



Kent Reliance Building Society

(incorporated in England and Wales under the Building Societies Act 1986 under no. 269B)

£15,000,000

7.875 per cent. Permanent Interest Bearing Shares

Issue Price: 99.489 per cent.

Kent Reliance Building Society (the “Society”) will issue £15,000,000 7.875 per cent. Permanent Interest Bearing Shares (the “PIBS”) at an issue price of 99.489 per cent. of their principal amount, comprising 15,000 PIBS of £1,000 each. Application has been made to list the PIBS on the Luxembourg Stock Exchange.

Attention is drawn to the description in “Certain Provisions of the Building Societies Act” on pages 20 to 21 of this document of the ways in which a building society can, without the consent of holders of permanent interest bearing shares, amalgamate with or transfer its rights and obligations to another building society or a company pursuant to the relevant legislation.

It is anticipated that the PIBS will be issued in registered form in the denomination of £1,000. The PIBS will be settled through the CREST System operated by CREST Co Limited (“CRESTCo.”). The PIBS are also eligible for settlement through Clearstream Banking, société anonyme (“Clearstream, Luxembourg”) and Euroclear Bank S.A./N.V., as operator of the Euroclear System (“Euroclear”) (each a “Clearing System” and together the “Clearing Systems”).

The PIBS will be deferred shares in the Society for the purposes of section 119 of the Building Societies Act 1986, as amended, and will not be an investment or a protected deposit in respect of which a claim may be entertained by the Financial Services Compensation Scheme established under the Financial Services and Markets Act 2000 (“FSMA”). Attention is drawn to certain characteristics of the PIBS as described in “Risk Factors” on pages 4 to 6 of this document.

The PIBS will not be withdrawable at the option of the PIBS investors and will be repayable only in certain limited circumstances as described in “Special Conditions of Issue of the PIBS – 6 Repayment” on page 14 of this document.

Barclays Capital

20 August 2004

The Society accepts responsibility for the information contained in this document. To the best of the knowledge and belief of the Society (which has taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

*No person is authorised to give any information or to make any representation not contained in this document and any information or representation not contained in this document must not be relied upon as having been authorised by the Society or Barclays Bank PLC (the “**Manager**”). Neither the delivery of this document nor any subscription, sale or purchase made in connection herewith shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Society and the Society and its subsidiary undertakings (together, the “**Group**”) since the date of this document.*

*The PIBS have not been and will not be registered under the U.S. Securities Act of 1933 (the “**Securities Act**”), and may not be offered or sold within the United States.*

This document does not constitute an offer of, or an invitation by or on behalf of the Society or the Manager to subscribe for or purchase, any of the PIBS. The distribution of this document and the offering of the PIBS in certain jurisdictions may be restricted by law. Persons into whose possession this document comes are required by the Society and the Manager to inform themselves about and to observe any such restrictions. For a further description of certain restrictions on offering and sales of the PIBS and on distribution of this document, see “Marketing Arrangements” on page 56 of this document.

The information contained in this document is intended for sophisticated investors capable of understanding the nature of the PIBS and the risks attaching to them. There are fundamental differences between the PIBS and ordinary share accounts and deposit products of building societies. A number of these differences significantly increase the risk element involved in investing in the PIBS. Accordingly, attention is drawn to certain characteristics of the PIBS as described in “Risk Factors” set out on pages 4 to 6 of this document.

In connection with this issue, the Manager and any person acting for it may each over-allot or effect transactions with a view to supporting the market price of the PIBS at a level higher than that which might otherwise prevail for a limited period. However, there is no obligation on the Manager or any agent of it to do this. Such stabilising, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

*In this document, unless otherwise specified or the context otherwise requires, references to “**pounds**”, “**pence**”, “**sterling**”, “**£**” and “**p**” are to the currency of Great Britain and Northern Ireland (the “**United Kingdom**”) and to the “**Building Societies Act**” are to the Building Societies Act 1986 of the United Kingdom, which expression shall include, where applicable, any statutory modification or re-enactment thereof and any statutory instrument, order or regulation made thereunder or under any such statutory modification or re-enactment.*

*Terms used in this document shall, unless otherwise defined in this document, or as the context otherwise requires, have the same meanings as are given to them in the Building Societies Act or, as the case may be, the Rules of the Society (the “**Rules**”) or the Memorandum of the Society (the “**Memorandum**”).*

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RISK FACTORS

Investors should be aware that the PIBS are undated and subordinated and that the terms of the PIBS vary considerably from the terms of ordinary share accounts and deposit products of building societies in the United Kingdom. They should particularly note the following characteristics of the PIBS:

1. Permanence

The PIBS will be repayable only at the option of the Society on 27 August 2014 and every fifth successive year thereafter, or in certain limited circumstances as described in “Special Conditions of Issue of the PIBS – 6 Repayment” on page 14 of this document, in each case subject to the permission of the statutory authority responsible for regulating building societies in the United Kingdom, which is currently the Financial Services Authority (the “FSA”), which expression shall in this document (except where the context otherwise requires) include any successor body performing for the time being the same or similar functions in relation to building societies (or, in the event that the Society transfers its business to a company under section 97 of the Building Societies Act, companies of that nature) in the United Kingdom. The Society is under no obligation to seek any such permission to repay the PIBS and it should not be assumed that any consent, if requested, will be given.

2. Liquidity

In order to realise its capital investment in the PIBS, an investor must either go to an established secondary market or look to make a private sale. **There is no guarantee that the investor will be able to liquidate its investment in the PIBS** for cash either because the future liquidity of the secondary market is not guaranteed or because the investor may be unable to find any potential private purchasers. Therefore, there is a risk that an investor cannot realise its investment in the PIBS when it wishes to do so.

3. Capital value of investment

As the capital value of the PIBS will vary with market interest rates, the market perception of the value of the Society and the availability of purchasers, **there is a real chance that the investor will make a capital loss** when it comes to sell its PIBS.

4. Subordination

The PIBS are subordinated to all other liabilities of the Society other than liabilities in respect of other deferred Shares (as defined in the Rules). In a winding up or dissolution of the Society, the claims of the PIBS holders will rank behind all other creditors of the Society and the claims of Members holding shares (other than deferred Shares, as so defined) as to principal and interest. Investors should be aware that this subordination is a primary factor behind the higher interest rate that is paid on the PIBS when compared to other investment products of the Society i.e. that there is a direct link between higher interest and higher risk.

5. Investor protection

Unlike normal building society investment products, the PIBS are not an investment or a protected deposit in respect of which a claim may be entertained by the United Kingdom Financial Services Compensation Scheme.

6. Payments of interest may be missed

Interest in respect of the PIBS will not be payable where the directors of the Society resolve that to make payment would result in the Society’s capital falling below prescribed minimum levels and that accordingly such interest should not be paid or where the Society has not paid interest in respect of deposits or shares (other than deferred shares, as defined in the Building Societies Act).

7. Interest is not cumulative

If the Society does not make an interest payment in respect of the PIBS in accordance with paragraph 6 above, such interest will be cancelled.

8. Rights

The rights of the PIBS holders are markedly different from those of shareholders in a United Kingdom company, including in particular, as to voting rights and protection of minorities. For example, as indicated in “Summary of Certain Provisions of the Rules of the Society and the Building Societies Act relating to the PIBS – 6 Meetings” on page 8 of this document, each PIBS holder only has one vote at general meetings of the Society, irrespective of the number of PIBS it holds, whereas shareholders, on a poll at a general meeting of a company, would normally have one vote for each share held.

9. Membership rights whilst the PIBS are held through Euroclear and/or Clearstream, Luxembourg Accounts

Any investor may elect that its holding of PIBS be held and transferred through accounts with Euroclear and/or Clearstream, Luxembourg, and not through an account with CRESTCo. Any investors which elect to hold their PIBS through a Euroclear or Clearstream, Luxembourg account will not themselves be entered on the PIBS Register as holder of the relevant PIBS. Instead, the holder entered on the PIBS Register for such PIBS shall be Euroclear and/or Clearstream, Luxembourg’s nominee accountholder with CRESTCo. and the relevant investor’s holding of PIBS will be registered in the internal records of Euroclear and/or Clearstream, Luxembourg.

This means that investors in the PIBS who hold through Euroclear and/or Clearstream, Luxembourg will not themselves be members of the Society and, accordingly, will not be entitled to vote at any general meeting of the Society or in a postal ballot or to any other similar membership rights. Instead the members’ rights attaching to those PIBS which are held through Euroclear and/or Clearstream, Luxembourg will be held by their nominee accountholder with CRESTCo. Such nominee accountholder will be entered in the PIBS Register as the holder of PIBS held in this manner, and will be entitled to exercise the vote attributable to all those PIBS so held.

Given the difficulty of casting that vote in a manner which reflects the views of all the relevant investors and the relative insignificance of that vote in the context of all the votes which may be cast by members of the Society, the nominee accountholder will not exercise that vote.

As investors in the PIBS holding through Euroclear and/or Clearstream, Luxembourg accounts will not be members of the Society they will also not be entitled to any windfall rights (including any rights to windfall payments) arising on a demutualisation of the Society. Any windfall rights arising on a demutualisation of the Society will be passed instead to the Euroclear and/or Clearstream, Luxembourg nominee accountholder with CRESTCo., as the registered holder of the relevant PIBS in the PIBS Register. Any windfall payment made to the Euroclear and/or Clearstream, Luxembourg nominee accountholder arising in respect of a demutualisation of the Society shall be divided equally between such number of investors holding their PIBS through Euroclear and/or Clearstream, Luxembourg accounts and passed through to each investor in accordance with the procedures of the relevant Clearing System. Such amount will therefore vary significantly depending on the number of investors holding their PIBS through Euroclear and/or Clearstream, Luxembourg accounts at the time of the demutualisation and will almost certainly be significantly less than an investor would have received had it been holding its PIBS through an account with CRESTCo.

For the avoidance of doubt, PIBS held through CRESTCo. confer on their holders full membership rights in the Society, in accordance with the terms of the PIBS.

10. Amalgamation of the Society and transfer of its engagements

If the Society amalgamates with, or transfers all or part of its engagements to, another building society, the PIBS will not become repayable as a consequence thereof, but will become deferred shares in that society. If the Society transfers the whole of its engagements to any other body, the transfer will incorporate arrangements to secure that the PIBS are effectively converted into undated subordinated debt of that body, and do not become repayable other than at the option of that body on 27 August 2014 and every fifth successive year thereafter or in the limited circumstances as described in “Special Conditions of Issue of the PIBS – 6 Repayment”, in each case subject to the permission of the FSA.

11. Taxation of Interest

Because the PIBS will be listed on a recognised stock exchange, interest will be paid without withholding or deduction for tax under current law. Nevertheless, tax may be withheld or deducted if there is a change of law or if the PIBS cease to be listed on a recognised stock exchange.

12. The EU Transparency Obligations Directive

Application has been made to list the PIBS on the Luxembourg Stock Exchange. However, the Society may seek to list the PIBS on an alternative stock exchange outside the European Union in the event that, in the opinion of the directors of the Society, after consultation with the Manager, the proposed EU Transparency Obligations Directive, at such time as it comes into force, and/or application of Regulation (EC) No 1606/2002 on the application of international accounting standards, imposes excessively onerous obligations on the Society.

Investors' attention is also drawn to the information in respect of the Society appearing on pages 22 to 27 of this document.

SUMMARY OF CERTAIN PROVISIONS OF THE RULES OF THE SOCIETY AND THE BUILDING SOCIETIES ACT RELATING TO THE PIBS

The rights and restrictions attaching to the PIBS will be governed by the Rules, certain provisions of the Building Societies Act and the “Special Conditions of Issue of the PIBS” (the “**Conditions**”) set out on pages 10 to 19 of this document. Set out below is a summary of the key provisions of the Rules and certain provisions of the Building Societies Act insofar as they might affect the rights of the PIBS holders, together with certain explanatory notes which are italicised. Terms defined in the Rules will, unless the context otherwise requires, have the same meanings when used in this summary.

For those investors which hold their PIBS through an account with Euroclear and/or Clearstream, Luxembourg, instead of through an account with CRESTCo., such PIBS will be registered in the name of Euroclear and/or Clearstream, Luxembourg’s nominee accountholder with CRESTCo., who shall be the PIBS holder for those PIBS for the purpose of the Rules and the Conditions and not the investors holding the beneficial interests in the PIBS through Euroclear and/or Clearstream, Luxembourg. Except to the extent that an investor holding PIBS through Euroclear and/or Clearstream, Luxembourg is a member of the Society in some other capacity, such investors in the PIBS will not directly be bound by the Rules and the Memorandum or by the Act.

Investors holding the beneficial interests in the PIBS through Euroclear and/or Clearstream, Luxembourg shall, save in respect of voting rights and demutualisation rights as described in “Risk Factors – 9 Membership Rights whilst the PIBS are held through Euroclear and/or Clearstream, Luxembourg Accounts” on page 5 of this document, be entitled to the same rights as the registered PIBS holder in respect of their beneficial interests, in accordance with the rules of the relevant Clearing System.

1. General

The person whose name is entered in the PIBS Register as the holder of a PIBS is a Shareholding Member of the Society (as defined in the Rules).

Each PIBS holder (as defined in the Conditions), and all Persons (as defined in the Rules) claiming through him or on his behalf or under the Rules, shall be bound by the Rules and by the Memorandum and, where applicable, the Additional Rules (which are set out in the Rules).

2. Register

The Society shall maintain a PIBS Register for the purposes of the PIBS, in which shall be entered the name and address of each PIBS holder. Each PIBS holder shall notify the Society immediately of any change of name or address and shall produce such evidence of such change as the Society may require.

Transfers and other documents or instructions relating to or affecting the title of any PIBS shall also be recorded in the PIBS Register. No charge shall be made in respect of any entry in the PIBS Register. The PIBS Register shall be maintained at the Principal Office, or at such other place as the board of directors of the Society (the “**Board**”) thinks fit.

The Society has appointed Lloyds TSB Registrars as its registrar for the PIBS issue.

3. PIBS Certificates

Each PIBS holder, within one month after becoming entered in the PIBS Register as the holder of a PIBS (or within such other period as the terms and conditions of issue of the PIBS may provide), shall, if he shall make a written request to the Society at the time of applying to be so entered, be supplied by the Society with a duly executed PIBS Certificate (which shall not be the property of the Society).

Every Person entered into the records of the Society as the holder of a PIBS who has not previously requested to be supplied by the Society with a PIBS Certificate shall within one month after making a written request to the Society be supplied by the Society with a PIBS Certificate.

Save as aforesaid, nothing in the Rules requires a PIBS to be evidenced by a PIBS Certificate or other written instrument. PIBS Certificates shall be made available at the offices of the Transfer Agent or Registrar, as the case may be.

4. Replacement of a PIBS Certificate

A PIBS holder losing his PIBS Certificate shall immediately give notice in writing of such loss to the Society at its Principal Office and to the Registrar or the Transfer Agent. If a PIBS Certificate is damaged or alleged to have been lost, stolen or destroyed, a new PIBS Certificate representing the same PIBS shall be issued to that PIBS holder upon request, subject to delivery of the old PIBS Certificate or (if alleged to have been lost, stolen or destroyed) subject to compliance with such conditions as to evidence and indemnity as the Society and the Registrar may think fit and to payment of any exceptional expenses of the Society and the Registrar incidental to its investigation of the evidence of such alleged loss, theft or destruction. The new PIBS Certificate will be made available at the offices of the Transfer Agent or the Registrar (as the case may be). Where a holder of a certificated PIBS has sold part of his holding he will be entitled to a PIBS Certificate for the balance without charge.

5. Transfers

A PIBS holder may transfer his PIBS to any Person and no fee shall be charged in respect of a transfer of a PIBS. No transfer of PIBS shall be valid unless made in a form approved by the Board and until registered in the PIBS Register. A transferee of a fully paid PIBS shall be entitled to have his name entered in the PIBS Register following notice by him to the Registrar or Transfer Agent of such a transfer, such notice to be made or given in the form endorsed on the PIBS Certificate or in such other manner as the Board in its absolute discretion may permit.

The registration of transfers of PIBS may be suspended at such times and for such periods as the Board may determine, but not for more than thirty days in the year, and notice of such suspension shall be given by advertisement in at least one national daily newspaper.

A fully paid-up PIBS shall be free from all liens in respect of liabilities to the Society.

Two or more Persons may jointly hold a PIBS. No PIBS shall be issued to the holders, or be held by them at any time, as tenants in common.

The Society may decline to issue any PIBS, or register any transfer of PIBS, to more than four Persons jointly. Joint PIBS holders shall be entitled to choose the order in which they are named in the records of the Society.

6. Meetings

As Members of the Society, the PIBS holders will, subject to the provisions of the Rules, be entitled to receive notice of, to propose resolutions at, to attend, to be counted in a quorum and to vote or appoint a proxy at general meetings of the Society.

A PIBS holder is entitled to vote on a resolution (whether an Ordinary Resolution or Special Resolution or a Shareholding Members' Resolution, but not a Borrowing Members' Resolution) if:

- (a) being an Individual, he is not a minor on the voting date or, where he is voting by proxy, on the date of the meeting at which the resolution is intended to be moved; and
- (b) in the case of a joint Shareholding, he is the Representative Joint Shareholder; and
- (c) he was entered in the PIBS Register as the holder of a PIBS:
 - (i) at the end of the last Financial Year before the voting date; or
 - (ii) if the voting date falls during that part of the Financial Year which follows the conclusion of the Annual General Meeting commenced in that year, at the beginning of the period of 56 days immediately preceding the voting date for Members voting in person at a special general meeting or a postal ballot,
as the case may be; and
- (d) he has not ceased to be a PIBS holder at any time between the time referred to in (c)(i) or (ii) above (as applicable) and the voting date.

At a general meeting of the Society, each PIBS holder will have one vote regardless of the principal amount of PIBS held by that PIBS holder or whether the PIBS holder is otherwise a Member of the Society.

7. Winding up and dissolution

Upon the winding up of the Society, or upon it being dissolved by consent, if there are insufficient assets to repay all Members the amounts paid up on their Shares, no repayments shall be made in respect of any deferred Share (including the PIBS) until after all other Members have been repaid in full.

Upon the winding up of the Society, or upon it being dissolved by consent, any surplus remaining after payment in full of the Society's creditors and repayment to Members (including PIBS holders) of the amount of their Shares (together with any interest due thereon) according to their priority under their respective terms and conditions of issue, shall be applied as follows:

- (a) up to 20 per cent. to holders of all or some of the deferred Shares in the Society (including the PIBS). The proportion (if any) of such 20 per cent. to which any particular issue of deferred Shares (including the PIBS) is entitled shall be set forth in the terms and conditions of issue of that issue of deferred Shares (*see note below which describes the way in which the Society has determined the exercise of this discretion*); and
- (b) the remainder among qualifying Members (other than holders of deferred Shares (including the PIBS)) in proportion to the value of their Shareholdings.

For the purposes of these provisions of the Rules, “**qualifying Members**” means Persons who hold on the date of commencement of the dissolution or winding-up and have held, throughout the period of two years up to that date, Shares to the value of not less than £100.

The Society has determined that, in exercising its discretion regarding the distribution of any surplus on a winding up or dissolution of the Society referred to in sub-paragraph 7(a) above, no proportion of any final surplus will be paid to the holders of PIBS.

8. Disputes and legal proceedings

Subject to the provisions of section 1 of the Courts and Legal Services Act 1990, section 85 of and Schedule 14 to the Building Societies Act provide that no court other than the High Court of Justice in England shall have jurisdiction to hear and determine disputes between a building society and a member or a representative of a member in that capacity in respect of any rights or obligations arising from the rules of a building society or the Building Societies Act. Pursuant to section 1 of the Courts and Legal Services Act 1990, the High Court and County Courts Jurisdiction Order 1991 No. 724 has been made which empowers the High Court to transfer cases over which it has jurisdiction to the County Court.

9. Unclaimed interest

In certain circumstances set out in the Rules, the Society shall be entitled to sell for the best price reasonably obtainable any PIBS in respect of which no interest has been claimed during a period of 12 years. The Society shall be obliged to account (as debtor and not as trustee) to the PIBS holder or any other Person entitled to the PIBS for the net proceeds of sale of the PIBS.

SPECIAL CONDITIONS OF ISSUE OF THE PIBS

The following, save for the paragraphs in italics, are the special conditions of the issue of the PIBS in the form in which they will appear on the reverse of each PIBS Certificate issued in respect of each holding of PIBS (a “PIBS Certificate”):

The PIBS holders (as defined below) are entitled to the benefit of, are bound by and are deemed to have notice of the Rules (as defined below) of the Society (as defined below). The PIBS (as defined below) are also issued subject to, and with the benefit of, these special conditions of issue (the “Conditions”). In the event of inconsistency between the Rules and these Conditions, the Rules will prevail.

For those investors which hold their PIBS through an account with Euroclear and/or Clearstream, Luxembourg instead of through an account with CRESTCo., such PIBS will be registered in the name of Euroclear and/or Clearstream, Luxembourg’s nominee accountholder with CRESTCo., who shall be the PIBS holder for those PIBS for the purposes of the Conditions, and not the investors holding the beneficial interests in the PIBS through Euroclear and/or Clearstream, Luxembourg. Those investors holding the beneficial interests in the PIBS through Euroclear and/or Clearstream, Luxembourg accounts shall, save in respect of voting rights and demutualisation rights as described in “Risk Factors – 9 Membership rights whilst the PIBS are held through Euroclear and/or Clearstream, Luxembourg Accounts” on page 5 of this document, be entitled to the same rights as the registered PIBS holder in respect of their beneficial interests, in accordance with the rules of the relevant Clearing System.

For the avoidance of doubt, PIBS held through CRESTCo. confer on their holders full membership rights in the Society, in accordance with the terms of the PIBS.

1. General

- (1) The “**Society**” means Kent Reliance Building Society.
- (2) The “**PIBS**” means £15,000,000 7.875 per cent. Permanent Interest Bearing Shares of the Society and, unless the context otherwise requires, includes any further permanent interest bearing shares issued pursuant to Condition 12 and forming a single series with the PIBS.
- (3) “**PIBS holder**” means a Person whose name is entered in the PIBS Register (as defined below) as the holder of a PIBS or, in the case of a joint holding of PIBS, the first person whose name is entered in the PIBS Register in respect of the joint holding of the PIBS.
- (4) “**Registrar**” means Lloyds TSB Registrars or such other registrar appointed by the Society from time to time in respect of the PIBS.
- (5) Terms defined in the Rules of the Society for the time being (the “**Rules**”) will, unless the context otherwise requires, have the same meanings when used in these Conditions.
- (6) The PIBS:
 - (a) are deferred shares for the purposes of section 119 of the Building Societies Act 1986 as amended (the “**Building Societies Act**”);
 - (b) are not investments or protected deposits for the purpose of the Financial Services Compensation Scheme established under the Financial Services and Markets Act 2000;
 - (c) are not withdrawable; and
 - (d) are permanent interest bearing Shares for the purposes of the Rules.
- (7) The expressions “**Creditors**” and “**Relevant Supervisory Consent**” shall have the meanings given thereto in Conditions 6(3) and 6(7) respectively.
- (8) Upon a transfer of PIBS by a PIBS holder the Society will procure that the new PIBS holder is issued with a PIBS Certificate within 14 days after the lodgement of the instrument of transfer if the holder wishes to hold PIBS in certificated form. The PIBS Certificate will be made available at the offices of the Registrar or the Transfer Agent (as the case may be).

- (9) A PIBS may be held jointly by up to four persons.
- (10) Rights to Conversion Benefits to which a PIBS holder may become entitled by reason of his holding of PIBS shall not be required to be assigned to a charity nominated by the Society pursuant to any scheme for charitable assignment established by the Society for the time being. In the event that a holder of PIBS is a Member of the Society other than by reason of its holding of PIBS and has made a declaration to assign any Conversion Benefits to a charity, that assignment declaration shall not apply to Conversion Benefits derived from his holding of PIBS. If there is a conflict between these Conditions and any other provisions for the assignment of Conversion Benefits to which a Member is subject, then these Conditions shall prevail in relation to Conversion Benefits derived from PIBS held by any PIBS holder, whenever the assignment of Conversion Benefits is made. For these purposes, “**Conversion Benefits**” shall mean any benefits under the terms of any future transfer of the Society’s business to a company and, if the Society merges with any other building society, “**Society**” shall, after the date of such merger, extend to such other society.

2. Form and denomination

The PIBS are in registered form and are available and transferable in accordance with the Rules in amounts and integral multiples of £1,000.

3. Registrar, Transfer Agent and Notice Agent

- (1) The Society has appointed Lloyds TSB Registrars as the Registrar under the terms of a Registrar Agreement (the “**Registrar Agreement**”) dated 27 August 2004 and made between the Society and the Registrar. The Society has also appointed Dexia Banque Internationale à Luxembourg, société anonyme as the Transfer Agent in respect of transfers of the PIBS and HSBC Bank plc as the Notice Agent (together, the “**Agents**”) under the terms of an Agency Agreement (the “**Agency Agreement**”) dated 27 August 2004 and made between the Society, the Transfer Agent, the Registrar and the Notice Agent. The Society shall at all times maintain a Transfer Agent in Luxembourg so long as the PIBS are listed on the Luxembourg Stock Exchange.
- (2) Copies of the Registrar Agreement and Agency Agreement are available for inspection during normal business hours at the specified offices of the Registrar and the Transfer Agent. PIBS holders are deemed to have notice of all the provisions of the Registrar Agreement and Agency Agreement applicable to them.
- (3) The Society shall procure that the Registrar maintains the PIBS Register, in which shall be entered the name and address of each PIBS holder. Each PIBS holder shall notify the Registrar immediately of any change of name or address and shall produce such evidence of change of name or address as the Registrar may reasonably require.
- (4) A PIBS holder must provide the Registrar or the Transfer Agent with a written order containing such instructions and other information as the Society and the Registrar or Transfer Agent may require to complete, execute and deliver a PIBS Certificate to such PIBS holder. On receipt of such documents, the Society shall instruct the Registrar to arrange for the authentication and either the Registrar or the Transfer Agent to deliver to, or to the order of, the person or persons named in such written order of a PIBS Certificate, registered in the name or names requested by such person or persons.
- (5) Transfers and other documents or instructions relating to or affecting the title of any PIBS shall be recorded in the PIBS Register. No charge shall be made in respect of any entry in the PIBS Register. The PIBS Register shall be maintained at the principal office of the Registrar or at such other place as the Society and the Registrar shall agree.
- (6) The Registrar or the Transfer Agent shall, on behalf of the Society, issue a PIBS Certificate in respect of each holding of all PIBS held by each PIBS holder (or, in the case of a joint holding, to the joint holder whose name appears first in the PIBS Register in respect of such joint holding)

within 14 days after one is requested. If any PIBS holder entitled to receive a PIBS Certificate wishes to have the same delivered to him otherwise than at the specified office of the Registrar or of the Transfer Agent, such delivery shall be made, upon his written request to the Registrar or the Transfer Agent, at his risk and (except where sent by post to the address specified by the PIBS holder) at his expense.

- (7) No person shall have any right to enforce any term or condition of the PIBS under the Contracts (Rights of Third Parties) Act 1999.

4. Transfers

- (1) No legal transfer of a PIBS shall be valid unless made in the form endorsed on the PIBS Certificate or in such other form as the Board of Directors of the Society may agree, which form shall be presented to the Registrar or the Transfer Agent, accompanied by such documents, evidence and information as may be required pursuant to these Conditions and such other evidence as the Society may reasonably require to prove the title of the transferor of the relevant PIBS or his right to transfer such PIBS and, if the form of transfer is executed by some other person on his behalf or in the case of the execution of a form of transfer on behalf of a corporation by its officers, the authority of that person or those persons to do so.
- (2) Legal title to the PIBS will pass upon registration of such transfer in the PIBS Register and the Registrar or the Transfer Agent shall on behalf of the Society issue a PIBS Certificate in respect of such holding and a PIBS Certificate in respect of the balance (if any) of the PIBS held by the relevant transferor (each of which will be made available at the offices of the Transfer Agent or the Registrar, as the case may be).

Beneficial interests in the PIBS held through accounts with Euroclear and/or Clearstream, Luxembourg will be evidenced by, and transfers thereof will be effected only through, records maintained in book-entry form by Euroclear and Clearstream, Luxembourg in accordance with the applicable procedures of Euroclear and Clearstream, Luxembourg.

5. Interest

- (1) The PIBS bear interest from and including 27 August 2004 to but excluding 27 August 2014 at the rate of 7.875 per cent. per annum and thereafter at a rate calculated in accordance with Condition 5(2) below (each a “**Rate of Interest**”), in each case payable, subject as set out below, in arrear by equal half-yearly instalments on 27 February and 27 August in each year (each an “**Interest Payment Date**”), commencing on 27 February 2005. Each half-yearly period from (and including) one Interest Payment Date to (but excluding) the next succeeding Interest Payment Date is called an “**Interest Period**”. Interest on the PIBS is non-cumulative.

Where it is necessary to calculate an amount of interest in respect of any PIBS for a period which is not an Interest Period, such interest shall be calculated on the basis of the actual number of days in the period from (and including) the most recent Interest Payment Date (or, if none, 27 August 2004) to (but excluding) the date on which the relevant interest is payable, divided by the product of (a) the actual number of days in the period from (and including) such Interest Payment Date (or, if none, 27 August 2004) to (but excluding) the next (or first) scheduled Interest Payment Date and (b) two.

- (2) (i) The Rate of Interest payable in respect of the PIBS from and including 27 August 2014 in respect of each Reset Period (as defined below) shall be determined by such leading bank or investment banking firm in London as shall be appointed by the Society (the “**Agent Bank**”) on the following basis. On the Determination Date (as defined below) relating to each Reset Period, the Agent Bank shall determine the Gross Redemption Yield (as defined below). The Rate of Interest for the relevant Reset Period shall be the aggregate of 4 per cent. per annum and the Gross Redemption Yield for that Reset Period, as determined by the Agent Bank.

In these Conditions:

“**Benchmark Gilt**” means, in respect of a Reset Period, such fixed income United Kingdom government security denominated in sterling having a maturity date on or about the last day of such Reset Period as the Agent Bank, with the advice of the Reference Market Makers, may determine to be appropriate;

“**Determination Date**” means, in relation to any Reset Period, the 45th day prior to the first day of such Reset Period; provided that if such day is not a day on which banks are open for business in London, it shall be postponed to the next such day;

“**Gross Redemption Yield**” means, in respect of a Reset Period, the gross redemption yield (as calculated by the Agent Bank on the basis set out by the United Kingdom Debt Management Office in the paper “Formulae for Calculating Gilt Prices from Yields” page 4, Section One: Price/Yield Formulae “Conventional Gilts; Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date” (published 8 June 1998 and as updated on 15 January 2002) on a semi-annual compounding basis (converted to an annualised yield and rounded up (if necessary) to four decimal places) of the Benchmark Gilt in respect of that Reset Period, with the price of the Benchmark Gilt for this purpose being the arithmetic average (rounded up (if necessary) to four decimal places) of each of the bid and offered prices of such Benchmark Gilt quoted by the Reference Market Makers at 11.00 a.m. (London time) on the relevant Determination Date on a dealing basis for settlement on the next following dealing day in London;

“**Reference Market Makers**” means three gilt edged market makers selected by the Agent Bank, failing which such other three persons operating in the gilt edged market as are selected by the Agent Bank;

“**Reset Date**” means 27 August 2014 and every fifth successive year thereafter; and

“**Reset Period**” means the period beginning on and including a Reset Date and ending on and including the day immediately preceding the next succeeding Reset Date.

- (ii) As soon as practicable after 11.00 a.m. (London time) on each Determination Date, the Agent Bank shall determine the Rate of Interest for the relevant Reset Period and calculate the amount of interest payable on each £1,000 principal amount of PIBS (the “**Interest Amount**”) on each of the 10 Interest Payment Dates that fall after the commencement of the Reset Period to which such Determination Date relates. The Society shall cause such Rate of Interest, Reset Period and each such Interest Amount to be notified to the Registrar as soon as practicable after their determination and calculation and shall procure that the Registrar gives notice thereof to the PIBS holders in accordance with Condition 13 and, so long as the PIBS are listed on the Luxembourg Stock Exchange, to the Luxembourg Stock Exchange.
- (iii) The Society may from time to time appoint any leading bank or investment banking firm in London as the Agent Bank in substitution for any existing Agent Bank. In the event of the appointed office of the Agent Bank being unable or unwilling to continue to act as the Agent Bank, the Society shall forthwith appoint the London office of such other leading bank or investment banking firm in London to act as such in its place. The Agent Bank may not resign its duties or be removed without a successor having been appointed as aforesaid.
- (iv) All notifications, opinions, advice, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 5(2) by the Agent Bank shall (in the absence of wilful default, bad faith or manifest error) be binding on the Society, the Agent Bank, the Registrar, the Transfer Agent, the Notice Agent and all PIBS holders and (in the absence as aforesaid) no liability shall attach to the Agent Bank or the Reference Market Makers in connection with the exercise or non-exercise of their powers, duties and discretions.

(3) Interest in respect of the PIBS shall not be paid or credited in respect of any Interest Period if the Society has at any time before the date for payment of that interest cancelled, or failed to make, the payment of any interest or dividend upon:

- (a) any other Share of any class (other than deferred shares (as defined in the Building Societies Act)) of the Society; or
- (b) any deposit (as defined in the Building Societies Act) with the Society,

which falls, in accordance with the terms of the Share or deposit, to be paid or credited at any time before the end of the relevant Interest Period.

For the purposes of this Condition 5(3):

- (a) where the Society has deferred or suspended or otherwise failed to make any payment it shall be taken to have cancelled and failed to make the payment only for so long as the payment remains outstanding; and
- (b) a payment is to be taken to fall to be paid or credited in circumstances where it would have so fallen but for any provisions relating thereto entitling the Society to cancel, defer or suspend payment.

If, and to the extent that, the payment or crediting of interest is prohibited under this Condition 5(3), interest in respect of the PIBS for that Interest Period will be cancelled and the PIBS holders will have no rights in respect of the cancelled interest.

(4) Interest in respect of the PIBS shall not be paid or credited for any Interest Period if the Board is of the opinion that:

- (a) there has been a failure by the Society to satisfy any requirement relating to capital adequacy imposed on the Society by or pursuant to the Financial Services and Markets Act 2000, including any statutory modification or re-enactment thereof, or any other enactment imposing capital adequacy requirements and such failure is then continuing; or
- (b) the payment or crediting of the interest or, as the case may be, the payment or crediting in full of the interest would cause or contribute to such a failure by the Society,

and, in the case of (a) above, the Board passes a resolution cancelling such interest or, in the case of (b) above, the Board passes a resolution cancelling or, as the case may require, reducing the interest to such extent as may be necessary to secure that, in the opinion of the Board, such payment would not cause or contribute to a failure to satisfy the requirement in Condition 5(4)(a). On the passing of any such resolution, each PIBS holder shall cease to have any right to the interest for that period so cancelled or, as the case may be, any interest other than the reduced amount payable in accordance with that resolution.

(5) Any amount representing principal or interest on a PIBS in respect of which no cheque has been cashed and no payment claimed shall cease to be payable after twelve years from the due date and shall revert to the Society.

6. Repayment

- (1) The PIBS constitute permanent non-withdrawable deferred shares (as defined in the Building Societies Act) in the Society and have no specified final maturity.
- (2) The Society may, having obtained Relevant Supervisory Consent (as defined in Condition 6(7)) and having given not less than 30 nor more than 60 days' notice to the PIBS holders in accordance with Condition 13 (which notice shall be irrevocable), elect to repay all, but not some only, of the PIBS on any Reset Date (as defined in Condition 5(2)) at their principal amount together, subject to Conditions 5(3) and 5(4), with any interest accrued to but excluding the date of repayment.

- (3) The PIBS will become repayable on the date that an instrument or order is made or an effective resolution is passed for the winding-up or, otherwise than by virtue of section 93(5), section 94(10), section 97(9) or section 97(10) of the Building Societies Act, dissolution of the Society but only if and subject to the condition that all sums due from the Society to Creditors claiming in the winding-up or dissolution have been paid in full.

For the purposes of these Conditions, “**Creditors**” means all creditors (including all subordinated creditors) of the Society and Shareholding Members (other than holders of deferred Shares (including the PIBS)) as regards the principal and interest due in respect of their Shares.

- (4) The claims of the PIBS holders in a winding-up or dissolution of the Society will be for the principal amount of their PIBS together, subject to Condition 5, with interest accrued to but excluding the date of repayment after all sums due from the Society to Creditors have been paid in full.
- (5) The Society may, having obtained prior Relevant Supervisory Consent, purchase any of the PIBS. In the case of purchases by tender, tenders shall be made available to all PIBS holders alike.
- (6) All PIBS repaid or purchased by the Society as aforesaid shall be cancelled forthwith and such PIBS may not be reissued or resold.
- (7) For the purposes of these Conditions, “**Relevant Supervisory Consent**” means consent by the Financial Services Authority (or any successor body performing for the time being the same or similar functions in relation to building societies (or, in the event that the Society transfers its business to a company under section 97 of the Building Societies Act, companies of that nature) in the United Kingdom) to the relevant repayment or (as referred to in Condition 6(5)) purchase.

7. Payments

All payments in respect of the PIBS will be made by sterling cheque drawn on a bank or building society in the United Kingdom, posted on the business day immediately preceding the relevant due date and made payable to the PIBS holders appearing in the PIBS Register on the Record Date (as defined below) and made payable to or to the order of the relevant PIBS holder (which shall be the person appearing in the PIBS Register in respect of the PIBS of which he is the holder at the close of business on the fifteenth day before the relevant due date (the “**Record Date**”)) at the addresses shown in the PIBS Register at the Record Date provided that payments of principal in respect of the PIBS will be made against presentation and surrender of the relevant PIBS Certificate at the specified office of the Transfer Agent or the Registrar. Upon application of a PIBS holder or the person to whose order the payment is to be made to the Society, the Registrar or the Transfer Agent in the form obtainable from the Principal Office of the Society or the specified office of the Registrar or the Transfer Agent, not less than ten days before the due date for any payment, the payment may be made by transfer on the due date or, if the due date is not a business day, on the immediately following business day to a sterling account maintained by the relevant PIBS holder or the person to whose order the payment is to be made with a bank or building society in the United Kingdom. In this Condition 7, “**business day**” means any day (other than a Saturday or a Sunday) on which banks are open for business in England. All payments in respect of the PIBS shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature (“**Taxes**”) imposed or levied by or on behalf of the United Kingdom or any political subdivision or any authority thereof or therein having power to tax, unless the withholding or deduction of the Taxes is required by law.

For a description of applicable United Kingdom Taxation Considerations see “United Kingdom Taxation” on page 55.

Notwithstanding Condition 7, all payments in respect of interests in PIBS held through Euroclear and Clearstream, Luxembourg accounts will be credited to the cash accounts of Euroclear and Clearstream, Luxembourg accountholders in accordance with each system’s rules and procedures.

8. Replacement of PIBS Certificates

A PIBS holder who has lost a PIBS Certificate shall immediately give notice in writing of such loss to the Society at its Principal Office and to the Registrar or the Transfer Agent at its specified office. If a PIBS Certificate is damaged or alleged to have been lost, stolen or destroyed, a duplicate PIBS Certificate shall be issued by the Registrar, on behalf of the Society, to the PIBS holder upon request, subject to delivery up of the old PIBS Certificate or (if alleged to have been lost, stolen or destroyed) subject to compliance with such conditions as to evidence and indemnity as the Society and the Registrar may think fit and to payment of any expenses of the Society and the Registrar in connection therewith. The duplicate PIBS Certificate will be made available at the offices of the Transfer Agent or the Registrar (as the case may be).

9. Succession and transfers

- (1) Upon an amalgamation by the Society with another building society under section 93 of and Schedule 16 to the Building Societies Act or a transfer of its engagements to any extent to another building society under section 94 of and Schedule 16 to the Building Societies Act, the PIBS shall become deferred shares in the amalgamated or transferee building society (as appropriate) without any alteration in their terms.
- (2) Upon a transfer by the Society of the whole of its business to a successor in accordance with section 97 of the Building Societies Act, the successor will, in accordance with section 100(2)(a) of the Building Societies Act, assume as from the vesting date a liability (subject to this Condition 9(2)) to every qualifying Member of the Society as in respect of a deposit made with the successor corresponding in amount to the value of the qualifying Shares held by the Member in the Society. The liability so assumed by the successor in respect of each PIBS shall be the same as the liability in respect of a nontransferable subordinated deposit carrying the same rate of interest as the PIBS ranking behind any undated subordinated debt previously issued by the Society (each a “**Subordinated Deposit**”). Each Subordinated Deposit will be applied on the vesting date (or as soon as reasonably practicable thereafter), on behalf of the PIBS holder, in the subscription of a principal amount of undated subordinated bonds of the successor ranking behind any undated subordinated debt previously issued by the Society or its successor (the “**Bonds**”) equivalent to the principal amount of the Subordinated Deposit and carrying the same Rate of Interest as the PIBS.

The terms of each Subordinated Deposit and the terms and conditions of the Bonds will be such as to secure in the opinion of the Board that they will be treated as capital designated perpetual subordinated debt (as referred to in Chapter CA of the Interim Prudential Sourcebook for Banks as replaced, amended or supplemented from time to time) or its equivalent (if any) as determined by the auditors of the Society for the purposes of capital adequacy regulations made from time to time by the Financial Services Authority or any other or successor body performing for the time being the same or similar functions in the United Kingdom in relation to companies of a similar nature.

The terms of the Subordinated Deposits and the terms and conditions of the Bonds will, not later than the time at which notice is given to Members of resolutions to be proposed to approve such transfer, be available for inspection by the PIBS holders at the Principal Office of the Society and the specified office of the Registrar at that time and, subject as provided above, will be determined by the Board in its absolute discretion.

- (3) The Society undertakes to procure that any amalgamation or transfer referred to in Condition 9(1) or (2) above will comply with the provisions of Condition 9(1) or, as the case may be, (2) above.

10. Variations of these Conditions

- (1) These Conditions may only be varied by the Society with the consent in writing of PIBS holders holding not less than three-quarters in principal amount of the PIBS for the time being outstanding or with the sanction of a resolution passed at a separate meeting of the PIBS holders held in accordance with Condition 11.

(2) The Society undertakes not to initiate any change to the Rules that is both (a) inconsistent with the provisions of these Conditions and (b) materially prejudicial to the interests of the PIBS holders in that capacity.

(3) These Conditions do not limit the rights of Members to change the Rules.

Any amendment to the Rules that is both (a) inconsistent with the provisions of these Conditions and (b) materially prejudicial to the interests of the PIBS holders in that capacity shall not limit any rights of any PIBS holder to bring an action for breach of contract against the Society in circumstances where the Society is in breach of these Conditions or afford the Society any defence to any claim made in any such action.

(4) In the event of a variation of these Conditions, notice shall be given to all PIBS holders in accordance with Condition 13.

Notwithstanding Condition 10, investors holding PIBS through Euroclear and/or Clearstream, Luxembourg accounts shall give their instructions in relation to Condition 10 to Euroclear and/or Clearstream, Luxembourg in accordance with each Clearing System's rules and procedures as appropriate.

11. Meetings of the PIBS holders

(1) The Society alone may at any time convene a separate meeting of the PIBS holders. Every meeting shall be held at such place as the Society may approve.

(2) At least 21 clear days' notice, calculated from the final date for the receipt of proxies under Condition 11(11), specifying the hour, date and place of the meeting shall be given to the PIBS holders entered in the PIBS Register 35 days prior to the date specified for the meeting by sending it by post to the addresses shown in the PIBS Register. The notice shall specify generally the nature of the business to be transacted at the meeting and the terms of any resolution to be proposed to alter these Conditions.

(3) Any person (who may, but need not, be a PIBS holder) nominated in writing by the Society shall be entitled to take the chair at every meeting but if no nomination is made or if at any meeting the person nominated shall not be present within 15 minutes after the time appointed for holding the meeting, the PIBS holders present shall choose one of their number who is present to be chairman.

(4) At any meeting one or more persons present in person or by proxy and holding or representing in aggregate not less than one-third of the principal amount of the PIBS for the time being outstanding shall form a quorum for the transaction of business and no business (other than the choosing of a chairman) shall be transacted at any meeting unless the requisite quorum shall be present at the commencement of business. Every question submitted to the meeting (other than the choosing of a chairman which will be decided by a simple majority) shall be decided by a poll of one or more persons present and holding PIBS or being proxies and representing in aggregate not less than three-quarters of the principal amount of the PIBS represented at such meeting voting in favour of such question.

(5) If within half an hour after the time appointed for any meeting a quorum is not present, the meeting shall stand adjourned for such period, being not less than 14 days nor more than 42 days and at such place as may be appointed by the chairman and if at the adjourned meeting a quorum shall not be present within half an hour from the time appointed for the adjourned meeting, the PIBS holders present in person or by proxy at the adjourned meeting shall be a quorum.

(6) Notice of any adjourned meeting shall be given in the same manner as notice of an initial meeting but as if 11 were substituted for 21 in Condition 11(2).

(7) A poll shall be taken in such manner as the chairman directs and the result of the poll shall be deemed to be the resolution of the meeting.

- (8) The chairman may with the consent of (and shall if directed by a resolution of) the meeting adjourn any meeting from time to time and from place to place but no business shall be transacted at any adjourned meeting other than business left unfinished or not reached at the meeting from which the adjournment took place.
- (9) Any director or officer of the Society and its professional advisers may attend and speak at any meeting of the PIBS holders. Save as provided above, no person shall be entitled to attend and speak nor shall any person be entitled to vote at any such meeting unless he is a PIBS holder or is a proxy thereof.
- (10) Subject as provided in Condition 11(9), at any meeting every person who is present shall have one vote in respect of each £1,000 in principal amount of the PIBS so held or in respect of which he is a proxy. Any person entitled to more than one vote need not use all his votes or cast all the votes to which he is entitled in the same way.
- (11) A PIBS holder entitled to attend a separate meeting of the Society:
 - (a) may appoint one Person (whether a PIBS holder or not) as his proxy to attend and, on a resolution, to vote at such meeting instead of him; and
 - (b) may direct the proxy how to vote at the meeting.

A proxy shall be appointed by an instrument in writing which shall be in such form and include such declarations as the Board may from time to time determine. The instrument shall enable the PIBS holder appointing the proxy to direct him how to vote and, if the instrument is not in the form specified by the Society or is not signed by the appointer, the appointment of the proxy shall be invalid. The appropriate forms of declaration shall, with such additional or amended wording as the Board may consider appropriate, be used in the case of a body corporate. If the appropriate declaration is not included in the instrument, the appointment of the proxy shall be invalid. The instrument appointing a proxy or a representative shall be deposited at the Principal Office not less than two clear days before the day appointed for holding the meeting, or adjourned meeting, and in default the instrument shall not be treated as valid. The instrument appointing a proxy shall be deemed to confer authority to demand or join in demanding a poll but, save as provided by this Condition 11(11), a proxy shall have no right to speak at the meeting. A vote given in accordance with the terms of an instrument of proxy shall be valid notwithstanding the previous death or mental disorder of the appointer or revocation of the proxy or of the authority under which the proxy was executed, or the transfer of a PIBS in respect of which the proxy is given, provided that no intimation in writing of such death, mental disorder, revocation or transfer shall have been received by the Society at its Principal Office before the commencement of the meeting or adjourned meeting at which the proxy is used.

- (12) Any resolution passed at a meeting duly convened and held in accordance with these provisions shall be binding upon all the PIBS holders whether or not present at the meeting and whether or not voting and each of them shall be bound to give effect to the resolution accordingly and the passing of any resolution shall be conclusive evidence of the circumstances justifying the passing of the resolution. Notice of any resolution duly passed by the PIBS holders shall be given in writing to each PIBS holder by the Society within 14 days of the passing of the resolution, provided that the non-publication of the notice shall not invalidate the resolution.
- (13) Minutes of all resolutions and proceedings at every meeting shall be made and duly entered in books to be from time to time provided for that purpose by the Society and any minutes purporting to be signed by the chairman of the meeting at which resolutions were passed or proceedings had shall be conclusive evidence of the matters contained in the minutes and until the contrary is proved every meeting in respect of the proceedings of which minutes have been so made and signed shall be deemed to have been duly held and convened and all resolutions passed or proceedings had to have been duly passed or had.

- (14) The accidental omission to send notice of a separate meeting or to send any document required to be sent with the notice or otherwise before the meeting to, or the non-receipt of notice of a separate meeting or any such document as aforesaid by, any person entitled to receive notices or documents shall not invalidate the proceedings at that meeting.

Notwithstanding Condition 11, investors holding PIBS through Euroclear and/or Clearstream, Luxembourg accounts shall give their instructions in relation to Condition 11 to Euroclear and/or Clearstream, Luxembourg in accordance with each Clearing System's rules and procedures as appropriate.

12. Further issues

The Society shall be at liberty from time to time without the consent of the PIBS holders to create and issue further permanent interest bearing shares either:

- (a) ranking *pari passu* in all respects (or in all respects save for the first payment of interest thereon) and so that the same shall be consolidated and form a single series with the outstanding permanent interest bearing shares of any series (including the PIBS); or
- (b) upon such other special terms of issue as the Society may at the time of issue determine provided that the Society shall not issue any further permanent interest bearing shares ranking ahead of the PIBS.

13. Notices

All notices regarding the PIBS shall be valid if sent by post to the PIBS holders at their respective addresses in the PIBS register. Any such notice shall be deemed to have been given on the second day following the mailing of such notice. In addition, if required by the rules of the Luxembourg Stock Exchange all notices will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*).

In addition, in the event that the PIBS are withdrawn from CRESTCo. but held within Euroclear and/or Clearstream, Luxembourg, investors holding PIBS through Euroclear and/or Clearstream, Luxembourg accounts shall receive notices from the Notice Agent for and on behalf of the Society in accordance with each Clearing System's rules and procedures as appropriate.

14. Governing law

The rights and obligations in respect of the PIBS are governed by, and shall be construed in accordance with, English law.

Amalgamation

Section 93 of the Building Societies Act permits a building society to amalgamate with one or more building societies by establishing a building society as their successor. Amalgamation requires a shareholding members' resolution passed by the shareholding members of each amalgamating society and by a borrowing members' resolution (as defined in Schedule 2 to the Building Societies Act) of the borrowing members of each amalgamating society and confirmation by the FSA. The Building Societies Act provides that on the date specified by the FSA all of the property, rights and liabilities (which, in the case of the Society, would include the PIBS) of each of the societies shall by virtue of the Building Societies Act be transferred to and vested in the successor, whether or not otherwise capable of being transferred or assigned. In the event of such an amalgamation by the Society with another building society, the PIBS would, pursuant to their terms, become deferred shares in the successor without any alteration of their terms.

Transfer of Engagements

Section 94 of the Building Societies Act permits a building society to "transfer its engagements to any extent" to another building society which undertakes to fulfil such engagements. A transfer requires approval by a shareholding members' resolution passed by the shareholding members of the transferor society and the transferee society, and by a borrowing members' resolution of the borrowing members of the transferor society and the transferee society. However, the resolutions of the transferee society are not required if the FSA consents to the transfer proceeding by a resolution of its board of directors only. The transfer must be confirmed by the FSA. The Building Societies Act provides that on the date specified by the FSA and to the extent provided in the instrument of transfer, the property, rights and liabilities of the transferor society shall by virtue of the Building Societies Act be transferred to and vested in the transferee society, whether or not otherwise capable of being transferred or assigned. In the event of a transfer of all or part of the property and/or all or some of the liabilities (including the PIBS) of the Society, the PIBS would, pursuant to their terms, become deferred shares in the transferee without any alteration of their terms.

Transfer of Business

Sections 97 to 102D of the Building Societies Act permit a building society to transfer the whole of its business to a company which has been specially formed by the society wholly or partly for the purpose of assuming and conducting the society's business in its place or is an existing company which is to assume and conduct the society's business in its place. The transfer must be approved by a requisite shareholding members' resolution, in accordance with Schedule 2, paragraph 30(2)-(5) of the Building Societies Act, passed by shareholding members and by a borrowing members' resolution passed by borrowing members and the society must obtain the confirmation of the FSA to the transfer and its terms. If the FSA confirms the transfer then the Building Societies Act provides that on the vesting date (as defined in the Building Societies Act) all of the property, rights and liabilities (which would include the PIBS) of the transferor society, whether or not capable of being transferred or assigned, shall by virtue of the Building Societies Act and in accordance with the transfer regulations (then in force) be transferred to and vested in the company. Pursuant to section 100(2)(a) of the Building Societies Act, the PIBS would be converted into deposits with the successor. The terms of the PIBS provide that the deposits will be subordinated and will be applied in the subscription of perpetual subordinated bonds of the successor subject as provided therein.

Where, in connection with any transfer by a building society, rights are to be conferred on members of the society to acquire shares in priority to other subscribers, the right is restricted to shareholding members of the society who have held their shares throughout the period of two years expiring on a qualifying day specified by the society in the transfer agreement. Also, all shareholding members' shares, including PIBS, are converted into deposits with the successor. On any such transfer, shareholding members of the society who were members on the qualifying date but not entitled to vote on the transfer resolution will receive a cash bonus equal to their notional share of the reserves of the society. If the transfer is to an existing

company, any distribution of funds (apart from the statutory cash bonus referred to above) may only be made to those shareholding members of the society who have held their shares for at least two years expiring on a qualifying day specified by the society in the transfer agreement.

General

The Society may, as a result of an amalgamation, transfer of engagements or transfer of business as described above, be replaced, as the principal debtor under all or some of the PIBS, by an entity substantially different in nature from the Society at present or with a substantially different capital position. In all cases the confirmation of the FSA is required before any such change can take place.

Introduction and Constitution

The Society is a building society incorporated under the Building Societies Act, as amended, for an unlimited duration. As such, it is a mutual organisation owned by its members, and is regulated by the FSA under the Register Number 269B. Its business is conducted in accordance with the Building Societies Act and its Memorandum and Rules. The Society adopted its present name in 1986 and is the result of mergers of the Chatham Reliance Building Society (established 1898) with the Dover District Building Society (established 1861) in 1977, with the Kent & Canterbury Building Society (established 1847) in 1984 and with the Herne Bay Building Society (established 1888) in 1986.

The affairs of the Society are conducted and managed by a Board of Directors who are elected and serve in accordance with the Society's Memorandum and Rules. The Board is responsible to the members of the Society for the proper conduct of affairs of the Society, and a Management Board, which reports to the Board, is responsible for the daily management of the Society.

The principal purpose of the Society as stated in Clause 2 of its Memorandum is that of making loans which are secured on residential property and are funded substantially by its members. The Group also raises funds in the wholesale money markets. It is an independent regionally based building society with a strong commitment to mutuality. Reflecting this commitment to mutuality, the Society introduced a charitable assignment scheme in June 2000 to reduce disruption to its business caused by speculators opening investment accounts in the hope of receiving a windfall conversion benefit. The PIBS are excluded from the charitable assignment scheme.

As the Society is a mutual organisation, both retail investors and borrowers with the Society have membership rights including rights to vote at general meetings of the Society as prescribed by the Society's Rules. Their eligibility to vote at general meetings is governed by the Building Societies Act and by the Society's Rules. Members are eligible to vote as an investor or borrower or both, but are only entitled to one vote except where there are separate shareholding members' and borrowing members' resolutions.

Business and Strategy of the Society

The Society's core business is the making of mortgage advances to members secured on residential property, funded out of shares and deposits subscribed by members supplemented by funds raised in the wholesale money markets. The Society's strategy for its core business is to differentiate itself from its competitors by building its brand to reflect a business built on long term relationships with members.

As at 30 September 2003, 95.6 per cent. of business assets (as prescribed by Sections 6 and 7 of the Building Societies Act) were in the form of loans fully secured on residential properties. At the same date, funding from members represented 81.9 per cent. of all shares and borrowings of the Society.

In 2002 the Society began a forward looking programme to assess its current and future capability in a rapidly evolving marketplace for its core activity. A three year plan was created to build a programme of change to modernise the Society, in particular the innovative application of technology combined with the outsourcing to India and elsewhere of administrative processes to provide capacity for growth while minimising management costs. The Society's future strategy will focus heavily on members, seeking to understand their needs and deliver solutions to create a service-based, rather than a product-based, relationship with them. The Society's investment in technology and marketing is enabling it to understand better its existing customer base as a prerequisite to building such long term relationships with its members.

The Society has significant opportunities to secure further organic growth within its core territory of Kent and the South East, where long-term member relationships have been built. The Society has undertaken a major review of its branch network, and is in the course of transferring its branches to agencies where appropriate. While a high proportion of the Society's retail funds and mortgage lending has its origin within the core territory, national press comment has resulted in wider awareness which, together with appearances in best buy tables, has generated significant business from the rest of the country.

The Society aims to continue to develop its presence in Jersey through its subsidiaries. Whilst concentrating on opportunities in the South East of England and the Channel Islands, the Society will also continue to develop business in other areas through appropriate distribution channels.

Mortgage Lending

The Group's mortgage lending activity consists mainly of the making of loans to individuals for the purchase or re-mortgage of residential property, secured by a first legal charge over the property. At 30 September 2003, loans fully secured on residential property amounted to approximately £612.8 million, comprising 95.6 per cent. of all loans and advances to members and customers. Of the Group's total residential mortgage loan portfolio at 30 September 2003, 33.5 per cent. was at fixed or capped interest rates, 13.7 per cent. was linked to the Bank of England repo rate, and 24.9 per cent. at discounted administered variable rates, with the remainder on administered variable rates. Residential mortgage products are distributed through a number of channels, including the Society's branch and agency network and direct telephone links, as well as intermediaries.

At 30 September 2003, the Group also had loans of approximately £28.3 million secured on commercial property.

Lending is conducted in accordance with Board approved lending policy statements drawn up in compliance with the Interim Prudential Sourcebook for Building Societies published by the FSA. Within the agreed policy parameters, care, prudence and control are exercised by experienced underwriting staff to ensure that the quality of lending is maintained. Despite increasing market pressures in recent years, the Society has not relaxed its underwriting criteria with the fundamental pre-requisite for new mortgages continuing to be the perceived ability of the borrower to repay.

Appropriate Excess of Loss Insurance cover is arranged for each year of lending. The scope of cover relates to primary residential mortgage advances to individuals with loan to value ("LTV") ratios of more than 75 per cent. In the minority of cases where the LTV ratio exceeds 90 per cent. (primarily for first time buyers), the Society recoups the cost of the Excess of Loss Insurance through an additional fee charged to the borrower.

Arrears and Loan Loss Provisions

The Society reports on mortgage arrears for regulatory purposes where arrears on the account represent 2.5 per cent. or more of the mortgage balance outstanding. As at 30 September 2003 only 0.13 per cent. of all mortgage advances had arrears of 2.5 per cent. or more of the balance outstanding. These arrears have reduced significantly over recent years, in part reflecting the effectiveness of the Society's ongoing commitment to proactive arrears management.

The amount of actual loss arising from default on mortgage advances in the year ended 30 September 2003 was £29,000. In that year the provision for potential future losses on default was increased by £19,000 to create carried forward provisions for bad and doubtful debts of approximately £295,000 at 30 September 2003, of which £256,000 represented a general provision. The number of mortgage accounts 12 months or more in arrears at 30 September 2003 was one. The number of properties in possession at 30 September 2003 was three.

Other Income

In addition to net interest receivable, the Group has other sources of income. These include valuation and administration and related fees, and insurance commissions.

Liquidity

The Society, in common with other building societies, is required by the FSA, in accordance with the Interim Prudential Sourcebook for Building Societies, to maintain adequate assets in the form of cash or other liquid form. The classes of instrument which may be treated by the Society as liquid assets for these purposes are prescribed by the FSA, and include cash balances, advances to credit institutions and certain debt securities.

The Group's liquid assets for these purposes stood at £190.6 million at 30 September 2003, representing 24.08 per cent. of the total shares and borrowings of the Group at that date.

In addition the Society maintains standby liquid facilities with a range of credit institutions (amounting to £75 million at 30 September 2003).

Group Funding

The Society's activities are funded through a mixture of retail and non-retail funding. The proportion of retail to non-retail funds varies from time to time depending on market conditions. At 30 September 2003 the Group's total share and deposit liabilities ("SDL") were £791.5 million of which retail balances amounted to £648.2 million, representing 81.9 per cent. of SDL as at that date.

Retail Funding

The Society offers its members and potential members a range of share account and investment products covering both fixed and variable rates and varying notice periods. The Society's retail funding is obtained in part through direct contact with members through the Society's head office as a result of advertising and marketing activities and in part through the branch and agency network. In the year to 30 September 2003 the Society achieved a net increase in retail savings balances of £215.4 million, the majority being secured through advertising and marketing activities.

Non-Retail (Wholesale) Funding

The Society is an active participant in the wholesale money markets. The Society increased its non-retail funding by a total of £7.4 million in the year to 30 September 2003. The Society transacts with a range of counter-parties.

Capital Base

At 30 June 2004 the consolidated gross and free capital ratios of the Group, as calculated for the purposes of the Building Societies (Accounts and Related Provisions) Regulations 1998, were as follows:

	%
Gross capital ratio	5.92
Free capital ratio	5.52
Other capital ratios are set out below:	
Total capital (i) as a percentage of risk weighted assets (ii)	11.44
Tier 1 capital (iii) as a percentage of risk weighted assets	6.87

For the purpose of these capital ratios:

- (i) "Total capital" represents the aggregate of Group general reserves, subordinated liabilities and general provisions for bad and doubtful debts;
- (ii) "Risk weighted assets" represent Group assets weighted according to risk category as stated in Annex 1B of the Interim Prudential Sourcebook for Building Societies issued by the FSA; and
- (iii) "Tier 1 Capital" represents Group general reserves.

Subsidiaries

The following are the principal operating subsidiaries of the Society:

<i>Name of Subsidiary</i>	<i>Principal Activity</i>	<i>Country of Registration</i>	<i>Interest of the Society</i>	<i>Class of Shares Held</i>	<i>Commenced Trading</i>
Jersey Home Loans Limited	Secured lending on land and buildings	England and Wales	100%	Ordinary	September 2002
Jersey Home Loans Limited	Secured lending on and and buildings	Jersey	100%	Ordinary	January 2004

Directors and Employees

The Directors

At the date of this circular the Society has nine directors, comprising six non-executive directors and three executive directors who are the Society's most senior executives. Brief details of the directors are set out below:

John P Cheele MBA Chairman (Aged 67)

John Cheele is a business consultant specialising in corporate governance. He has served as a director on a variety of other boards. He gained a Master's degree from Exeter University in 1991, joining the Society's Board in that year. He was first elected Chairman in 1996. His business management career spanned almost 30 years and from 1975 to 1987 he was Chief Executive of the M P Harris Group of builders' merchants. He served as Master of the Worshipful Company of Builders Merchants in 2002-3. He chairs the Remuneration and Nomination Committees.

Chris Byrne LLB Vice Chairman (Aged 58)

Chris Byrne is a Solicitor and Notary Public and is a partner in the Kent based solicitors Messrs Girlings. He is non-executive Vice Chairman of the Society having been appointed a director in 1979. He chairs the Mortgage Committee and is a member of the Remuneration and Establishment Committees.

David Kemp (Aged 56)

David Kemp was formerly the Chief Executive of the Herne Bay Building Society. Following the merger with the Chatham Reliance Building Society he became Operations Director until becoming a non-executive in 1990. He is Chairman of the Audit Committee and is a member of the Remuneration and Establishment Committees. David is the Diocesan Secretary for the Diocese of Canterbury.

Mike Lazenby FCIB FRSA (Aged 49)

Mike Lazenby joined the Society as Chief Executive in April 2000. Formerly Marketing Director with the Nationwide Building Society and Managing Director of UCB Home Loans Corporation Limited he has extensive knowledge of the industry. Prior to joining Nationwide in 1991 he spent 18 years with Midland Bank plc and one year with Standard Chartered Bank rising to a senior management position in corporate banking. His career has led to Board level responsibilities for business development, marketing, public relations, sponsorship and community affairs. He is a member of the Asset and Liability Committee, the Mortgage Committee and the Establishment Committee.

Malcolm Mackenzie BA (Aged 56)

Malcolm Mackenzie joined the Board in 2002. After 16 years as an officer with the British Army, Malcolm joined an underwriting agency at Lloyd's of London ultimately becoming Chief Executive. Subsequently he became Chief Executive of another Lloyd's agency and also served as Chairman of the Lloyd's Underwriting Agents' Association and as a member of the Lloyd's Market Board. He has overseen a number of successful IT implementations and the development and implementation of strategy in times of strong growth and change. He is founder and Director of MacKenzie Health Limited and Director of Seaforth Brook Limited and is a trustee of the Tank Museum. He is a member of the Mortgage Committee and the IT Project Group.

Anne-Marie Nelson CBE DL MA (Aged 63)

Anne-Marie Nelson brings to the Board considerable experience at chairman and director level of various employing organizations, serving the community in the fields of health, education, training and economic development. She currently chairs the Board of the University of Greenwich and two micro companies specialising in people development. She is a member of the Kent & Medway Learning and Skills Council and a Trustee of the Kent Community Foundation. Appointed to the Board in 1995 she has served on the Mortgage Committee and is currently a member of the Audit Committee.

Alan Palmer FCA FCT (Aged 59)

Alan Palmer joined the Board in 2002. After qualifying as a chartered accountant, Alan worked with a Canadian investment bank before joining the Commercial Union Group where he enjoyed a career spanning more than thirty years at increasingly senior levels. This included 12 years as Director of its investment arm, CU Investment Management Limited. Alan is currently Secretary of the Department of Constitutional Affairs' Strategic Investment Board and a Director of G-Mex Limited. He brings to the Board considerable financial expertise and City experience, coupled with a broad strategic outlook. He is a member of the Asset and Liability and Audit Committees.

Rob Procter BA FCIB (Aged 46)

Rob Procter joined the Society in 1989 and is Managing Director of the Society's wholly-owned subsidiary Jersey Home Loans Limited. He was appointed to the Board in 2004 as Deputy Chief Executive. He is a member of the Asset and Liability Committee and the Mortgage Committee.

Bob Scruton MSc FCA (Aged 52)

Bob Scruton is an accountant by profession. He joined the Society as Secretary in 2002 and was appointed to the Board as Finance Director in 2004. He is a member of the Asset and Liability Committee.

Management Board

Mike Lazenby FCIB FRSA	Chief Executive
Rob Procter BA FCIB	Deputy Chief Executive
Les Davies MAAT	Head of Treasury
Phil Sanders FCIB	Secretary and Head of Compliance
Bob Scruton MSc FCA	Finance Director

Employee Numbers

During the year to 30 September 2003, the Group employed an average of 76 full time and 75 part time employees. For the financial year ended 30 September 2002 the corresponding figures were 55 full time and 84 part time employees. This increase in employee members is attributable to the investments made by the Society in providing higher service levels for members. Employee numbers have since decreased and will decrease further as administrative processes are outsourced.

Certain Provisions of the Rules relating to the Directors

The Rules contain, *inter alia*, the following provisions in relation to the Directors:

Notwithstanding his interest, a Director may be counted in the quorum present at any meeting at which he or any other Director is appointed to hold any office or place of profit with the Society or with any body corporate in which the Society is, or will be, interested or at which the terms of any such appointment are arranged. He may vote on any such appointment or arrangement other than his own appointment or the arrangement of the terms of that appointment.

In addition, subject to a Director complying with the provisions for the time being of the Statutes (as specified in the Rules), he may enter into or be interested, whether directly or indirectly, in contracts with the Society and shall not be disqualified from office as a result of his interest, nor shall he be liable to account to the Society for any profit arising out of any such contract to which he is a party or in which he is interested by reason of his being at the same time a Director. Except for those circumstances, no Director may vote as a Director in regard to any contract, or proposal for a contract, in which he is interested, whether directly or indirectly, or upon any matter arising out of it. A contract includes any transaction or arrangement.

All powers of the Society to borrow money are exercisable by the Directors.

The Board may determine from time to time the annual remuneration of the Directors as members of the Board (exclusive of any remuneration paid in respect of executive duties) which shall be paid at a rate not exceeding 5p per £100 of total assets of the Society as at the first day of the Financial Year (as defined in the Rules) in which payment is made, together with such reasonable travelling, accommodation and other expenses as might be incurred while attending business of the Society with the approval of the Board.

The Board may also resolve that a Director may be paid for professional or other work done by him on behalf of the Society in addition to his usual services as a Director. The Board may provide, establish, maintain and administer pension, life assurance, sickness, annuity and other funds or schemes (whether contributory or not) for the benefit of past, present or future directors of the Society and any society with which the Society may merge in the future and their spouses, children and dependents. In addition, the Board may grant pensions, allowances, gratuities, donations and bonuses to such persons.

A Director shall cease to hold office upon attaining the age of 70 years.

Recent Developments

There has been no material change in the nature of the Group's business since 30 September 2003. The plans to transfer branch offices to agencies have been developed further and most are expected to be implemented by the end of the financial year. In addition the modernisation programme has continued with the emphasis on reviewing the Group's administrative structures and processes in order to minimise management costs in the medium term. There has been a further growth in retail lending and at 30 June 2004 the (unaudited) total mortgage lending net of provisions stood at £765.9 million: an increase of £124.8 million over the 30 September 2003 figure of £641.1 million. Details of funding as at 30 June 2004 are set out on page 28.

CAPITALISATION AND INDEBTEDNESS

The following table is a summary of the Consolidated Shareholders' Funds and Indebtedness of the Group as shown in the unaudited Consolidated Balance Sheet as at 30 June 2004, unadjusted for the proposed issue of the PIBS:

	<i>Group £m</i>
Shareholders' funds	
Share accounts	747.0
Subscribed capital	—
General reserves	30.9
Total shareholders' funds	<u>777.9</u>
Other indebtedness	
Amounts owed to credit institutions	29.2
Amounts owed to other customers	73.5
Subordinated liabilities	19.9
Accruals	1.2
Total indebtedness	<u>123.8</u>
Total capitalisation and indebtedness	<u>901.7</u>

The Society, as a building society, is a mutual organisation and, unlike a company incorporated under the Companies Act 1985, does not have equity shareholders in the usual sense. A share in the Society is not the same as a share in a company and the voting power is not weighted according to the number or value of shares held. Holders of investment shares may withdraw funds from their share accounts, subject to the Rules and the terms upon which their shares are issued. Depositors with, and lenders to, the Society are not members and accordingly have no voting rights.

Save for the proposed issue of the PIBS, there has been no material change to the consolidated capitalisation and indebtedness of the Group since 30 June 2004.

GROUP FINANCIAL STATEMENTS

The information on pages 29 to 31 has been extracted without material adjustment from figures appearing in the Annual Report and Accounts for the Society for the year ended 30 September 2003.

Consolidated Income and Expenditure Accounts

	<i>Notes</i>	<i>2003</i>	<i>2002</i>
		<i>£'000</i>	<i>£'000</i>
Interest receivable and similar income	2	31,845	27,586
Interest payable and similar charges	3	<u>(22,788)</u>	<u>(19,384)</u>
Net interest receivable		9,057	8,202
Fees and commissions receivable		1,879	733
Fees and commissions payable		<u>(1,527)</u>	<u>(562)</u>
Total income		9,409	8,373
Administrative expenses	4	(6,197)	(4,985)
Depreciation and amortisation	13	<u>(595)</u>	<u>(359)</u>
		2,617	3,029
Provision for bad and doubtful debts	11	<u>(48)</u>	<u>(42)</u>
Profit on ordinary activities before tax		2,569	2,987
Tax on profit on ordinary activities	7	<u>(770)</u>	<u>(896)</u>
Profit for the financial year	21	<u><u>1,799</u></u>	<u><u>2,091</u></u>

The above results are derived wholly from continuing operations. The Society's subsidiary Jersey Home Loans Ltd., commenced trading on 27 September 2002. No amount was included within the results for the year to 30 September 2002 in respect of Jersey Home Loans Ltd due to its immateriality and accordingly the results of the Group and Society were the same.

There have been no recognised gains or losses other than the profit for the financial year.

Consolidated Balance Sheet

	<i>Notes</i>	<i>2003</i> <i>£'000</i>	<i>2002</i> <i>£'000</i>
Assets			
Liquid assets			
Cash in hand and balances with the Bank of England		1,764	15,018
Loans and advances to credit institutions	8	188,823	107,032
Debt securities	9	0	1,028
		190,587	123,078
Loans and advances to customers			
Loans fully secured on residential property	10	612,809	453,528
Other loans	10	28,274	28,515
		641,083	482,043
Tangible fixed assets	13	4,009	3,096
Other assets	14	8	85
Prepayments and accrued income	15	2,269	1,602
Total assets		<u>837,956</u>	<u>609,904</u>
Liabilities			
Shares	16	648,167	432,795
Amounts owed to credit institutions	17	51,254	134,019
Amounts owed to other customers	18	92,117	1,993
		791,538	568,807
Other liabilities	19	982	570
Accruals and deferred income		731	521
Subordinated liabilities	20	14,900	12,000
		808,151	581,898
Reserves			
General reserve	21	29,805	28,006
Total liabilities		<u>837,956</u>	<u>609,904</u>

The accounts and annual business statement were approved by the board of directors on 25 November 2003.

J P Cheele
D S Kemp
M J Lazenby

Chairman
Audit Committee Chairman
Chief Executive

Consolidated Cash Flow Statement

	2003 £'000	2002 £'000
Net cash inflow from operating activities	20,892	64,301
Taxation	(409)	(1,005)
Capital expenditure and financial investment:		
Purchase of tangible fixed assets	(1,508)	(1,144)
Disposal of tangible fixed assets	0	473
Net cash outflow from purchase of portfolio of receivables	0	(53,453)
Proceeds of issue of subordinated liabilities	2,900	12,000
Increase in cash	<u>21,875</u>	<u>21,172</u>
Reconciliation of operating profit to net cash inflow from operating activities		
Operating profit	2,569	2,987
Increase in prepayments and accrued income	(3,014)	(897)
Increase/(decrease) in accruals and deferred income	210	(636)
Provisions for bad and doubtful debts	48	(13)
Depreciation	595	359
Net cash inflow from trading activities	<u>408</u>	<u>1,800</u>
Movement in:		
Loans and advances to customers	(156,934)	(129,251)
Repayment of other loans	241	0
Shares	215,372	67,376
Amounts owed to credit institutions and other customers	7,359	128,213
Loans and advances to credit institutions and other customers	(46,662)	(4,054)
Debt securities	1,028	237
Other liabilities	51	(20)
Other assets	29	0
Net cash inflow from operating activities	<u>20,892</u>	<u>64,301</u>
Analysis of increase in cash		
Cash balances at 30 September 2002	38,858	17,686
Net increase for the year	21,875	21,172
Cash balances at 30 September 2003	<u>60,733</u>	<u>38,858</u>
Being:		
Cash in hand and balances with the Bank of England	1,764	15,018
Loans and advances to credit institutions repayable on demand	58,969	23,840
	<u>60,733</u>	<u>38,858</u>

NOTES TO THE ACCOUNTS

The following are notes to the accounts as extracted from the Annual Report and Accounts of the Society for the year ended 30 September 2003, with references therein to page numbers amended to accord to the page numbering used in this document.

1. Accounting Policies

(a) *Basis of preparation*

The accounts have been prepared under the historical cost convention and in accordance with the Building Societies (Accounts and Related Provisions) Regulations 1998 and applicable accounting standards.

(b) *Basis of consolidation*

The Group accounts include the results of the Society and its subsidiary undertakings. In the Society accounts investments in subsidiary undertakings are stated at cost less provision for any impairment.

(c) *Deferred taxation*

Deferred taxation is provided at tax rates expected to be applicable when a liability or asset crystallises, on a non-discounted basis, on all timing differences between the recognition of gains and losses in the accounts and their recognition in a tax computation where this results in an obligation or right to pay more or less tax in the future. Deferred tax assets are recognised only to the extent that there will be sufficient taxable profits available against which they can be offset in the future.

(d) *Premiums on the acquisition of mortgage portfolios*

Premiums arising on the acquisition of mortgage portfolios are capitalised and included in prepayments in the balance sheet. They are amortised over the expected life of the mortgage against interest receivable.

(e) *Fixed assets and depreciation*

The balance sheet fixed asset value represents original cost less cumulative depreciation. The cost less estimated residual value of fixed assets is depreciated on a straight-line basis over their estimated useful lives as follows:

Freehold and long leasehold buildings	50 years
Short leasehold premises	over the remainder of the lease
Computer equipment	3 to 5 years
Other equipment, fixtures and vehicles	5 years

Freehold and long leasehold land is not depreciated.

The cost of repairs and renewals is charged to the income and expenditure account in the year in which the expenditure is incurred.

(f) *Liquid assets*

Debt securities intended for use on a continuing basis in the Society's activities are classified as financial fixed assets and are stated at cost. Premiums or discounts are amortised over the period to maturity.

(g) *Pension costs*

The Society operated a defined benefit pension scheme and a group personal pension plan for staff until 31 December 2001, and a defined contribution scheme from 1 January 2002. The assets of all arrangements are held separately from those of the Society in independently administered funds. Contributions to the defined benefit pension scheme were charged to the income and expenditure account so as to spread the cost of the pensions over the employees' working lives with the Society. Contributions to the group personal pension plan and the defined contribution scheme are charged to the income and expenditure account as incurred.

1. Accounting Policies (continued)

(h) *Leased assets*

Assets financed by leasing arrangements (“finance leases”) are included in the balance sheet at cost less depreciation in accordance with Society’s accounting policy for fixed assets and depreciation. Future instalments under such leases, net of finance charges, are included in other liabilities. The finance charges element of rental obligations is charged to the income and expenditure account at a constant annual rate.

(i) *Incentives to borrowers*

Interest discounts are accounted for within interest receivable over the period of the discount. Other incentives are included within fees and commissions payable in the year in which they are incurred.

(j) *Off balance sheet instruments*

Interest rate contracts, which are classified as hedging contracts, are valued. Income and expenditure is recognised on an equivalent basis to the underlying assets or liabilities.

(k) *Provisions for loans and advances*

Provisions are made to reduce the value of advances and loans to the amount which the directors consider is likely ultimately to be received.

Throughout the year and at the year end individual assessments are made of all advances and loans on properties which are in possession, or in arrears by more than 2.5 per cent. of the outstanding balance. Specific provision is made against those advances which are considered to be impaired. In considering the specific provision for impaired loans, account is taken of any discount which may be needed against the value of the property at the balance sheet date to agree a sale within three months of that date, the amounts recoverable under mortgage indemnity policies and anticipated realisation costs.

A general provision is made against those advances which have not been specifically identified as impaired but where the Society’s experience and the general economic climate would indicate that losses may ultimately be incurred.

Interest in respect of all loans is credited to the income and expenditure account as it becomes receivable except in respect of advances where the property has been taken into possession and where the collectability of the interest is subject to significant doubt. Such interest is credited to the interest suspense account.

Loans to customers are shown in the balance sheet net of specific and general provisions and net of the balance in the interest suspense account. The charge or credit to the income and expenditure account represents new or additional provisions made less any recoveries of amounts previously provided.

2. Interest Receivable and Similar Income

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£’000</i>	<i>£’000</i>
On loans fully secured on residential property	23,662	18,304
On other loans	2,047	1,822
On debt securities:		
Interest and other income	0	10
On other liquid assets:		
Interest and other income	6,136	7,450
	<u>31,845</u>	<u>27,586</u>

There is no interest requiring suspension on non performing loans at year end (2002: £Nil).

3. Interest Payable and Similar Charges

	<i>Group</i>	
	<u>2003</u>	<u>2002</u>
	<i>£'000</i>	<i>£'000</i>
On shares held by individuals	16,599	16,098
On deposits and other borrowings	5,470	2,962
Net expenditure on financial instruments	<u>719</u>	<u>324</u>
	<u><u>22,788</u></u>	<u><u>19,384</u></u>

4. Administrative Expenses

	<i>Group</i>	
	<u>2003</u>	<u>2002</u>
	<i>£'000</i>	<i>£'000</i>
Staff costs	3,814	2,969
Remuneration of auditors – audit services	60	40
Remuneration of auditors – non-audit services	14	13
Other administrative expenses	2,246	1,897
Operating lease rentals – plant and machinery	<u>63</u>	<u>66</u>
	<u><u>6,197</u></u>	<u><u>4,985</u></u>

5. Staff Numbers and Costs

The average number of persons employed (including executive directors) during the year was as follows:

	<i>Full-time</i>		<i>Part-time</i>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
	<i>Number</i>	<i>Number</i>	<i>Number</i>	<i>Number</i>
Principal office and administration centre	66	49	15	11
Branch offices	<u>10</u>	<u>6</u>	<u>60</u>	<u>73</u>
	<u><u>76</u></u>	<u><u>55</u></u>	<u><u>75</u></u>	<u><u>84</u></u>

The aggregate costs of these persons were:

	<u>2003</u>	<u>2002</u>
	<i>£'000</i>	<i>£'000</i>
Salaries	3,329	2,994
Social security costs	265	165
Other pension costs	<u>220</u>	<u>(190)</u>
	<u><u>3,814</u></u>	<u><u>2,969</u></u>

Other pension costs above includes a provision release of £100,000 (2002: release of £400,000) in respect of an anticipated position on winding up the Society's defined benefit staff pension scheme. This is explained further at Note 24.

6. Directors' Emoluments and Transactions

	<i>Salary & fees £'000</i>	<i>Bonus £'000</i>	<i>Taxable benefits £'000</i>	<i>Contribution to personal pension policy £'000</i>	<i>Total £'000</i>
Executive directors' emoluments					
M J Lazenby	139	11	0	17	167
P G Bridgman (from 25 February 2003)	49	0	0	5	54
Total executive emoluments 2003	<u>188</u>	<u>11</u>	<u>0</u>	<u>22</u>	<u>221</u>
Total executive emoluments 2002	<u>168</u>	<u>31</u>	<u>10</u>	<u>15</u>	<u>224</u>
Non-executive directors' emoluments					
J P Cheele (Chairman)	27	0	0	0	27
C J Byrne	22	0	0	0	22
D S Kemp	22	0	0	0	22
M S MacKenzie	19	0	0	0	19
Mrs A S Nelson	19	0	0	0	19
A H Palmer	19	0	0	0	19
Total non-executive emoluments 2003	<u>128</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>128</u>
Total non-executive emoluments 2002	<u>81</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>81</u>
Total directors' emoluments 2003	<u>316</u>	<u>11</u>	<u>0</u>	<u>22</u>	<u>349</u>
Total directors' emoluments 2002	<u>249</u>	<u>31</u>	<u>10</u>	<u>15</u>	<u>305</u>

At 30 September 2003 there were outstanding loans granted in the ordinary course of business to 5 (2002: 5) directors and their connected persons amounting to £889,620 (2002: £517,220). Details of all such contracts and loans are contained in a register which will be available for inspection by members at the Society's head office for a period of 15 days up to and including the Annual General Meeting.

7. Tax on Profit on Ordinary Activities

	<i>Group</i>	
	<i>2003 £'000</i>	<i>2002 £'000</i>
UK corporation tax	693	758
Adjustment in respect of prior periods	0	(12)
Deferred taxation (see note 14)	77	150
	<u>770</u>	<u>896</u>
Factors affecting the tax charge for the year:		
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK at 30% (2002: 30%)	770	896
Effect of:		
Disallowed expenses and non-taxable income	9	22
Capital allowances in excess of depreciation	(55)	(10)
Reversal of timing difference from prior period	(23)	0
Marginal relief	(8)	0
Adjustments in respect of prior years	0	(12)
Current tax charge for the year	<u>693</u>	<u>896</u>

8. Loans and Advances to Credit Institutions

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Loans and advances to credit institutions have a remaining maturity as follows:		
Accrued interest	804	442
Repayable on demand	58,969	23,840
In not more than three months	107,050	72,750
In more than three months but not more than one year	22,000	9,000
In more than one year but not more than five years	0	1,000
	<u>188,823</u>	<u>107,032</u>

9. Debt Securities

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Issued by borrowers other than public bodies	0	1,028
	<u>0</u>	<u>1,028</u>

Debt securities, all of which are unlisted all have a remaining maturity of less than one year.

Movements in financial fixed assets during the year are analysed as follows:

	<i>Group</i>	
	<i>Cost</i>	<i>Maturity value</i>
	<i>£'000</i>	<i>£'000</i>
At 1 October 2002	1,028	1,000
Disposals	(1,028)	(1,000)
At 30 September 2003	<u>0</u>	<u>0</u>

10. Loans and Advances to Customers

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Loans fully secured on residential property	612,809	453,528
Other loans fully secured on land	28,274	28,382
Other loans	0	133
	<u>641,083</u>	<u>482,043</u>

10. Loans and Advances to Customers (continued)

Maturity analysis

Advances secured on residential property and other loans are repayable from the date of the balance sheet as follows:

	<i>Group</i>	
	<u>2003</u>	<u>2002</u>
	<u>£'000</u>	<u>£'000</u>
In not more than three months	333	358
In more than three months but not more than one year	3,197	1,290
In more than one year but not more than five years	22,090	21,672
In more than five years	<u>615,758</u>	<u>458,999</u>
	641,378	482,319
Less provisions (see Note 11)	<u>(295)</u>	<u>(276)</u>
	<u><u>641,083</u></u>	<u><u>482,043</u></u>

It should be noted that this analysis may not reflect actual experience of repayments, since many mortgage loans are repaid early.

11. Provision for Bad and Doubtful Debts

Provision against loans and advances to customers has been made as follows:

	<i>Loans fully secured on residential property £'000</i>	<i>Other loans fully secured on land £'000</i>	<i>Total £'000</i>
At 1 October 2002			
– general provision	120	120	240
– specific provision	36	0	36
Charge/(credit) for the year	<u>128</u>	<u>(109)</u>	<u>19</u>
At 30 September 2003	<u><u>284</u></u>	<u><u>11</u></u>	<u><u>295</u></u>
Being			
– general provision	245	11	256
– specific provision	<u>39</u>	<u>0</u>	<u>39</u>
	<u><u>284</u></u>	<u><u>11</u></u>	<u><u>295</u></u>
The charge in the income and expenditure account comprises:			
– general provision	125	(109)	16
– specific provision	<u>3</u>	<u>0</u>	<u>3</u>
Provisions for bad and doubtful debts	128	(109)	19
Adjustments have been made in respect of:			
– write-offs	30	0	30
– recoveries	<u>(1)</u>	<u>0</u>	<u>(1)</u>
	<u><u>157</u></u>	<u><u>(109)</u></u>	<u><u>48</u></u>

12. Investments

On 27 September 2002 the Society's wholly owned subsidiary, Jersey Home Loans Limited ("JHL"), commenced trading following the purchase of a portfolio of receivables in Jersey.

The Society has the following wholly owned subsidiaries:

	<i>Class of shares</i>	<i>Activity</i>	<i>Country of registration</i>
Jersey Home Loans Ltd	Ordinary	Mortgage provider	England
Jersey Property Loans Ltd	Ordinary	Dormant	England
Guernsey Home Loans Ltd	Ordinary	Dormant	England
Guernsey Property Loans Ltd	Ordinary	Dormant	England

During the year the Society disposed of its investment in Mutual Vision Technologies Ltd ("MVT") at cost. The loan made by the Society to MVT was repaid in full.

13. Tangible Fixed Assets

<i>Group</i>	<i>Freehold and long leasehold land and buildings £'000</i>	<i>Leasehold under 50 years unexpired £'000</i>	<i>Equipment, fixtures and vehicles £'000</i>	<i>Total £'000</i>
Cost				
At 1 October 2002	1,737	143	2,191	4,071
Additions	0	0	1,508	1,508
At 30 September 2003	<u>1,737</u>	<u>143</u>	<u>3,699</u>	<u>5,579</u>
Depreciation and amortisation				
At 1 October 2002	62	79	834	975
Charged in year	19	10	566	595
At 30 September 2003	<u>81</u>	<u>89</u>	<u>1,400</u>	<u>1,570</u>
Net book value				
at 30 September 2003	<u>1,656</u>	<u>54</u>	<u>2,299</u>	<u>4,009</u>
at 30 September 2002	<u>1,675</u>	<u>64</u>	<u>1,357</u>	<u>3,096</u>

The net book value of land and buildings occupied by the Society for its own activities is analysed as follows:

	<i>2003 £'000</i>	<i>2002 £'000</i>
Freehold	1,656	1,572
Long leasehold	0	103
Short leasehold	54	64
	<u>1,710</u>	<u>1,739</u>

14. Other Assets

Other assets represents a deferred tax asset as analysed below:

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Accelerated capital allowances	(71)	(17)
General provision	79	72
Pensions and other post-retirement benefits	0	30
Deferred tax asset	<u>8</u>	<u>85</u>

15. Prepayments and Accrued Income

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Premium on acquisition of mortgage portfolio	738	582
Prepayments	<u>1,531</u>	<u>1,020</u>
	<u>2,269</u>	<u>1,602</u>

16. Shares

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Shares held by individuals	<u>648,167</u>	<u>432,795</u>
Repayable from the date of the balance sheet in the ordinary course of business as follows:		
Accrued interest	8,831	5,832
In not more than three months	<u>639,336</u>	<u>426,963</u>
	<u>648,167</u>	<u>432,795</u>

17. Amounts Owed to Credit Institutions

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Repayable from the date of the balance sheet in the ordinary course of business as follows:		
Accrued interest	304	987
In not more than three months	24,100	71,482
In more than three months but not more than one year	26,250	61,550
In more than one year but not more than five years	<u>600</u>	<u>0</u>
	<u>51,254</u>	<u>134,019</u>

18. Amounts Owed to Other Customers

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Repayable from the date of the balance sheet in the ordinary course of the business as follows:		
Accrued interest	497	11
In not more than three months	42,870	1,982
In more than three months but not more than one year	47,750	0
In more than one year but not more than five years	1,000	0
	<u>92,117</u>	<u>1,993</u>

19. Other Liabilities

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Falling due within one year		
Corporation tax	672	311
Other creditors	310	259
	<u>982</u>	<u>570</u>

20. Subordinated Liabilities

The Society has entered into two subordinated debt issues. The first is for £5,000,000 with a final maturity in 2017 and a coupon linked to the the average standard mortgage rate of the five largest building societies. The second issue is for £10,000,000 (of which £7,000,000 had been drawn at 30 September 2002 and a further £2,900,000 was drawn on 26 September 2003) with a final maturity in 2024, and a coupon linked to the Treasury benchmark gilt.

The rights of repayment of the holders of these issues are subordinated to the claims of all depositors, all creditors and members holding shares in the Society as regards the principal of their shares and interest due on them.

21. General Reserve

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
At 1 October 2002	28,006	25,915
Profit for the financial year	1,799	2,091
At 30 September 2003	<u>29,805</u>	<u>28,006</u>

22. Guarantees and Other Financial Commitments

- The Society has a contingent liability in respect of contributions to the Financial Services Compensation Scheme under the provisions of the Financial Services and Markets Act 2000.
- The Society has a contingent liability in respect of an employment dispute. A senior member of staff was made redundant and the Society offered a significant payment, above the statutory minimum, which has been fully provided for in these Accounts. The offer has been rejected and the employee has made a material claim against the Society. The directors consider the claim to be without foundation and intend to vigorously defend it. Having taken legal advice the directors are satisfied that the amount of any settlement is unlikely to be significantly different from the amount already provided in the Accounts.

22. Guarantees and Other Financial Commitments (continued)

(c) There were no capital commitments for the Group contracted but not provided for as at 30 September 2003.

(d) Operating leases

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Payments committed at the end of the year in respect of the next financial year:		
Land and buildings		
Expiring within 1 to 5 years	48	45
Expiring after 5 years	33	36
	<u>81</u>	<u>81</u>

23. Financial Instruments

A financial instrument is one which gives rise to a financial asset or a financial liability. The Society is a retailer of financial instruments in the form of mortgages, savings and insurance products. The Group also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and to manage the risks arising from its operations.

The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates and other control procedures. The structure is reviewed regularly by the Asset and Liability Committee ("ALCO") which is charged with the responsibility for managing and controlling the balance sheet exposures of the Group. The ALCO reports to the Board on a monthly basis.

Instruments used for risk management purposes include derivative financial instruments ("derivatives") which are contracts whose value is derived from one or more of underlying price, rate or index inherent in the contract or agreement, such as interest rates. Derivatives are solely used by the Group, in accordance with the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors specified in the legislation. Derivatives are not used for speculative purposes.

At the year end, the contract or underlying principal amount of derivative financial instruments, together with their risk weighted amount and replacement cost were:

	<i>Group</i>	
	<i>2003</i>	<i>2002</i>
	<i>£'000</i>	<i>£'000</i>
Notional principal amount	31,800	32,800
Risk weighted amount	347	49
Replacement cost	<u>158</u>	<u>0</u>

The risk weighted amount of interest rate contracts has been calculated in accordance with the EC Solvency Ratio Directive. The replacement cost has been obtained by marking to market contracts and aggregating those with a positive value.

Risk Management

The main financial risks arising from the Group's activities are credit risk, liquidity risk, operational risk and interest rate risk. The Board determines policies for each of these risks and these are summarised below:

Credit Risk

All loan applications are assessed with reference to the Group's lending policy. Changes to policy are approved by the Board and the approval of loan applications is mandated. The ALCO is responsible for approving treasury counterparties.

23. Financial Instruments (continued)

Liquidity Risk

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets, through wholesale funding facilities and through control of the growth of the business.

Operational Risk

Operational risk, which is inherent in all business activities, is the direct or indirect loss resulting from inadequate or failed internal process, people and systems or from external events. It can occur in any of the Group's businesses and includes errors, omissions, natural disasters and deliberate acts such as fraud. The Group manages this risk within an overall governance and control strategy. Within this structure, potential risk exposures are assessed to determine the appropriate type of controls to be applied. It is recognised that such risks can never be entirely eliminated and that the cost of controls in minimising these risks may outweigh the potential benefits. However, where required, the Group continues to invest in risk management and mitigation such as business continuity management and incident management. Independent assessment of the effectiveness of the management of operational risk is undertaken by the Internal Audit function.

Interest Rate Risk

The Group is exposed to movements in interest rates and manages the exposure on a continuous basis within limits set by the Board, using both on and off balance sheet instruments.

The interest rate sensitivity exposure of the Group at 30 September 2003 was as follows:

	<i>Not more than three months</i> £'000	<i>More than three months but not more than six months</i> £'000	<i>More than six months but not more than one year</i> £'000	<i>More than one year but not more than five years</i> £'000	<i>More than five years</i> £'000	<i>Non-Interest bearing</i> £'000	<i>Total</i> £'000
Assets							
Liquid assets	172,482	11,000	6,000	0	0	1,105	190,587
Loans and advances to customers	428,195	2,913	6,952	171,955	28,721	2,347	641,083
Tangible fixed assets	0	0	0	0	0	4,009	4,009
Other assets	0	0	0	0	0	8	8
Prepayments and accrued income	0	0	0	0	0	2,269	2,269
Total assets	600,677	13,913	12,952	171,955	28,721	9,738	837,956
Liabilities							
Shares	579,732	1,823	12,549	45,252	0	8,811	648,167
Amounts owed to credit institutions and other customers	108,570	18,650	14,350	1,000	0	801	143,371
Other liabilities	0	0	0	0	0	982	982
Accruals and deferred income	0	0	0	0	0	731	731
Subordinated liabilities	5,000	0	0	0	9,900	0	14,900
Reserves	0	0	0	0	0	29,805	29,805
Total liabilities	693,302	20,473	26,899	46,252	9,900	41,130	837,956
Net assets/liabilities	(92,625)	(6,560)	(13,947)	125,703	18,821	(31,392)	0
Off balance sheet items	31,800	(1,000)	0	(11,500)	(19,300)	0	0
Interest rate sensitivity gap	(60,825)	(7,560)	(13,947)	114,203	(479)	(31,392)	0

23. Financial Instruments (continued)

The interest rate sensitivity exposure of the Group at 30 September 2002 was as follows:

	<i>Not more than three months</i> £'000	<i>More than three months but not more than six months</i> £'000	<i>More than six months but not more than one year</i> £'000	<i>More than one year but not more than five years</i> £'000	<i>More than five years</i> £'000	<i>Non-Interest bearing</i> £'000	<i>Total</i> £'000
Assets							
Liquid assets	102,618	1,000	4,000	0	0	15,460	123,078
Loans and advances to customers	412,711	4,323	7,357	43,315	14,337	0	482,043
Tangible fixed assets	0	0	0	0	0	3,096	3,096
Other assets	0	0	0	0	0	85	85
Prepayments and accrued income	0	0	0	0	0	1,602	1,602
Total assets	515,329	5,323	11,357	43,315	14,337	20,243	609,904
Liabilities							
Shares	382,136	471	719	43,637	0	5,832	432,795
Amounts owed to credit institutions and other customers	91,214	28,400	15,400	0	0	998	136,012
Other liabilities	0	0	0	0	0	570	570
Accruals and deferred income	0	0	0	0	0	521	521
Subordinated liabilities	0	0	0	0	12,000	0	12,000
Reserves	0	0	0	0	0	28,006	28,006
Total liabilities	473,350	28,871	16,119	43,637	12,000	35,927	609,904
Net assets/liabilities	41,979	(23,548)	(4,762)	(322)	2,337	(15,684)	0
Off balance sheet items	32,800	(5,000)	(3,000)	(12,500)	(12,300)	0	0
Interest rate sensitivity gap	74,779	(28,548)	(7,762)	(12,822)	(9,963)	(15,684)	0

Fair Values of Financial Instruments

Set out below is a comparison of carrying values and fair values of some of the Group's financial assets and financial liabilities as at 30 September 2003. The table excludes certain financial assets and financial liabilities which are not listed or publicly traded, or for which a liquid and active market does not exist. It therefore excludes items such as mortgages, share accounts and bank deposits.

<i>Group</i>	<i>Book Value</i>		<i>Fair Value</i>	
	<i>2003</i> £'000	<i>2002</i> £'000	<i>2003</i> £'000	<i>2002</i> £'000
Financial assets and liabilities for which active markets exist				
Debt securities	0	1,028	0	1,028
Interest rate contracts	0	0	(857)	(1,254)

The fair value of interest rate contracts represents unrealised gains and losses at the balance sheet date. Gains and losses on instruments used for hedging are not recognised, as these hedges are recognised on an accruals basis in line with the underlying instruments being hedged. The table shows gains and losses that would occur if these instruments were carried at market value.

24. Pension Scheme

The Society operates a defined benefit pension scheme (the Scheme) funded by the payment of contributions to a separately administered fund for nine retired members. The Board decided to close the Scheme with effect from 31 December 2001 and introduced a new defined contribution scheme to cover service of Scheme members from 1 January 2002.

The Scheme Trustees, having taken actuarial advice, decided to wind up the Scheme rather than continue to operate it on a “paid up” basis. The winding up is largely complete. As at 30 September 2003 the actuarial estimate of the liability to remaining members is £536,000 and is matched by Scheme assets. Accordingly the provision in the Society’s accounts for the anticipated shortfall on the Scheme has been reduced from £100,000 to £nil.

**ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 30 SEPTEMBER 2003**

The information on pages 45 and 46 has been extracted from figures appearing in the Annual Report and Accounts of the Society for the year ended 30 September 2003, amended to reflect references to pages in this document.

1. Statutory Percentages

	<i>2003</i>	<i>Statutory Limit</i>
	%	%
The Lending Limit	4.39	25
The Funding Limit	18.11	50

The percentages have been calculated in accordance with the provisions of Building Societies Act 1986 as amended by the Building Societies Act 1997.

The Lending Limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets comprise total assets plus provision for bad and doubtful debts less liquid assets and tangible fixed assets.

The funding limit measures the proportion of shares and other borrowings not in the form of shares held by individuals.

The statutory limits are laid down in the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other Percentages

	<i>2003</i>	<i>2002</i>
	%	%
As a percentage of shares and borrowings:		
Gross Capital	5.65	7.03
Free Capital	5.17	6.53
Liquid Assets	24.08	21.64
As a percentage of mean total assets:		
Profit after taxation	0.25	0.41
Management expenses	0.94	1.06

“Shares and borrowings” represents the total value of shares, amounts owed to credit institutions, and amounts owed to other customers.

“Gross capital” represents the aggregate of general reserve and subordinated liabilities.

“Free capital” represents the aggregate of the gross capital, general loss provision and bad and doubtful debts less tangible fixed assets and intangible assets.

“Liquid assets” represents the total of cash in hand and balances with BoE, debt securities and other liquid assets.

“Mean total assets” represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

“Management expenses” represents the aggregate of administrative expenses, depreciation and amortisation.

3. Information Relating to Directors and Officers as at 30 September 2003

<i>Name</i>	<i>Date of birth</i>	<i>Date of appointment</i>	<i>Occupation</i>	<i>Other Directorships</i>
Directors				
J P Cheele MBA (Chairman)	01.05.37	01.07.91	Business Consultant	I D Communications Services Ltd
C J Byrne LL.B (Vice-Chairman)	01.06.46	01.04.79	Solicitor and Notary Public	Canterbury Volunteer Bureau Company Limited
P G Bridgman BA, ACA	16.09.61	25.02.03	Finance Director	None
D S Kemp	16.10.47	01.04.86	Diocesan Secretary	None
M J Lazenby FCIB, FRSA	08.05.55	10.07.00	Building Society Chief Executive	mikelazenby.com Ltd* Jersey Home Loans Ltd Jersey Property Loans Ltd* Guernsey Home Loans Ltd* Guernsey Property Loans Ltd*
M S MacKenzie BA	12.07.47	29.01.02	Director	Seaforth Brook Ltd
A S Nelson CBE, DL, MA	22.04.41	01.03.95	Director	University of Greenwich Ltd Individual Learning Co Ltd Fair Play South East Ltd 29 Moreton Place Management Co Ltd
A H Palmer FCA, FCT	15.08.44	23.04.02	Director	G-Mex Ltd Jersey Home Loans Ltd Jersey Property Loans Ltd* Guernsey Home Loans Ltd* Guernsey Property Loans Ltd*

Only the executive directors have service contracts with the Society, which may be terminated by either party giving 1 year prior notice.

Correspondence to the directors jointly or individually should be addressed "Private and Confidential" and c/o the Society's Head Office, Reliance House, Sun Pier, Chatham, Kent. ME4 4ET.

Officers

M J Lazenby FCIB, FRSA	Chief Executive	mikelazenby.com Ltd* Jersey Home Loans Ltd Jersey Property Loans Ltd* Guernsey Home Loans Ltd* Guernsey Property Loans Ltd*
P G Bridgman BA, ACA	Finance Director	None
L G Davies MAAT	Head of Treasury	
R Procter BA, FCIB	Head of Lending	Jersey Home Loans Ltd Jersey Property Loans Ltd* Guernsey Home Loans Ltd* Guernsey Property Loans Ltd*
P V Sanders FCIB	Head of Compliance	None
R Scruton MSc, FCA	Society Secretary	Kent Ambulance NHS Trust St Martins Emmaus
A Wicks BSc, MBA	Head of Information Technology	Jersey Home Loans Ltd Jersey Property Loans Ltd* Guernsey Home Loans Ltd* Guernsey Property Loans Ltd*

* represents a dormant company

No director or officer has any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society.

DIRECTORS' REPORT

The following pages 47 to 50, with the exception of the text in italics, contain information which has been reproduced from the Annual Report and Accounts of the Society for the year ended 30 September 2003 (amended to reflect references to pages in this document). This information is included in this document to comply with the provisions of section 80(6) of the Building Societies Act 1986.

The directors are pleased to present their annual report and accounts for the year ended 30 September 2003.

Business review and future developments

The year to 30 September 2003 has been another period of sustained high growth and strong financial progress. During the year the Society has featured consistently in the 'best buy' tables of most national newspapers for its award-winning mortgage and savings products. In particular, its mini cash ISA has generated a significant inflow of funds, leading to a 37 per cent. increase in total assets, which now stand at over £830 million, compared to £401 million only two years ago.

The directors are delighted that national recognition and prestigious awards from financial services industry publications have accompanied this growth, for high quality customer service and product innovation. The Society won the Editor's Special Award from 'Your Money', was highly commended in the 'Personal Finance' Readership Awards and for the second successive year, was named Best Regional Lender of the Year by 'Mortgage Magazine'.

The Society has continued its programme of modernisation in order to increase efficiency. As part of the considerable investment in technology, new software was introduced to make the investment account opening process less labour intensive. As a result, the Society was able to open five times more accounts than in the previous year (53,000 new accounts compared to 10,500), without a proportionate increase in staff numbers.

As competition remains fierce, and is expected to stay so, it is essential that the Society can operate successfully in a low cost environment. Accordingly, every aspect of the Society's operations including the branch and agent network is under continual review to ensure that efficiencies are generated wherever possible, that unnecessary costs are eliminated, and that a quality service is provided to members. Already this has resulted in the management expense ratio being reduced to 94p per £100 of assets; lower than most of its major competitors.

Another area that has seen increased investment is compliance. Banks, building societies and other financial institutions are heavily regulated and this will increase further with the introduction of new mortgage regulations in 2004. Building societies have an enviable reputation as a safe haven for savings and investments, and the Society welcomes any measure which increases protection to consumers, or which enhances the customer's awareness of its products and services. Compliance represents a heavy cost for the Society, as it does to all financial institutions, however as the Society grows, the cost can be absorbed more readily.

The Society's subsidiary, Jersey Home Loans Limited has enjoyed a thriving first year, increasing in size by 83 per cent. to over £97 million. This is a great achievement considering the Society has no formal presence on the island of Jersey, as customers are managed from the Society's Head Office in Chatham.

This clearly shows that the residents of Jersey are receptive to an alternative lender to the large banks, who have previously been the principal mortgage providers on the Island, thus signifying that the Society can compare favourably against these banks.

Although the Society has been successful in expanding its customer base beyond the county of Kent, it remains committed to being involved in a number of local initiatives. In particular, during the year the Society launched its innovative *Really Useful Savings and Loan Account* in partnership with Maidstone and Gravesham Borough Councils to a number of local housing associations. These schemes help reduce financial exclusion offering tenants competitive rates of interest in an easy access savings account and the opportunity to take out small loans.

During the year the Society continued to support the work of the NSPCC Full Stop Campaign in Kent and was delighted by member response to the collection of foreign coins and notes in branches. In addition, a number of staff members ran the London Marathon and Great South Run, resulting in the Society raising a grand total of £10,000 for the campaign. The Society once again sponsored the Kent Village of the Year competition in order to promote local communities. The *Sportsaver* account in conjunction with Kent Sports Development Unit continues to help young sports people in Kent. The Society's commitment to the Chatham Marine Cadets has grown, leading to the presentation of a new minibus to the cadets. Further afield, over fifty borrowers with learning disabilities now have mortgages with the Society under a special scheme. This is designed to increase their independence and improve the quality of their lives by enabling them to purchase their own homes near to their families and friends.

The directors remain convinced that retaining mutual status is in the best interests of current and future members. Mutuality ensures all profits are reinvested into the business for the ultimate benefit of members, rather than being paid out to external shareholders. This enables the Society to develop and grow. The charitable assignment scheme provides the assurance that quality and service will not be disturbed by the activities of speculative investors who may otherwise wish to see the Society lose its mutual status.

The Society's strategy is to continue to reduce relative costs, through growth and improved business processes, building upon the efficiencies that technology enables. Costs are constantly reviewed to ensure that competitive, attractive and innovative products can be offered to both investing and borrowing members.

Review of the Year

Total Assets

Total assets increased by £228 million during the year to £838 million at 30 September 2003, a rise of 37 per cent.

Shares and Deposits

Gross receipts from investing members and depositors, excluding deposits raised from the wholesale money markets, were another new record at over £365 million, an increase of 68 per cent. compared to the previous year. Investing members' balances increased by 50 per cent. and at the year end amounted to £648 million.

Commercial Assets

During the year advances and loans made to borrowers amounted to £249 million, another new record representing an increase of 27 per cent. compared to last year. Total mortgage balances at 30 September 2003 were £639 million, an increase of 33 per cent. over 2002. The total mortgage balance included those in Jersey, where total balances stood at £97 million compared to £53 million at September 2002, an increase of 83 per cent. The Society has maintained its efforts to minimise mortgage arrears and to help borrowers in difficulties to resolve their situation. As last year, at this year end there were no cases where repayments were more than 12 months in arrears.

The directors continue to provide for potential mortgage losses on a prudent and consistent basis. All mortgage accounts in arrears at the year end by more than 2.5 per cent. of the outstanding balance have been reviewed in detail. Having regard to the provisions made in previous years a net charge of £48,000 has been taken into account in the income and expenditure account resulting in a specific provision at 30 September 2003 of £39,000 and a general provision of £256,000.

Treasury

As noted in last year's accounts the Society has a £75 million three year revolving credit facility with a panel of banks, which gives a secure funding source. The Society also has two subordinated debt structures which now provide £15 million and which are explained further in note 20 to the accounts. The subordinated debt provides funding and enhances the Society's reserve base to support future growth.

Capital

Gross capital, being the general reserve and subordinated liabilities, increased to £45 million at 30 September 2003 by virtue of the profit for the year of £1,799,000 and the further drawdown of £3 million subordinated liabilities referred to above. At 30 September 2003 this represented 5.65 per cent. of share and deposit liabilities. Free capital (as defined on page 45) as at September 2003 was 5.17 per cent. as a percentage of shares and borrowings.

Creditor Payment Policy

The Society's continuing policy concerning the payment of its trade creditors is to pay within the agreed terms of credit, usually 30 days from invoice, once the supplier has discharged its contractual obligations. These terms of payment are settled with suppliers when agreeing the terms of each transaction. The "creditor days" at 30 September 2003 were 17.

Charitable Donations

Charitable donations made during the year amounted to £1,500 paid under deed of covenant to Charities Aid Foundation to be used for the benefit of local charities nominated by the Society. In accordance with the terms of the Sportsaver account, an amount of £8,000 was paid to Kent County Council to be distributed to local community sports projects. The Society, its staff and members also continued to support the NSPCC's Full Stop Campaign, raising a total of £10,000 through the collection of foreign coin and other fund raising activities.

Directors

The names of the directors at the date of this circular, together with brief biographical details are listed on pages 24 to 26.

The following persons were directors of the Society and served on the board committees shown during the year.

John Cheele MBA	Non Executive Director	Chairman, Remuneration Committee Mortgage Committee
Chris Byrne LL.B	Non Executive Director	Vice-Chairman, Mortgage Committee Establishment Committee Remuneration Committee
David Kemp	Non Executive Director	Chairman, Audit Committee Audit Committee Establishment Committee Remuneration Committee
Mike Lazenby FCIB, FRSA	Chief Executive	Mortgage Committee Establishment Committee
*Paul Bridgman BA, ACA (appointed 25 February 2003)	Finance Director	
Malcolm Mackenzie BA	Non Executive Director	Mortgage Committee
Anne-Marie Nelson CBE, DL, MA	Non Executive Director	Audit Committee
Alan Palmer FCA, FCT	Non Executive Director	Audit Committee

* Paul Bridgman resigned on 23 December 2003.

The Audit Committee meets quarterly to consider internal audit reports and accounting and systems issues. The Mortgage Committee, which is chaired by the Vice-Chairman, also meets quarterly to consider mortgage lending policy and attainment of the Society's lending objectives in the light of market conditions. This committee also has delegated authority for approval of mortgage applications. The Establishment Committee considers the appointment, terms and conditions, and fees of non-executive directors and executive staff salaries, while the Remuneration Committee considers the appointment and terms and conditions of executive directors.

John Cheele, Mike Lazenby, and Anne-Marie Nelson retire by rotation and, being eligible, offer themselves for re-election.

A resolution for the re-appointment of the auditors, Ernst & Young LLP, will be proposed at the Annual General Meeting.

On behalf of the board

John Cheele
Chairman
25 November 2003

GOVERNANCE AND DIRECTORS' RESPONSIBILITIES

Governance

The Group complies with the Sample Code of Governance contained within the 'Interim Prudential Sourcebook for Building Societies' issued by the Financial Services Authority. The Group also complies with the banking code of best practice and the Mortgage Code.

Directors' Responsibilities for Preparing the Annual Accounts

The following statement, which should be read in conjunction with the independent auditors' responsibilities on page 52, is made by the directors to explain their responsibilities in relation to the preparation of the annual accounts, annual business statement and directors' report.

The directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, annual accounts which give a true and fair view:

- of the state of affairs of the Society and Group as at the end of the financial year, and
- of the income and expenditure and cash flows of the Society and Group for the financial year.

In preparing these accounts, the directors are required to:

- select appropriate accounting policies and apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any material departure being disclosed and explained in the accounts, and
- prepare the accounts on the going concern basis, unless it is inappropriate to presume that the Society will continue in business.

In addition to the accounts, the Act requires the directors to prepare, for each financial year, an annual business statement and a directors' report, each containing prescribed information relating to the business of the Society and Group.

Directors' Responsibilities for Accounting Records and Internal Control

The directors are responsible for ensuring that the Society and its connected undertakings:

- keep accounting records in accordance with the Building Societies Act 1986, and
- take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Society and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Going Concern

The directors are satisfied that the Society has adequate resources to continue in business for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

On behalf of the board

John Cheele
Chairman
25 November 2003

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF KENT RELIANCE BUILDING SOCIETY

We have audited the annual accounts for the Group and Society for the year ended 30 September 2003 which comprise the statement of accounting policies, the Group and Society income and expenditure accounts, the Group and Society balance sheets, the Group cash flow statement and the related notes on pages 32 to 44. These annual accounts have been prepared under the historical cost convention and in accordance with the accounting policies set out therein. We have examined the annual business statement (other than the details of directors and officers upon which we are not required to report) and the directors' report.

This report is made solely to the Society's members, as a body, in accordance with Sections 78 and 79 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of Directors and Auditors

As described on page 51, the directors are responsible for the preparation of the annual accounts in accordance with applicable United Kingdom law and accounting standards, and the annual business statement and the directors' report in accordance with relevant legal and regulatory requirements.

Our responsibility is to audit the annual accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards. We report to you our opinion as to whether the annual accounts give a true and fair view. We also report to you our opinions as to whether the annual business statement (other than the details of directors and officers) gives a true representation of the matters in respect of which it is given, the information given in the directors' report is consistent with the accounting records and annual accounts, and the annual accounts, annual business statement and directors' report have been prepared in accordance with the Building Societies Act 1986 and regulations made under it.

We read other information contained in the annual report and consider whether it is consistent with the annual accounts. This other information comprises the chairman's statement, directors' report, governance and directors' responsibilities and the annual business statement. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the annual accounts. Our responsibilities do not extend to any other information.

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 annual accounts. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the annual accounts, and of whether the accounting policies are appropriate to the Society's and 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 annual accounts are free from material mis-statement, 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 annual accounts.

Audit Opinion

In our opinion the annual accounts give a true and fair view of the state of affairs of the Society and Group as at 30 September 2003 and of the income and expenditure of the Society and the Group for the year then ended and of the cash flows of the Group for the year then ended.

Other opinions

In our opinion:

- (a) the information given in the annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given;
- (b) the information given in the directors' report is consistent with the accounting records and the annual accounts; and
- (c) the annual accounts, the annual business statement, and the directors' report have each been prepared so as to conform to the requirements of Part VIII of the Building Societies Act 1986 and regulations made thereunder.

Ernst & Young LLP
Registered Auditor, London

28 November 2003

USE OF PROCEEDS

The net proceeds of the issue of the PIBS (estimated to be approximately £14,735,850) will be used by the Society to strengthen its capital base. It is intended that the discounted proceeds of the issue of the PIBS will be treated for capital adequacy purposes as Tier 1 capital.

UNITED KINGDOM TAXATION

The following is a summary of the Society's understanding of current law and practice in the United Kingdom relating to the taxation of the PIBS. The summary only relates to the deduction of United Kingdom tax from interest on the PIBS and to the taxation treatment of United Kingdom corporation taxpayers which are the absolute beneficial owners of the PIBS and the interest on them and some aspects do not apply to certain classes of taxpayer (such as dealers). The summary does not apply to other United Kingdom taxpayers.

Prospective PIBS holders who are not United Kingdom corporation taxpayers, who are in any doubt as to their tax position or who may be subject to tax in a jurisdiction other than the United Kingdom should seek their own professional advice.

Interest on the PIBS

1. While the PIBS continue to be listed on a recognised stock exchange within the meaning of section 841 Income and Corporation Taxes Act 1988, payments of interest may be made without withholding or deduction for or on account of income tax. The Luxembourg Stock Exchange is a recognised stock exchange for these purposes.
2. Persons in the United Kingdom paying interest to or receiving interest on behalf of another person who is an individual may be required to provide certain information to the United Kingdom Inland Revenue regarding the identity of the payee or person entitled to the interest and, in certain circumstances, such information may be exchanged with tax authorities in other countries.
3. If the PIBS cease to be listed interest will generally be paid under deduction of income tax at the lower rate (currently 20 per cent.) subject to any direction to the contrary from the Inland Revenue in respect of such relief as may be available pursuant to the provisions of any applicable double taxation treaty.

Corporation Taxpayers

4. PIBS holders within the charge to United Kingdom corporation tax will be subject to tax as income on all profits and gains broadly in accordance with their statutory accounting treatment. Such PIBS holders will generally be charged in each accounting period by reference to interest and any profit or loss which, in accordance with such PIBS holder's authorised accounting method, is applicable to that period.

Stamp Duty

5. No United Kingdom stamp duty or stamp duty reserve tax is payable on the issue or transfer of the PIBS or on their purchase by the Society.

Proposed European Union Directive on the Taxation of Savings Income

6. The European Union has adopted a Directive regarding the taxation of savings income. Subject to a number of important conditions being met, it is proposed that Member States will be required from a date not earlier than 1 July 2005 to provide to the tax authorities of other Member States details of payments of interest or other similar income paid by a person to an individual in another Member State, except that Austria, Belgium and Luxembourg will instead impose a withholding system for a transitional period unless during such period they elect otherwise.

MARKETING ARRANGEMENTS

The Manager has, pursuant to a subscription agreement dated 20 August 2004 (the “**Subscription Agreement**”), agreed with the Society, subject to the satisfaction of certain conditions, to subscribe for, or procure subscribers for, the PIBS at the issue price of 99.489 per cent. of their principal amount. The Society has agreed to pay the Manager a commission of 1.25 per cent. of such principal amount if the conditions to which the issue of the PIBS is subject are satisfied or waived by the Manager. The Manager is entitled to terminate the Subscription Agreement in certain circumstances prior to payment to the Society. The Society has agreed to indemnify the Manager against certain liabilities in connection with the issue of the PIBS.

It is the intention of the Society to distribute the PIBS to a wide range of institutional investors. Accordingly, the Manager reserves the right to retain a portion of the offering for the purpose of making ongoing sales, at its absolute discretion, to professional intermediaries.

The PIBS have not, prior to the date of this document, been marketed or made available in whole or part to the public.

The PIBS have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States. The PIBS are being offered and sold outside of the United States in reliance on Regulation S.

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

The Manager has represented to and agreed with the Society that (1) it has not offered or sold and, prior to the expiry of a period of six months from the issue date of the PIBS, will not offer or sell any PIBS to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended), (2) it has complied and will comply with all applicable provisions of FSMA with respect to anything done by it in relation to the PIBS in, from or otherwise involving the United Kingdom, and (3) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of Section 21 of FSMA) received by it in connection with the issue or sale of any PIBS in circumstances in which Section 21(1) of FSMA does not apply to the Society.

No action has been or will be taken by the Society or the Manager that would, or is intended to, permit a public offer of the PIBS in any country or jurisdiction where action for that purpose is required. The PIBS may not be, directly or indirectly, offered or sold in any country or jurisdiction where action for that purpose is required. Accordingly, the PIBS may not, directly or indirectly, be offered or sold and neither this document nor any other circular, prospectus, form of application, advertisement or other material may be distributed in or from, or published in, any country or jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations.

Neither the Society nor the Manager represents that the PIBS may at any time lawfully be sold in or from any jurisdiction (other than in or from the United Kingdom) in compliance with any applicable registration requirements or pursuant to an exception available thereunder or assumes any responsibility for facilitating such sales.

GENERAL INFORMATION

Listing

In connection with the application to list the PIBS on the Luxembourg Stock Exchange, a legal notice relating to the issue of the PIBS and copies of the constitutional documents of the Society will be deposited with the Luxembourg Trade and Companies Register (“**Registre de Commerce et des Sociétés à Luxembourg**”) where such documents may be examined and copies obtained.

Significant change

There has been no significant change in the financial or trading position of the Society or of the Group or any material adverse change in the prospects of the Society or the Group since 30 September 2003, being the date to which the latest published audited accounts of the Society were made up.

Litigation

Neither the Society nor the Group is or has been involved in any litigation or arbitration proceedings relating to claims or amounts that are material in the context of the issue of the PIBS nor so far as the Society or the Group is aware is any such litigation or arbitration pending or threatened.

Accounts

The consolidated accounts for the Society for the two years ended 30 September 2003 and the accounts of the Society for the year ended 30 September 2001 have been audited by Ernst & Young LLP, independent auditors. The audit reports for each of the three years ended 30 September 2003, 2002 and 2001 were unqualified. The Society does not publish non-consolidated accounts other than the Society balance sheet, income and expenditure accounts and cash-flow statement included in the annual audited consolidated accounts of the Society.

Authorisation

The issue of the PIBS was authorised by resolutions of the Board passed on 27 July 2004 and 18 August 2004.

PIBS Certificates

No temporary documents of title shall be issued by the Society in respect of the PIBS. The Registrar will, from 27 August 2004, commence despatching the PIBS Certificates to all PIBS holders who decide to hold their PIBS in certificated form, at the risk of the persons entitled thereto, by first class post to the address detailed on the relevant application form.

The SEDOL number for the PIBS is BO2FJS3 and the PIBS have been accepted for and may be held and transferred through CRESTCo. The PIBS have been accepted for clearance and settlement by the Clearstream Luxembourg and Euroclear systems and, as such, may be held and transferred through such systems with a Common Code of 019965562 and the International Securities Identification Number of GB00BO2FJS38.

Documents

Copies of the following documents may be inspected at, and in the case of the accounts, are obtainable from, the offices of the Registrar at The Causeway, Worthing, West Sussex, BN99 6DA and of the Transfer Agent in Luxembourg during normal business hours on any weekday (Saturdays and public holidays excepted):

- (i) the Rules and the Memorandum of the Society;
- (ii) the published audited consolidated accounts of the Society for each of the years ended 30 September 2002 and 2003, the published audited accounts of the Society for the year ended 30 September 2001 and all the future published audited annual and unaudited interim consolidated accounts of the Society (no interim accounts are currently produced by the Society);
- (iii) a draft (subject to modification) of a PIBS Certificate (including the special conditions of issue of the PIBS);
- (iv) the Registrar Agreement; and
- (v) the Agency Agreement.

PRINCIPAL OFFICE OF THE SOCIETY

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NOTICE AGENT

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