Uncertificated Securities Regulations 1995 or the facilities and requirements of CREST, in which case share certificates in respect of such New Shares will be issued in the usual way. If part of your registered holding is in CREST and the balance is represented by share certificates, you will receive separate Mandate Forms for these two parts of your holding. You must complete and return both Mandate Forms to receive New Shares in respect of both your CREST and non-CREST holdings.

11. Share entitlement counterfoil/CREST entitlement statement

A counterfoil will be attached to each share certificate for New Shares allotted under the Plan or, if your holding is in uncertificated form, a CREST entitlement statement will be sent to you, which will state the number of Ordinary Shares held by you on the Record Date, the number of New Shares allotted, any residual cash entitlement carried forward, the cash equivalent of the allotted shares and the income tax treated as paid in respect of those shares (calculated on the assumption that the recipient is a UK resident individual). After any dividend payment date, you may contact the Registrars to obtain details of your holding.

12. Participants in the Bank of Scotland Profit Sharing Stock Ownership Scheme and the Halifax Group plc Annual Bonus Plan 2001

The Bank of Scotland Profit Sharing Stock Ownership Scheme (the 'Scheme')

These Rules also apply to participants in the Scheme. The Scheme register is maintained separately from the register of Shareholders and the register of HBOS Shareholder Account Holders. Participants in the Scheme can elect to participate in the Plan by completing and returning a Mandate Form addressed to the trustees of the Scheme. For the purposes of this Plan, Ordinary Shares held on behalf of a participant under the Scheme cannot be aggregated with any Ordinary Shares which he may hold in his own name or which are held on his behalf in an HBOS Shareholder Account or under the Halifax Sharekicker. Separate Mandate Forms must, accordingly, be used where appropriate.

For the purposes of determining the entitlement of participants in the Scheme to New Shares under these Rules and the treatment of associated fractional entitlements thereunder, participants will be treated as if they were registered shareholders of the Ordinary Shares beneficially owned by them and held for them under the Scheme as notified to the Company by the trustees of the Scheme. Accordingly, for these purposes, the Company will treat an election made by a participant and submitted to it by the trustees of the Scheme as if it were an election made by the registered shareholder of the Ordinary Shares to which that election relates. Any entitlement under the Plan of a participant amounting to less than the value of one New Share will be dealt with in accordance with paragraph 5 above and shall, subject to the provisions of paragraph 5, be carried forward by the Company on behalf of that participant. The New Shares arising from such elections will be issued to the trustees of the Scheme and then transferred by them to the relevant participants to be held in the participants' own names. The New Shares so transferred will not form part of the Ordinary Shares held on the behalf of a participant under the Scheme and will not be subject to the rules of the Scheme.

Any cash to which a participant is entitled (such as any accumulated residual cash entitlement pursuant to paragraph 4 above) will be paid to the trustees of the Scheme. The trustees will then account to participants for the cash in accordance with the rules of the Scheme.

The Halifax Group plc Annual Bonus Plan 2001 (the 'Halifax Sharekicker')

Participation in the Plan is also open to participants in the Halifax Sharekicker. The operation of the Plan in relation to the Halifax Sharekicker will operate in the same way as for the Scheme as outlined in the paragraphs above, save that New Shares will be transferred into an HBOS Shareholder Account in the name of the Halifax Sharekicker participant. By electing to participate in the Plan, a Halifax Sharekicker participant who is not an existing HBOS Shareholder Account Holder will be taken to have agreed to have his New Shares transferred into a new HBOS Shareholder Account set up in his name. Halifax Nominees Ltd will include the information sent to Shareholders pursuant to paragraph 11 of these Rules in the HBOS Shareholder Account statement which will be sent to HBOS Shareholder Account Holders at least once a year.

13. HBOS Shareholder Account Holders

These Rules also apply to HBOS Shareholder Account Holders. The register for the HBOS Shareholder Account Holders is maintained separately from the register of Shareholders. If you are a HBOS Shareholder Account Holder, you can elect under the Share Dividend Plan by completing and returning a Mandate Form addressed to Halifax Nominees Ltd. For the purposes of the Share Dividend Plan, Ordinary Shares held on your behalf as a HBOS Shareholder Account Holder cannot be aggregated with any Ordinary Shares which you may hold in your own name as a Shareholder or which may be held on your behalf under the Scheme or Halifax Sharekicker. Separate Mandate Forms must accordingly be used where appropriate.

For the purposes of determining your entitlement to New Shares under these Rules and the treatment of associated fractional entitlements thereunder, you shall be treated as if you were a registered Shareholder of the Ordinary Shares beneficially owned by you and held for you as an HBOS Shareholder Account Holder as notified to the Company by Halifax Nominees Ltd. Accordingly, for these purposes the Company shall treat an election made by you and submitted to it by Halifax Nominees Ltd as if it were an election made by the registered Shareholder of Ordinary Shares to which that election relates. Any entitlement under the Share Dividend Plan which amounts to less than the value of one new Ordinary Share shall be dealt with in accordance with paragraph 5 above and shall, subject to the provisions of paragraph 5, be carried forward by the Company on your behalf. The New Shares arising from such elections will be issued to Halifax Nominees Ltd and held by them on your behalf subject to the rules of the HBOS Shareholder Account. Halifax Nominees Ltd will arrange for any cash to which you are or become entitled (such as any accumulated residual cash entitlement pursuant to paragraph 5 above) to be paid to you in accordance with the rules of the HBOS Shareholder Account. Halifax Nominees Ltd will include the information sent to Shareholders pursuant to paragraph 11 of these Rules in your HBOS Shareholder Account statement which is sent to you at least once a year.

14. Operation, termination, suspension and amendment of the Share Dividend Mandate Plan

The operation of this Plan in respect of any particular dividend is entirely at the discretion of the Directors. If the Directors decide not to offer a Share Dividend Alternative then the dividend will be paid in cash in the usual way. In addition, the operation of the Plan requires the continued approval of the Shareholders. This Plan may be amended, suspended or terminated by the Directors at any time without notice. In the case of amendment, current Mandates will remain valid unless the Company receives notice in writing in accordance with paragraph 4. Any offer of the Share Dividend Alternative will be made subject to the condition that the Plan will be automatically suspended in respect of a particular dividend if on the Return Date (or, if not a business day, the preceding business day) the middle market quotation of an Ordinary Share as derived from the Daily Official List of the UKLA has fallen to a price which is 15% or more below the Reference Price.

15. Listing and ranking of the New Shares

Application will be made to the London Stock Exchange plc and the UKLA for admission of the New Shares to the official list of the UKLA ('Official List'). The New Shares will on issue be credited as fully paid and will rank *pari passu* in all respects with the existing issued Ordinary Shares and will rank for all future dividends.

16. General

No acknowledgement of Mandate Forms will be issued. Definitive share certificates for the New Shares held outside CREST will be posted, at the risk of the persons entitled thereto, on or shortly before the dividend payment date and CREST members should have their accounts credited on the dividend payment date. In the unlikely event that the UKLA does not agree to admit the New Shares to the Official List before the dividend payment date then Mandates will be disregarded in respect of that dividend payment only and the dividend will be paid in cash as soon as practicable. Further Mandate Forms are available from the Registrars on request.



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