



(incorporated in England under the Building Societies Act 1986 under no. 463 B)

£125,000,000
6.25 per cent. Permanent Interest Bearing Shares

Issue Price: 99.838 per cent.

Application has been made to the Financial Services Authority in its capacity as competent authority under the Financial Services and Markets Act 2000 (the "UK Listing Authority" and "FSMA" respectively) for the issue of £125,000,000 6.25 per cent. Permanent Interest Bearing Shares (the "PIBS"), comprising 125,000 PIBS of £1,000 each, of Portman Building Society (the "Society") to be admitted to the official list of the UK Listing Authority (the "Official List") and to the London Stock Exchange plc (the "London Stock Exchange") for such PIBS to be admitted to trading on the London Stock Exchange's market for listed securities.

Attention is drawn to the description in "Certain Provisions of the Act" on pages 15 and 16 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 on 22 October 2003, conditionally upon the PIBS being admitted to the Official List and to trading on the London Stock Exchange's market for listed securities, which in each case is expected to occur on 22 October 2003. The listing of the PIBS will be expressed as a percentage of their principal amount.

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

The PIBS will not be withdrawable at the option of the PIBS holders and will be repayable only in certain limited circumstances as described in "Special Conditions of Issue of the PIBS – 4 Repayment" on page 10 of this document.

The PIBS are rated Baa1 by Moody's Investors Service Inc.

Barclays Capital

This document comprises listing particulars issued in compliance with the listing rules made by the UK Listing Authority (the "Listing Rules") for the purpose of giving information with regard to the Society and its subsidiary undertakings (together the "Group") and the PIBS. The Directors of the Society, whose names appear on pages 22 to 23 of this document (the "Directors"), accept responsibility for the information contained in this document. To the best of the knowledge and belief of the Directors (who have 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 since the date of this document.

A copy of this document has been delivered to the Registrar of Companies in England and Wales for registration in accordance with section 83 of FSMA.

The PIBS have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Securities Act"), and may not be offered, sold or delivered, directly or indirectly, in the United States or to United States persons otherwise than in accordance with applicable United States securities laws and regulations.

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 64 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 page 4 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 "Act" are to the Building Societies Act 1986, 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, or as the context otherwise requires, have the same meanings as are given to them in the 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. They should particularly note the following characteristics of the PIBS:

- (a) **Permanence** – The PIBS will be repayable only at the option of the Society on 22 October 2024 and every fifth successive 22 October thereafter, or in certain limited circumstances as described in “Special Conditions of Issue of the PIBS – 4 Repayment” on page 10 of this document, in each case subject to the permission of the statutory authority responsible for regulating building societies, which is currently the Financial Services Authority (the “FSA”), which expression shall include any successor body performing for the time being the same or similar functions in relation to building societies in the United Kingdom. The Society is under no obligation to seek any such permission to repay the PIBS.
- (b) **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.
- (c) **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.
- (d) **Subordination** – The PIBS are subordinated to all other liabilities of the Society other than liabilities in respect of other deferred shares. 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 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 trade-off between higher interest and higher risk.
- (e) **Investor protection** – Unlike normal building society investment products, the PIBS are not an investment in respect of which a claim may be entertained by the Financial Services Compensation Scheme.
- (f) **Payments of interest may be missed** – Interest in respect of the PIBS will not be payable where the Directors 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).
- (g) **Interest is not cumulative** – If the Society does not make an interest payment in respect of the PIBS in accordance with paragraph (f) above, such interest will be cancelled.
- (h) **Taxation of interest** – Interest is paid without withholding or deduction for tax under current law. Nevertheless, tax may be withheld or deducted if there is a change of law.
- (i) **Rights** – The rights of the PIBS holders are markedly different from those of shareholders in a company, e.g. as to voting rights and protection of minorities. For example, as indicated in paragraph 6 on page 6 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 at a general meeting of a company would normally have one vote on a poll for each share held.
- (j) **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 engagement to any other body, the transfer will incorporate arrangements to secure that the PIBS are effectively converted into perpetual subordinated debt of that body, and do not become repayable other than at the option of that body on 22 October 2024 and every fifth successive 22 October thereafter or in the limited circumstances as described in “Special Conditions of Issue of the PIBS – 4 Repayment”, in each case subject to the permission of the FSA.

Investors’ attention is also drawn to the information in respect of the Society appearing on pages 17 to 61 of this document.

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

The rights and restrictions attaching to the PIBS will be governed by the Rules, certain provisions of the Act and the "Special Conditions of Issue of the PIBS" set out on pages 8 to 14 of this document. Set out below is a summary of the key provisions of the Rules and certain provisions of the Act insofar as they might affect the rights of the PIBS holders, together with certain explanatory notes which are italicised.

1 General

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

Each PIBS holder, 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 to 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 thinks fit.

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

3 PIBS Certificate

Each PIBS holder, within one month after becoming entered in the PIBS Register as the holder of PIBS, 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 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 PIBS to be evidenced by a duly executed PIBS Certificate or other written instrument.

Notwithstanding these provisions of the Rules regarding the issue of PIBS Certificates, the Society will procure that a PIBS Certificate is issued to all PIBS holders who hold their PIBS in certificated form, regardless of whether or not one is requested, within 14 days after the issue, or lodgement of any instrument of transfer, of such PIBS. The PIBS will also be capable of being held in uncertificated form.

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. 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 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 Board may think fit and to payment of any exceptional expenses of the Society incidental to its investigation of the evidence of such alleged loss, theft or destruction. 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 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 Society of such a transfer, such notice to be made or given in writing or in such other manner as the Society in its absolute discretion may permit.

The registration of transfers of the 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 PIBS shall be free from all liens in respect of liabilities to the Society.

Two or more Persons may jointly hold 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, 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 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 PIBS:
 - (i) at the end of the last Financial Year before the voting date; or
 - (ii) if the voting 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) and (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, any surplus remaining after payment in full of the Society's creditors and repayment to Members (including holders of the PIBS and holders of the £60,000,000 7.25 per cent. Permanent Interest Bearing Shares issued on 5 December 2001 (the "Existing PIBS")) of the amount of their Shares (together with 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 and the Existing PIBS). The proportion (if any) of such 20 per cent. to which any particular issue of deferred Shares (including the PIBS and the Existing PIBS) is entitled shall be set forth in the terms and conditions of issue of that issue of deferred Shares; and
- (b) the remainder among qualifying Members (other than holders of deferred Shares (including the PIBS and the Existing PIBS)) in proportion to the value of their Shareholdings.

Notwithstanding these provisions of the Rules regarding the application of any surplus on a winding-up or dissolution of the Society, the PIBS holders and holders of the Existing PIBS will not be entitled to any share in any final surplus upon a winding-up or dissolution of the Society.

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.

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.

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 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 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 must first give written notice to the UK Listing Authority of its intention to sell the PIBS. 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 paragraph 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:

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.

1 General

- (1) The "Society" means Portman Building Society.
- (2) The "PIBS" means £125,000,000 6.25 per cent. Permanent Interest Bearing Shares of the Society and, unless the context otherwise requires, includes any further deferred Shares issued pursuant to Condition 9 and forming a single series with the PIBS.
- (3) "PIBS holder" means a Person whose name and address is entered in the PIBS Register as the holder of 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) "PIBS Register" means the records of the Society maintained for the purposes 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 "Act");
 - (b) are not 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 4(3) and 4(7) respectively.
- (8) Upon a transfer of PIBS 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 he holds his PIBS in certificated form.
- (9) The PIBS may be held jointly by up to four Persons.
- (10) The PIBS rank *pari passu* in all respects with the £60,000,000 7.25 per cent. Permanent Interest Bearing Shares issued on 5 December 2001 (the "Existing PIBS").

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 Interest

- (1) The PIBS bear interest from and including 22 October 2003 to but excluding 22 October 2024 at the rate of 6.25 per cent. per annum and thereafter at a rate calculated in accordance with paragraph (2) below (each a "Rate of Interest"), in each case payable, subject as set out below, in arrear by equal half-yearly instalments on 22 April and 22 October in each year (each an "Interest Payment Date"), commencing on 22 April 2004. 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 as described below and, except in certain circumstances, will be paid without withholding or deduction for or on account of tax, except as required by law. *For a description of applicable United Kingdom Taxation Considerations see "United Kingdom Taxation" on page 62.*

Where it is necessary to compute an amount of interest in respect of any PIBS for a period of less than one year (other than a semi-annual 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, 22 October 2003) to (but excluding) the relevant Interest Payment Date, divided by the product of (a) the actual number of days in the period from (and including) the most recent Interest Payment date (or, if none, 22 October 2003) to (but excluding) the next (or first) scheduled Interest Payment Date and (b) the number of Interest Periods in any year.

- (2) (i) The Rate of Interest payable in respect of the PIBS from and including 22 October 2024 in respect of each Reset Period (as defined below) shall be determined by the Agent Bank whose name is set out at the end of these Conditions or such other person as may be appointed from time to time pursuant to Condition 3(2)(iii) (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 2.58 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 (as defined below), may determine to be appropriate;

"Determination Date" means, in relation to any Reset Period, the forty-fifth 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) 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 the bid and offered prices of such Benchmark Gilt quoted by the Reference Market Makers at 3.00 p.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, failing which such other three persons operating in the gilt edged market as are selected by the Agent Bank;

"Reset Date" means 22 October 2024 and every fifth successive 22 October thereafter; and

"Reset Period" means the period beginning on a Reset Date and ending on 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 ten 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 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 10.
- (iii) The Society may from time to time appoint any leading bank or investment banking firm in London as 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 3(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 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 Act)) of the Society; or
 - (b) any Deposit 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 3(3):

- (a) where the Society has deferred or suspended 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 3(3), interest in respect of the PIBS 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, 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 3(4)(a). On the passing of any such resolution, the 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 interest in respect of which no cheque or warrant 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.

4 Repayment

- (1) The PIBS constitute permanent non-withdrawable deferred Shares in the Society and have no specified final maturity.
- (2) The Society may, having obtained Relevant Supervisory Consent (as defined in Condition 4 (7)) and having given not less than 30 nor more than 60 days' notice to the PIBS holders in accordance with

Condition 10, which notice shall be irrevocable, elect to repay all, but not some only, of the PIBS on any Reset Date (as defined in Condition 3(2)) at their principal amount together, subject to Conditions 3(3) and 3(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 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 3, with interest accrued to but excluding the date of repayment after all sums due from the Society to Creditors have been paid in full. The PIBS holders will not be entitled to any share in any final surplus upon a winding-up or dissolution of the Society.
- (5) The Society may, having obtained prior Relevant Supervisory Consent and, for so long as the PIBS are admitted to the official list maintained by the competent authority designated under Part VI of the Financial Services and Markets Act 2000 (the "UK Listing Authority", which expression shall include any body appointed to perform such functions under any successor legislation), and admitted to trading on the London Stock Exchange plc's market for listed securities, subject to and in accordance with the requirements from time to time of the UK Listing Authority and London Stock Exchange plc, 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 in the United Kingdom) to the relevant repayment or (as referred to in Condition 4(5)) purchase.

5 Payments

All payments in respect of the PIBS will be made by sterling cheque or warrant 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 (in the case of a joint holding of PIBS, the Representative Joint Shareholder) appearing in the PIBS Register 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 on the Record Date. Upon application of the PIBS holder (or in the case of a joint holding of PIBS, the Representative Joint Shareholder) to the Society, in the form from time to time prescribed by the Society, not less than ten days before the due date for any payment in respect of his PIBS, 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 with a bank or building society in the United Kingdom. In this Condition 5, "business day" means any day (other than a Saturday or a Sunday) on which banks are open for business in England.

6 Succession and transfers

- (1) Upon an amalgamation by the Society with another building society under section 93 of and Schedule 16 to the Act or a transfer of its engagements to any extent to another building society under section 94 of and Schedule 16 to the 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 Act, the successor will, in accordance with section 100(2)(a) of the Act, assume as from the vesting date a liability (subject to this Condition 6(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 as in respect of a non-transferable subordinated deposit carrying the same rate of interest as the PIBS (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 holder, in the subscription of a principal amount of perpetual 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 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 successor body performing for the time being the same or similar functions.

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 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 6 (1) or (2) above will comply with the provisions of Condition 6(1) or, as the case may be, (2) above.

7 Variations of these Conditions

- (1) These Conditions may only be varied by the Society with the consent in writing of the 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 8.
- (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 nor afford the Society any defence to any claim made in any such action.

8 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 8(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 10 were substituted for 21 in Condition 8(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 8(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 appointor, 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 2 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 by this Condition 8(11) provided, 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 appointor 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.

9 Further issues

The Society shall be at liberty from time to time without the consent of the PIBS holders to create and issue further deferred 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 deferred Shares of any series (including the PIBS and the Existing 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 deferred Shares ranking ahead of the PIBS.

10 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.

CERTAIN PROVISIONS OF THE ACT

Amalgamation

Section 93 of the 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 of the Act) of the borrowing members of each amalgamating society and confirmation by the FSA. The 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 and the Existing PIBS) of each of the societies shall by virtue of the Act be transferred to and vested in the successor, whether or not otherwise capable of being transferred or assigned.

Transfer of Engagements

Section 94 of the 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 transferor society and 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 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 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 and the Existing PIBS) of the Society, the PIBS and the Existing 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 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 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 Act provides that on the vesting date (as defined in the Act) all of the property, rights and liabilities (which would include the PIBS and the Existing PIBS) of the transferor society, whether or not capable of being transferred or assigned, shall by virtue of the 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 Act, the PIBS and the Existing 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 investing 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 investing members' shares, including PIBS, are converted into deposits with the successor. On any such transfer, investing 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 certain investing 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.

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.

PORTMAN BUILDING SOCIETY

Introduction and Constitution

The Society is a building society incorporated in England under the Act on 1 October 1990 for an unlimited duration. As such, it is a mutual organisation owned by its members and is registered, supervised and regulated by the FSA. It operates under the Act, regulations made under the Act, and the Rules and Memorandum of the Society.

The Society was formed as a result of a merger between the Regency & West of England and Portman Wessex building societies in 1990 followed by further mergers with the St Pancras Building Society in 1993 and the Greenwich Building Society in 1997. Its origins date back over 150 years.

As at 31 December 2002, the Society and its subsidiaries had consolidated total assets of approximately £10,373 million. The Society is the fourth largest building society in the United Kingdom, measured by total assets, as shown in the Society's audited accounts for the year ended 31 December 2002 and compared with the corresponding audited accounts of the other societies concerned.

The Society's principal purpose, as set out in clause 3 of the Memorandum, is to make loans which are secured on residential property and are funded substantially by its members. The Society provides products and services to its members through its 109 branches and through centralised postal and telephone operations based in Bournemouth, the internet and relationships with financial intermediaries. It has a regional concentration of investors and borrowers surrounding its branch base in the south of England.

As at 31 December 2002, the Group had approximately 1,707,000 investment accounts and 101,000 borrowers' accounts.

During the year to 31 December 2002, the Group employed an average of 1,235 full time and 354 part time employees. For the financial years ended 31 December 2001 and 2000, the corresponding figures were 1,055 full time and 348 part time employees, and 928 full time and 351 part time employees respectively.

Mutual Status

It is the Board's view that members' interests continue to be best served by the Society remaining mutual. Accordingly, the Society introduced a Charitable Assignment Scheme in January 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, and their eligibility to vote at general meetings of the Society is governed by the 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 objectives are to deliver demonstrable benefits of mutuality and an excellent service to its members that is both cost effective and profitable.

The Society's principal activities are the raising of funds through investment by members; making mortgage advances on residential property; and offering a wide range of related services through its branches. The Society emphasises the importance of high standards of quality and customer service in all aspects of its operations.

As at 31 December 2002, 95.7 per cent. of business assets (as defined on page 49 of this document) were in the form of loans fully secured on residential property. At the same date, funding from members represented 79.2 per cent. of all shares and borrowings with the Society.

It is the Board's view that the Society's core business objectives are best achieved by the Society remaining mutual. The Board believes that the Group should focus on:

- the Group's core businesses of savings and secured residential lending;

- the branch network to provide the personal, face-to-face environment preferred by the majority of the Society's customers;
- developing other delivery channels as required by customers;
- keeping costs under control; and
- further improving the Group's knowledge of its customers in order to deliver a high quality service tailored to their individual needs.

Mortgage Lending

The Group's mortgage lending activity consists mainly of the granting of advances to individuals for the purchase or re-mortgage of residential property, secured by a first legal charge over the property. At 31 December 2002, the Group's loans fully secured on residential property amounted to approximately £7.9 billion, comprising 96.3 per cent. of all loans and advances to customers. Of the Group's total residential mortgage loan portfolio as at 31 December 2002, 45.8 per cent. was at fixed or capped interest rates and 32.6 per cent. at discounted administered variable interest rates, with the remainder on administered variable interest rates. Although the Group operates on a national basis, its business has a strong focus in southern England where approximately 80 per cent. of its lending business (based on the total advances to customers of the Group) is concentrated.

The Group's mortgage lending is originated predominantly through the Society, but also through Sun Bank plc ("Sun Bank"), a wholly owned subsidiary acquired from SLC Financial Services (UK) Limited in November 2001 for a cash consideration of £96.3 million. At 31 December 2002, approximately £1.3 billion of outstanding mortgage lending had been originated by Sun Bank. The main activities of Sun Bank include prime and Complex Prime® (the bespoke underwriting of complex mortgage requirements) residential mortgage lending and buy-to-let mortgages.

At 31 December 2002, the Group also had loans of approximately £0.3 billion secured on commercial property. During 2000 the Board made a decision to withdraw from commercial lending business although the Society is continuing to manage its existing commercial lending portfolio.

The Group follows detailed Board Lending Policy Statements in accordance with the Interim Prudential Sourcebook for Building Societies (Section 6). Within the agreed policy parameters, care, prudence and control are exercised by managers and staff to ensure that the quality of the Group's lending is maintained. Residential mortgage loans are processed through the Society's branches and its Principal Office in Bournemouth. In each case, a detailed procedure is followed prior to making any offer of advance. On receipt of an application, a valuation of the property is made by one of the Group's panel of approved independent qualified valuers. Subject to the valuer's report, credit checks and various other factors, the Group may make an offer of an advance.

In the six months ended 30 June 2003, the Group's new mortgage advances totalled approximately £1.5 billion, compared with approximately £2.9 billion in the year ended 31 December 2002 and £2.0 billion in the year ended 31 December 2001. (The source of this information is the unaudited interim accounts of the Society for the six months ended June 2003 and the audited financial statements of the Society for the two years ended 31 December 2001 and 2002.)

Mortgage Arrears and Provisioning

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. At 30 June 2003, the aggregate value of all Group mortgage loans with an arrears balance representing 2.5 per cent. or more of the mortgage balance outstanding amounted to 0.42 per cent. of the value of all Group mortgage loans outstanding.

The Group's charges for bad and doubtful debts in the years ended 31 December 2002 and 2001 were approximately £1.6 million and approximately £0.7 million respectively. These charges represent 0.02 per cent. and 0.01 per cent. respectively of total loans and advances outstanding at the end of the relevant year. At 31 December 2002, the Group carried forward provisions for bad and doubtful debts of approximately £23.6 million, of which approximately £22.4 million represented a general provision.

The table below shows the relevant provision statistics at those dates:

	2002	2001
	%	%
Charge to loan loss provisions (LLP)/average loans	0.02	0.01
Adjusted charge to LLP*/average loans	0.02	0.01
Loan loss reserves/average loans	0.31	0.36

* Charge to loan loss provisions plus interest suspended

The numbers of mortgage accounts 12 months or more in arrears for the years ended 31 December 2002 and 2001 were 85 and 121 respectively. The numbers of properties in possession at the end of these years were 11 and 28 respectively.

Sources of Income

The principal source of income for the Group is net interest earned from the Group's mortgage lending, deposit taking and liquidity management activities, which amounted to £108.2 million, £92.0 million and £84.0 million in the years ended 31 December 2002, 2001 and 2000 respectively.

In the year ended 31 December 2002, income from fees, commissions, rent and other sources was £36.7 million.

Commissions are primarily derived from the sale of investment products through Portman Financial Services Limited (a wholly owned subsidiary of Aviva plc), and from general insurance commissions, emanating from the Group's role as a mortgage lender.

With the exception of the head office of the Society, there are no establishments of the Society which account for more than ten per cent. of its net turnover or operations. The Society's head office is located at Portman House, Richmond Hill, Bournemouth, Dorset. It has an internal area of approximately 104,000 square feet and is a freehold property.

Liquidity

The Society, in common with other building societies, is required by the FSA, in accordance with the Interim Prudential Sourcebook for Building Societies (Section 5), 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 following table sets out the levels of the Group's liquid assets for these purposes as at 31 December 2001 and 2002 expressed both in amounts and as a percentage of total shares and borrowings. Terms used for these purposes are defined on page 49 of this document.

	<i>Liquid Assets</i>	<i>Percentage of</i>
	<i>£m</i>	<i>shares and</i>
		<i>borrowings</i>
		<i>%</i>
As at 31 December 2002	1,970.7	20.37
As at 31 December 2001	1,898.0	22.64

Funding Activities

Savings from the personal retail sector are the primary source of funds for the Society. However, the Society also raises funds from wholesale markets, principally from short term money markets together with longer term bonds issued under a Euro Medium Term Note Programme.

A breakdown of the Society's funding position at 31 December 2002 is as follows:

	<i>£m</i>
Share accounts	7,660.1
Amounts owed to credit institutions	189.7
Amounts owed to other customers	1,063.9
Debt securities in issue	759.3
	9,673.0

The Group's subordinated liabilities at both 31 December 2002 and 30 June 2003 can be summarised as follows:

	<i>£m</i>
Floating Rate Subordinated Liabilities 2009	25.0
Fixed Rate 6.73 per cent. Subordinated Liabilities 2014	15.0
Fixed Rate 7.125 per cent. Subordinated Liabilities 2016	75.0
Fixed Rate 6.74 per cent. Subordinated Liabilities 2019	15.0
	130.0

Capital Base

During 2002, the Group's pre-tax profits increased for the seventh successive year, rising by 8.6 per cent. over the previous year to £64.1 million.

As at 31 December 2002 and 2001*, the consolidated gross and free capital ratios of the Society, as calculated for the purposes of the Building Societies (Accounts and Related Provisions) Regulations 1998, were as follows:

	<i>As at 31 December</i>	
	2002	2001*
	%	%
Gross capital ratio as a percentage of shares and borrowings	6.62	7.10
Free capital ratio	5.81	6.28

Source: *Financial Statements*

Other capital ratios are set out below:

Total capital ⁽ⁱ⁾ as a percentage of risk weighted assets ⁽ⁱⁱ⁾	13.28	13.80
Tier 1 capital ⁽ⁱⁱⁱ⁾ as a percentage of risk weighted assets	10.19	10.40

(i) "Total capital" represents the aggregate of 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 the Interim Prudential Sourcebook for Building Societies (Section 1); and

(iii) "Tier 1 capital" represents general reserves.

Source: *Society's Regulatory Financial Statements as at 31 December 2001 and 31 December 2002*

*The accounts for 2001 as restated for reasons set out in Note 17 to the Accounts on page 42.

2003 Unaudited Interim Results and 2002 Unaudited Interim Results

As at 30 June 2003, the Group's total assets amounted to £11,265 million (31 December 2002: £10,373 million) representing a growth of 8.6 per cent. for the first six months of its current financial year. The Group's profit before tax for the six months to 30 June 2003 and 30 June 2002 totalled £33.0 million and £31.2 million respectively. Group liquid assets as at 30 June 2003 and 30 June 2002 were £2,175 million and £1,818 million respectively, each representing 19.3 per cent. of total assets at that time.

Source: *Society's unaudited interim accounts for six months ended June 2003 and unaudited interim accounts for six months ended June 2002.*

Further details of the results of the Group for the six months ended 30 June 2003, six months ended 30 June 2002 and three years ended 31 December 2002 are set out on pages 57 to 60 of this document.

Recent Developments

On 24 June 2003, the Society and Staffordshire Building Society ("Staffordshire") announced that they had agreed to merge. The merger is expected to be effective from the end of 2003 and is subject to approval by the FSA. The Society has consent from the FSA to proceed with the merger by way of a resolution of its Board of Directors without needing the approval of its members.

Staffordshire celebrated its centenary in 2002 and is the UK's 18th largest building society with assets in excess of £1.7 billion. Staffordshire employs around 480 staff serving 287,000 members through a network of 42 branches and agencies located in the Midlands with its headquarters based in Wolverhampton.

The merger is likely to result in the combined societies' total assets being in excess of £13 billion by the end of 2003.

A merger bonus is expected to be paid to qualifying shareholding and borrowing members of Staffordshire. These bonuses, which will not exceed £65 million are payable out of the reserves of Staffordshire and are only payable to members of Staffordshire. No bonus is payable to members of the Society in respect of the merger with Staffordshire.

The merger is not conditional on the issue of the PIBS, which is intended to strengthen the Group's total capital and Tier 1 ratios, although these ratios are in any event expected to be comfortably in excess of regulatory minima after completion of the merger with Staffordshire.

The operations of both the Society and Staffordshire are geographically complementary which will significantly improve the distribution of products and services to members of the enlarged Group. The combined Society will be named Portman Building Society. However, Staffordshire will retain its well established branding in its current operating region and will trade as "The Staffordshire".

The following information has been extracted without material adjustment from the Staffordshire consolidated audited accounts for the last three full financial years:

	Year ended 31 December		
	2002	2001 <i>as restated</i>	2000
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Income and Expenditure Account			
Net interest income	29.2	28.2	25.1
Other income	5.6	4.4	3.7
Total operating income	34.8	32.6	28.8
Total operating expenses	(23.4)	(21.0)	(19.3)
Operating profit before provisions	11.4	11.6	9.5
Provisions for bad and doubtful debts	(0.9)	(0.6)	(0.8)
Operating profit on ordinary activities before tax	10.5	11.0	8.7
Tax on profit on ordinary activities	(3.1)	(3.3)	(2.7)
Profit for the financial year	7.4	7.6	6.0
Balance Sheet			
Liquid assets	305.0	271.5	253.3
Loans and advances to customers	1,355.9	1,340.2	1,265.5
Other assets	28.1	24.4	15.9
Total assets	1,689.0	1,636.1	1,534.7
Shares and deposits	1,547.9	1,507.0	1,415.9
Other liabilities	11.0	8.0	6.6
Revaluation reserve	5.2	3.8	3.9
General reserves	124.9	117.3	108.3
Total liabilities	1,689.0	1,636.1	1,534.7

Directors of the Society

The names of the Directors of the Society, their responsibilities within the Society, their business occupation and the names of all companies and partnerships where the Society's Directors hold or have held a position as director or partner over the past five years are detailed below. The business address of each of the Directors is that of the Society given at the back of this document.

Name	Responsibilities		Other Directorships and Partnerships in the last five years
	Within the Society	Business Occupation	
Susan Caroline Ellen	Non-Executive Director	Company Director	Asda Group Limited* Barnard & Hill Limited* Birmingham Midshires Building Society* Epsom Grandstand Association Limited (The)* Kempton Investments Limited* Kempton Park Holding Company Limited* Kempton Park Racecourse Company Limited (The)* S T Ellen Consultancy Limited Sandown Park Limited* Super 12 Racing Limited* United Racecourses (Holdings) Limited* United Racecourses Limited* West Middlesex University Hospital NHS Trust
Mark Patrick Nicholls	Non-Executive Director	Investment Banker and Lawyer	Ambion Brick Company Limited* Bovis Homes Group Plc Bovis Homes Limited* City of London Finance Company Limited (The) City of London Investments Limited Clifton House Acquisition Limited* CNW Nominees Limited* Expamet International Limited* Flow Industries Limited* MACA (The Mental After Care Association Limited)(Charity) MACA Trading Limited Natwest Finance Limited* Natwest Ventures Investments Limited* RBDC Administrator Limited* RBDC General Partner Limited* RBDC Investments Limited* RBDC (Ireland) Limited* RBDC Parallel Nominees Limited* RBEF Limited* RBS Investment Limited* Royal Bank Development Capital Limited* Royal Bank Development Limited* Royal Bank Investments Limited* Royal Bank Project Investments Limited Royal Bank Ventures Investments Limited* Royal Bank Ventures Limited* Save the Baby (Charity) The City of London European Trust Limited The City of London Investment Trust Plc
Francis Alastair Lavie Robinson	Non-Executive	Company Director	Marshall of Cambridge (Holdings) Limited New England Company (Charity)* RMC Group Plc St Nicholas Hospice (Suffolk) (Charity)
David John Seymour Roques	Chairman	Chartered Accountant and Company Director	Barmenta* BBA Group Plc British Nuclear Fuels Public Limited Company* Chubb Plc* Deloitte Consulting Limited* D&T Consulting Holdings Limited* D&T ATR Consulting Nominees Limited* Liberata Holdings Limited* Premier Farnell Plc The Health Foundation

Name	<i>Responsibilities Within the Society</i> <i>Business Occupation</i>		<i>Other Directorships and Partnerships in the last five years</i>
Robert Sharpe	Chief Executive		Burfield Management Company Limited* Confederation Mortgage Services Limited* Exeter Trust Limited* Exeter Trust Financial Services Limited* Marketing Matters Limited Portman Estate Agents Limited* Portman Financial Services Limited Portman Mortgage Services Limited* Primett Property Management Limited* Residential Property Reversions V Limited Ridgeway Mortgage Services Limited Ridgeway Rentals 1 Limited* Ridgeway Rentals 2 Limited* Ridgeway Rentals 3 Limited* Ridgeway Rentals IV Limited Ridgeway Rentals V Limited Ridgeway Rentals VI Limited Sun Bank plc
Glyn Michael Smith	Group Finance Director		Bournemouth University Confederation Mortgage Services Limited* Exeter Trust Limited* Exeter Trust Financial Services Limited* Portman Channel Islands Limited Portman Mortgage Services Limited* Primett Property Management Limited* Residential Property Reversions V Limited Ridgeway Mortgage Services Limited Ridgeway Rentals IV Limited Ridgeway Rentals V Limited Ridgeway Rentals VI Limited Sun Bank plc
William Tudor John	Non-Executive Director	Lawyer and Managing Director	Allen & Overy* Allen & Overy Legal Services* Allen & Overy Service Company* Alnery Incorporations No. 1 Limited* Alnery Incorporations No. 2 Limited* A&O (Legal Advisers)* A.O.Services* Far East Legal Consultants* First Combined Trust* Fleetside Legal Representative Services Limited* Lehman Brothers Europe Limited Lehman Brothers International (Europe) NFTS Foundation (Charity) Sun Bank plc* Wales in London Limited Woolwich Plc*
Patricia Mary Vaz	Non-Executive Director	Company Director	Partnership Sourcing* Roffey Park Institute Limited Tomorrow's People Limited (charity) UK Sports Institute (charity)*
Matthew Peter Vincent Wyles	Group Development Director		Portman Channel Islands Limited Portman Financial Services Limited Ridgeway Mortgage Services Limited Sun Bank plc

*The directorships and partnerships marked * are not currently held*

No Director has any unspent convictions in relation to indictable offences.

No Director has had a bankruptcy order made against him/her or been a party to an individual voluntary arrangement.

No Director has been a director with an executive function of a company which has been placed in receivership, compulsory liquidation, creditors voluntary liquidation, administration or has been a party to a composition or arrangement with its creditors generally or any class of its creditors either while a director of that company or within the 12 months preceding any such event.

No Director has been a partner in a partnership which has been placed in compulsory liquidation or administration or has been party to a partnership voluntary arrangement either while a partner in that partnership or within the 12 months preceding any such event.

No Director has been a partner in a partnership and had a receiver appointed over any of his/her or partnership assets either while a partner in that partnership or within the 12 months preceding any such appointment.

No Director has been subject to any public criticism by statutory or regulatory authorities (including recognised professional bodies) and no Director has ever been disqualified by a court from acting as a director of a company or from acting in management or conduct of the affairs of any company.

Certain provisions of the Rules relating to the Directors

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

Except in certain circumstances relating to a resolution of the Board to determine the annual remuneration of the Directors, 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. If he shall so vote, his vote shall not be counted nor shall he be counted in any quorum when any such contract, or proposal for a contract, is under consideration.

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 the 50p per £100 of total assets of the Society as at the first day of the financial year 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 schemes (whether contributory or not) for the benefit of past, present or future Executive 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 the conclusion of the Annual General Meeting next following the date at which he attains 70 years of age.

Directors' Interests

The Directors of the Society have no interest in any transaction which is or was unusual in its nature or conditions or significant to the business of the Group and which was effected by the Society during the current or immediately preceding financial year or was effected by the Society during an earlier financial year and remains in any respect outstanding or unperformed.

With the exception of Glyn Smith who holds a beneficial interest in £9,000 of Existing PIBS through the Portman Supplementary Retirements Benefits Plan 2, no Director of the Society nor any child, stepchild (in each case under the age of 18), spouse or other connected person of any Director of the Society (as ascertained by each Director with reasonable diligence) has any interest in any PIBS or any other share capital of the Society or options in respect of any PIBS or other such share capital.

Guarantees and Loans

There are no outstanding loans granted by the Society to the Directors nor any guarantees that have been provided by the Society for their benefit.

Employee Schemes

There are no existing share schemes involving the Directors or any employees of the Society or its subsidiary undertakings in any capital of the Society or its subsidiary undertakings.

Directors' Service Agreements

The Society has entered into the following service agreements (the "Service Agreements") with its Executive Directors:

- (a) a Service Agreement with Robert Sharpe dated 1 October 1999, pursuant to which he is employed as the Society's Chief Executive at a current basic annual salary of £305,000. The Agreement is terminable by the Society on 12 months' notice and by Mr Sharpe on 6 months' notice;
- (b) a Service Agreement with Glyn Smith dated 1 October 1999, pursuant to which he is employed as the Society's Group Finance Director at a current basic annual salary of £210,500. The Agreement is terminable by the Society on 12 months' notice and by Mr Smith on 6 months' notice; and
- (c) a Service Agreement with Matthew Wyles dated 1 October 1999, pursuant to which he is employed as the Society's Group Development Director at a current basic annual salary of £193,500. The Agreement is terminable by the Society on 12 months' notice and by Mr Wyles on 6 months' notice.

The Service Agreements contain provisions which allow the Society to terminate the employment of the respective Directors by payment in lieu of notice. The Service Agreements do not provide for compensation payable for early termination.

The salaries of the Executive Directors are reviewed once each year by the Chairman's Remuneration and Nomination Committee, whose recommendations are considered by the Board. The next review is to be with effect from 1 January 2004. Executive Directors participate in a discretionary performance-related bonus scheme which is calculated by reference to a number of financial and business indicators. The bonuses awarded in respect of the financial year ended 31 December 2002 amounted to £69,000 for Mr Sharpe, £44,000 for Mr Smith and £44,000 for Mr Wyles. They are also entitled to participate in the Society's contributory final salary pension scheme, and to private health insurance, permanent health insurance and life assurance cover and an appropriate fully expensed motor car. Executive Directors are also entitled to pension benefits provided through unfunded and funded retirement benefit schemes.

Save as disclosed above, no Director of the Society has a service agreement with either the Society or any of its subsidiary undertakings.

Amounts Payable to the Directors

Total aggregate remuneration and benefits in kind of £1,209,000 were paid to Directors of the Society by the Group in respect of the financial year ended 31 December 2002. It is estimated that an aggregate sum of approximately £1,300,000 will be payable to the Directors of the Society by the Group in respect of remuneration and benefits in kind during the financial year ending 31 December 2003.

CAPITALISATION AND INDEBTEDNESS

The following table is a summary of the Group's unaudited shareholders' funds and indebtedness as at 30 June 2003 as adjusted to reflect the issue of the PIBS.

	<i>£ million</i>
Shareholders' Funds	
Shares	7,935
Permanent interest bearing shares (including the PIBS)	185
General reserve	473
Total shareholders' funds	<u>8,593</u>
Indebtedness	
Amounts owed to credit institutions	223
Amounts owed to other customers	1,490
Other liabilities and provisions	47
Debt securities in issue	907
Subordinated liabilities	130
Total Indebtedness	<u>2,797</u>
Total Shareholders' Funds and Indebtedness	<u>11,390</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 issue of the PIBS, at the date of this document there has been no material change in the capitalisation and indebtedness of the Society and its subsidiary undertakings since 30 June 2003.

So far as is known to the Society, no persons, directly or indirectly, jointly or severally, exercise or could exercise control over the Society and no person is interested, directly or indirectly, in three per cent. or more of the Society's capital.

No capital of the Society or of its subsidiary undertakings is under any option or has been agreed to be put under any option to any person.

The following pages 27 to 56 contain information which has been reproduced from the Society's 2001 and 2002 audited financial statements (amended to reflect references to pages in this document).

GROUP FINANCIAL SUMMARY

The following information has been extracted from or, in the case of certain financial ratios, derived directly from figures appearing in the consolidated annual reports and accounts of the Society for the three years ended 31 December 2002.

	2002	<i>2001</i> <i>as restated</i>	<i>2000</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Balance Sheet			
Total assets	10,372.6	9,052.1	6,842.1
Loans and advances to customers	8,237.3	7,017.0	5,240.4
Shares	7,660.1	6,799.4	5,884.3
Deposits and debt securities in issue	2,012.9	1,585.3	501.7
Reserves	449.9	405.7	359.1
Balance Sheet Ratios			
<i>Percentage of total assets</i>	<i>%</i>	<i>%</i>	<i>%</i>
Liquidity	19.00	20.97	22.03
Reserves	4.34	4.48	5.25
Gross capital	6.17	6.58	6.05
Free capital	5.42	5.82	5.51
Profitability			
Net interest margin	1.11%	1.22%	1.28%
Pre tax profit	£64.1m	£59.0m	£54.3m
Financial Performance			
	<i>%</i>	<i>%</i>	<i>%</i>
Post tax return on mean total assets	0.46	0.55	0.57
Post tax return on mean total reserves	10.33	10.80	10.99
Costs to mean total assets	0.82	0.82	0.85
Cost income ratio	54.66	50.90	50.32
Mortgage provisions to mean mortgage assets	0.02	0.01	0.01
Growth Ratios			
	<i>%</i>	<i>%</i>	<i>%</i>
Total assets	14.59	32.30	8.32
Mortgage balances	17.39	33.90	6.26
Reserves	10.89	12.98	11.63
Shares	12.66	15.55	19.21
Pre tax profit	8.64	8.66	1.31

Investors should not just rely on the Group Financial Summary provided above but rather read this information in conjunction with the remainder of this document.

GROUP FINANCIAL STATEMENTS

The following information has been extracted without material adjustment from the Society's consolidated audited annual reports and accounts for the three years ended 31 December 2002.

Group Income and Expenditure Accounts

	Notes	Year ended 31 December			
		2002	2001	2001	2000
		<i>as restated</i>			
		<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Interest receivable and similar income	1	449.2	421.6	421.6	411.7
Interest payable and similar charges	2	(341.0)	(329.6)	(329.6)	(327.7)
Net interest receivable		108.2	92.0	92.0	84.0
Other income					
Fees and commissions receivable		37.3	31.2	31.2	27.7
Fees and commissions payable		(2.5)	(3.0)	(3.0)	(1.9)
Other operating income		1.9	1.4	1.4	0.9
Total other income		36.7	29.6	29.6	26.7
Total income		144.9	121.6	121.6	110.7
Administrative expenses	3	(71.0)	(56.7)	(56.7)	(46.9)
Depreciation and amortisation		(8.2)	(5.2)	(5.2)	(8.8)
Operating profit before provisions		65.7	59.7	59.7	55.0
Provisions for bad and doubtful debts	10	(1.6)	(0.7)	(0.7)	(0.7)
Profit on ordinary activities before tax		64.1	59.0	59.0	54.3
Tax on profit on ordinary activities	5	(19.9)	(17.7)	(18.2)	(16.9)
Profit for the financial year	27	44.2	41.3	40.8	37.4

Profit for the financial year arises from continuing operations.

Statement of Total Recognised Gains and Losses

	Notes	Year ended 31 December			
		2002	2001	2001	2000
		<i>as restated</i>			
		<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Profit for the financial year	27	44.2	41.3	40.8	37.4
Prior year adjustment	17	5.8	–	–	(4.8)
Total recognised gains since last annual report		50.0	41.3	40.8	32.6

The Statement of Accounting Policies and Notes to the Accounts on pages 31 to 48 of this document form part of this financial information.

Group Balance Sheets

	Notes	As at 31 December			
		2002 £m	2001 as restated £m	2001 £m	2000 £m
ASSETS					
Liquid assets					
Cash in hand and balances with the Bank of England		8.4	7.8	7.8	9.8
Loans and advances to credit institutions	8	386.3	777.3	777.3	772.9
Debt securities	9	1,576.0	1,112.9	1,112.9	724.0
Other liquid assets		–	–	–	0.5
Total liquid assets		1,970.7	1,898.0	1,898.0	1,507.2
Loans and advances to customers					
Loans fully secured on residential property	11	7,933.8	6,477.5	6,477.5	4,848.5
Loans fully secured on residential property subject to non-recourse finance	12	34.8	45.9	45.9	–
Less: non-recourse finance	12	(34.8)	(45.9)	(45.9)	–
Other loans	11	303.5	539.5	539.5	391.9
Total loans and advances to customers		8,237.3	7,017.0	7,017.0	5,240.4
Intangible fixed assets	13	13.8	15.3	18.5	–
Tangible fixed assets	14	86.4	74.4	74.4	54.6
Other assets	15	5.5	5.5	5.5	1.4
Prepayments and accrued income	17	58.9	41.9	32.9	38.5
Total assets		10,372.6	9,052.1	9,046.3	6,842.1
LIABILITIES					
Shares	18	7,660.1	6,799.4	6,799.4	5,884.3
Other borrowings					
Amounts owed to credit institutions	19	189.7	31.6	31.6	42.0
Amounts owed to other customers	20	1,063.9	1,179.8	1,179.8	214.7
Debt securities in issue	21	759.3	373.9	373.9	245.0
Total other borrowings		2,012.9	1,585.3	1,585.3	501.7
Total shares and other borrowings		9,673.0	8,384.7	8,384.7	6,386.0
Other liabilities	22	32.3	38.8	38.8	34.2
Accruals and deferred income	23	26.7	31.2	31.2	6.7
Provisions for liabilities and charges	24	0.7	1.7	1.7	1.1
Subordinated liabilities	25	130.0	130.0	130.0	55.0
Subscribed capital	26	60.0	60.0	60.0	–
Reserves - general reserves	27	449.9	405.7	399.9	359.1
Total liabilities		10,372.6	9,052.1	9,046.3	6,842.1
MEMORANDUM ITEMS					
Commitments	28	3.0	15.3	15.3	7.5

The Statement of Accounting Policies and Notes to the Accounts on pages 31 to 48 of this document form part of this financial information.

Group Cash Flow Statements

	Year ended 31 December		
	2002 £m	2001 £m	2000 £m
Net cash inflow from operating activities	507.2	343.6	205.2
Returns on investments and servicing of finance	(12.9)	(4.3)	(3.8)
Taxation	(19.3)	(16.7)	(19.0)
Capital expenditure and financial investment			
Purchase of investment securities	(2,941.8)	(1,900.0)	(1,085.3)
Sale and maturity of investment securities	2,487.7	1,512.8	877.7
Purchase of tangible fixed assets	(19.6)	(25.8)	(20.9)
Sale of tangible fixed assets	0.9	1.9	4.0
	(472.8)	(411.1)	(224.5)
Acquisitions			
Purchase of subsidiary undertaking	–	(93.8)	–
Net cash acquired with subsidiary	–	46.8	–
	–	(47.0)	–
Financing	–	135.0	–
Increase/ (decrease) in cash	2.2	(0.5)	(42.1)
Reconciliation of profit before tax to net cash inflow from operating activities			
Profit on ordinary activities before tax	64.1	59.0	54.3
(Increase)/ decrease in prepayments and accrued income	(23.1)	9.7	(19.8)
(Decrease)/ increase in accruals and deferred income	(26.2)	15.1	56.9
Provisions for bad and doubtful debts	1.9	1.9	1.4
Loans and advances written off net of recoveries	(0.7)	(0.6)	(4.0)
Depreciation and amortisation	8.5	5.8	8.8
Interest on subordinated liabilities and subscribed capital	12.9	4.3	3.8
Profit on sale of tangible fixed assets	(0.3)	(0.8)	(1.2)
Provisions for liabilities and charges	(1.0)	0.6	(0.1)
Other non-cash movements	–	0.1	–
Net cash inflow from trading activities	36.1	95.1	100.1
Net increase in loans and advances to customers	(1,221.3)	(653.3)	(317.6)
Net increase in shares	874.2	912.8	888.1
Net increase/ (decrease) in amounts owed to credit institutions and other customers	50.0	(122.7)	(386.3)
Net increase/ (decrease) in debt securities in issue	385.8	125.9	(63.3)
Net decrease/ (increase) in loans and advances to credit institutions	388.0	(9.1)	(20.3)
Net (increase)/ decrease in other assets	(0.2)	0.3	(0.8)
Net (decrease)/ increase in other liabilities	(5.4)	(5.4)	5.3
Net cash inflow from operating activities	507.2	343.6	205.2
Analysis of cash balances included in the balance sheet			
Cash in hand and balances with the Bank of England	8.4	7.8	9.8
Loans and advances to credit institutions repayable on demand	10.2	8.6	7.1
	18.6	16.4	16.9

Statement of Accounting Policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Group and Society Accounts.

Basis of preparation and consolidation

The Accounts have been prepared under the historical cost convention and in accordance with the Building Societies Act (Accounts and Related Provisions) Regulations 1998, applicable accounting standards and the relevant aspects of the Statements of Recommended Practice, issued by the British Bankers' Association and regarded as best practice for the industry. Comparative figures have been amended as a result of the adoption of FRS 19 'Deferred Tax' and consequent recognition for the first time of general provisions for doubtful debts as allowable timing differences. Details of this prior year adjustment are included in note 17 to the Accounts.

The Group Accounts consolidate the state of affairs, cash flows and income and expenditure of the Society, its subsidiary undertakings and other companies which were considered by the Directors to be quasi-subidiaries as defined in FRS 5 'Reporting the Substance of Transactions', using the acquisition method of accounting. These quasi-subidiaries had year ends other than 31 December and were consolidated using internal management accounts prepared to that date.

Investments in subsidiary undertakings are stated at the lower of cost and net recoverable amounts.

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings represents the excess of cost over the fair value of net assets acquired. Goodwill arising on acquisition is capitalised within intangible fixed assets and amortised using the straight line method over the Directors' best estimate of its useful economic life, which does not exceed 20 years.

Liquid assets

Debt securities intended for use on a continuing basis in the Group's activities are classified as financial fixed assets and are stated at cost. At the date of purchase, the cost is adjusted, where relevant, to exclude accrued interest and a similar adjustment is made on realisation. Where the adjusted purchase price differs from the nominal value, the premium or discount is amortised over the period to maturity. Any amounts so amortised are charged or credited to interest receivable in the income and expenditure account in the relevant financial years. Other liquid assets are stated at the lower of cost or net realisable value.

Provisions for bad and doubtful debts

Provisions are made to reduce the value of loans and advances 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 loans and advances on properties which are in possession, or where the value of arrears represents 1% or more of the balance outstanding. Specific provision is made against those loans and advances which are considered to be significantly impaired.

A general provision is also made to cover losses which, although not specifically identified, are known to be present at the year end in any portfolio of advances.

Interest from 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 or where there is significant risk of loss and, as a result, the recoverability of the interest is subject to doubt. Such interest is credited to an interest suspense account and is written off unless recovered after the sale of the property.

The charge to the income and expenditure account comprises the increase in the provisions together with losses written off during the year not previously provided for.

Fixed assets and depreciation

The cost of additions and major alterations to office premises and equipment is capitalised. The cost of fixed assets less estimated residual value is written off on a straight line basis over their estimated useful lives as follows:

Head Office premises	50 years
Head Office fit out costs	10 years
Short leasehold property	Period of lease up to 50 years
Equipment, fixtures, fittings and motor vehicles	3 to 10 years
Branch refurbishment costs	10 years

Land is not depreciated

Depreciation is not provided on freehold and long leasehold land and buildings where the estimated useful life exceeds 50 years, since the Directors consider it would be immaterial, at this time, in view of the long economic lives and high standards of maintenance of these properties. In accordance with FRS 15 'Tangible Fixed Assets', non-depreciated properties are reviewed annually for impairment. Any impairment in value of such properties is dealt with through the income and expenditure account.

Asset financing

The amounts due on all asset finance agreements are recorded in the balance sheet as loans and advances to customers at the amount of the net investment in the agreements after provisions for bad and doubtful debts. The income is accrued over the term of the agreement on the sum-of-digits basis.

Hedging

All interest rate related contracts are classified at the balance sheet date as hedging contracts. For an instrument to be classified as a hedge, the transaction should be expected to reduce significantly the risks inherent in the financial assets, liabilities or cash flows being hedged, arising from potential fluctuations in interest rates and market indices. The intention to hedge against such risks must be established at the outset of the transaction.

Income or expenditure on hedging contracts is recognised on an equivalent basis to the assets, liabilities or positions that are being hedged. If the hedge contract is terminated early, the realised gain or loss is amortised over the residual life of the underlying instrument. If the underlying instrument is redeemed, the remaining unamortised amount is immediately recognised in the income and expenditure account. Amounts accrued on hedging instruments are included within prepayments and accrued income or accruals and deferred income.

Debt securities

Premia and discounts, together with commissions and other costs incurred in the raising of debt securities, are amortised over the period to maturity. Any amounts so amortised are charged or credited to interest payable in the income and expenditure account in the relevant financial years.

Mortgage indemnities

The Society charges certain borrowers a premium for its exposure to uninsured mortgage losses. This income is deferred and offset against the initial loan balance within loans and advances to customers. It is credited to income on a level yield basis over the expected life of the loan.

Mortgage promotional costs

The cost of cash incentives and discounts given on certain mortgage products is charged against interest receivable in the income and expenditure account in the year in which it arises.

Operating leases

Rentals under operating leases are charged to administrative expenses in the income and expenditure account on a straight line basis over the life of the lease.

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Full provision is made for deferred taxation in accordance with the Group's adoption of FRS 19 'Deferred Tax'. Prior year figures have been restated accordingly as set out in note 17 to the Accounts.

Pension costs

The Society's contributions to its defined benefit pension scheme are charged to the income and expenditure account, under administrative expenses, so as to spread the cost of pensions as assessed by independent actuaries over the service lives of the members of the scheme. Any difference between the charge to the income and expenditure account and the Society's contributions paid to the scheme is shown in the balance sheet.

The Society also operates a defined contribution pension scheme. Contributions are charged to the income and expenditure account as they become payable in accordance with the rules of the scheme.

Notes to the Accounts

1 INTEREST RECEIVABLE AND SIMILAR INCOME

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
On loans fully secured on residential property	372.2	310.9	303.1
On other loans	22.7	26.1	31.9
On debt securities			
Interest and other income	54.1	43.5	33.1
On other liquid assets			
Interest and other income	23.5	47.3	43.4
Net expense on financial instruments	(23.3)	(6.2)	0.2
	449.2	421.6	411.7

Interest on secured advances, as shown above, has been increased by £0.1 million in 2002 (2001: £nil, 2000: £0.1 million), representing interest now considered recoverable in respect of repossessed properties in accordance with the Group's accounting policy.

Movements in the suspended interest account were as follows:

At 1 January	0.2	0.3	0.3
Interest written off during the year	–	(0.1)	(0.1)
Interest now considered recoverable	(0.1)	–	–
Interest suspended during period	–	–	0.1
At 31 December	0.1	0.2	0.3

The amount of interest suspended at the end of the year has been deducted from the appropriate assets in the Group and Society balance sheets in 2000, 2001 and 2002.

2 INTEREST PAYABLE AND SIMILAR CHARGES

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
On shares held by individuals	263.5	298.7	294.8
On other shares	0.1	0.1	0.1
On subscribed capital	4.3	0.6	–
On deposits and other borrowings			
Subordinated liabilities	8.5	5.3	3.8
Other	77.4	32.6	39.4
Net income on financial instruments	(12.8)	(7.7)	(10.4)
	341.0	329.6	327.7

3 ADMINISTRATIVE EXPENSES

Staff costs			
Wages and salaries	34.1	27.9	24.1
Social security costs	2.8	2.0	2.0
Other pension costs	4.0	4.2	3.3
	40.9	34.1	29.4
Other administrative expenses	30.1	22.6	17.5
	71.0	56.7	46.9
Remuneration of auditors and their associates			
Audit fees	0.2	0.1	0.1
Non-audit fees	0.7	0.6	0.1

£1.8 million of wages and salaries was capitalised during the year 2002 (2001: £0.4 million, 2000: £nil) for Group and Society as part of long-term projects to enhance the Society's computer systems.

4 STAFF NUMBERS

The average number of persons, including Executive Directors, employed during the year was as follows:

	FULL TIME			PART TIME		
	2002	2001	2000	2002	2001	2000
Group						
Central administration	819	627	554	86	70	69
Branches	416	428	374	268	278	282
	1,235	1,055	928	354	348	351

5 TAX ON PROFIT ON ORDINARY ACTIVITIES

	Year ended 31 December			
	2002	2001	2001	2000
	as restated			
	£m	£m	£m	£m
Current Tax				
UK Corporation tax at 30%	18.2	17.1	17.1	17.7
Corporation tax – adjustment for prior year	–	(0.7)	(0.7)	–
Total current tax	18.2	16.4	16.4	17.7
Deferred tax – origination and reversal of timing differences (note 17)	2.0	0.7	1.2	(0.5)
Deferred tax – adjustment for prior year (note 17)	(0.3)	0.6	0.6	(0.3)
	19.9	17.7	18.2	16.9

The current tax charge for the year differs from that calculated using the standard rate of UK corporation tax as follows:

Profit on ordinary activities before tax at the standard rate of UK corporation tax	19.2	17.7	17.7	
Effects of				
Expenses not deductible for tax purposes (including goodwill) and non-taxable income	1.6	0.6	0.6	
Capital allowances for year in excess of depreciation	(2.6)	(1.2)	(1.2)	
Adjustment to tax charge in respect of previous periods	–	(0.7)	(0.7)	
Current tax charge for the year	18.2	16.4	16.4	

As set out in note 17 to the Accounts, the Society and Group have adopted FRS 19 'Deferred Tax' and have restated 2001 year results accordingly.

6 DIRECTORS

Directors' emoluments

Emoluments of the Society's Directors for 2002 are detailed below:

	Feelsalary £000	Bonus £000	Increase		Total £000
			Other benefits £000	in accrued pension £000	
Non-Executive Directors					
D John S Roques	63	–	–	–	63
Lord Stewartby (to 30/6/02))	21	–	–	–	21
F Alastair L Robinson	34	–	–	–	34
Rosemary S Barnes (to 30.06.02)	14	–	–	–	14
Susan C Ellen	28	–	–	–	28
Mark P Nicholls (from 1/12/02)	2	–	–	–	2
William Tudor John	28	–	–	–	28
Patricia M Vaz	28	–	–	–	28
A Harry Westropp	28	–	–	–	28
Year ended 31 December 2002	246	–	–	–	246
Year ended 31 December 2001	220	–	–	–	220
Year ended 31 December 2000	208	–	–	–	208

6 DIRECTORS (continued)

	<i>Feelsalary</i> £000	<i>Bonus</i> £000	<i>Other</i> <i>benefits</i> £000	<i>Increase</i> <i>in accrued</i> <i>pension</i> £000	<i>Total</i> £000
Executive Directors					
Robert Sharpe	286	69	25	14	394
Glyn M Smith	200	44	46	3	293
Matthew P V Wyles	184	44	45	3	276
Year ended 31 December 2002	670	157	116	20	963
Year ended 31 December 2001	615	153	76	25	869
Year ended 31 December 2000	583	212	116	28	939
Total emoluments					
Year ended 31 December 2002	916	157	116	20	1,209
Year ended 31 December 2001	835	153	76	25	1,089
Year ended 31 December 2000	791	212	116	28	1,147

Pension payments of £11,000 (2001: £20,000, 2000: £22,000) were made to a past Director, or connected person thereof, in respect of services as a Director.

Further details of the basis of remuneration of Directors are set out in the Report on Directors' Remuneration. Executive Directors receive benefits from the Society's approved UK pension arrangements and, to the extent that they are subject to the earnings cap, also receive benefits from either funded or unfunded arrangements, which do not qualify for certain tax exemptions under the Income and Corporation Taxes Act 1988.

Included within other benefits above for the year ended 31 December 2002 is £67,000 (2001: £25,000) representing the Society's contributions to the funded pension arrangements for two Executive Directors (G M Smith £35,000 and M P V Wyles £32,000).

The following information shows the value of Directors' pension benefits. The increase in accrued pension represents the change in the annual pension to which each Director is entitled as a result of changes in pensionable earnings and pensionable service during the year. The transfer value equivalent represents the present capital value of the changes in Directors' accrued pension entitlements, excluding their contributions for the year, and has been calculated in accordance with Actuarial Guidance Note GN 11.

	<i>Increase in</i> <i>accrued</i> <i>pension during</i> <i>year ended</i> <i>31 December</i> <i>2002</i> £000	<i>Accrued pension</i> <i>entitlement at</i> <i>31 December</i> <i>2002</i> £000	<i>Transfer value</i> <i>equivalent of</i> <i>increase in accrued</i> <i>pension for</i> <i>year ended</i> <i>31 December</i> <i>2002</i> £000	<i>Directors'</i> <i>contributions</i> <i>for year ended</i> <i>31 December</i> <i>2002</i> £000
Executive Directors				
Robert Sharpe	14	72	261	14
Glyn M Smith	3	9	29	5
Matthew P V Wyles	3	16	19	5

Directors' loans and related party transactions

At 31 December 2002, there were no outstanding mortgage loans granted to any Director or connected person.

A register is maintained at the Head Office of the Society which shows details of all loans, transactions and arrangements with Directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 December 2002, will be available for inspection during normal working hours at the Head Office, Portman House, Richmond Hill, Bournemouth, for a period of 15 days up to and including the Annual General Meeting.

7 PENSION ARRANGEMENTS

The Group operates a defined benefit type scheme based on final pensionable salaries, which is contributory. The funds of the scheme are administered by trustees and are independent of the funds of the Group. Contributions to the scheme are paid in accordance with the recommendations of independent actuaries using the projected unit method.

The latest actuarial valuation of the scheme was at 6 April 2000. The assumptions which have the most significant effect on the results of the latest valuation are those relating to the rate of return on investments and the rate of increase in salaries and pensions. It was assumed that the rate of return on investments would exceed the rate of increase in salaries by 2% per annum compound, that pensions in payment would increase at the rate of 5% per annum compound in respect of credited service to 1 August 2000 and at the lower of 5% or retail price inflation in respect of credited service thereafter.

At the date of the latest valuation, the market value of the assets of the scheme was £72.1 million. The actuarial value of those assets represented 92.3% of the benefits which had accrued to members after allowing for expected future increases in earnings. The Group is maintaining a level of contributions so that the actuarial value of the fund will be equal to the value of accrued benefits within the future life of the current membership.

The defined benefit pension charge for the year 2002 amounted to £3.9 million (2001: £4.2 million, 2000: £3.3 million). An amount of £2.0 million (2001: £nil, 2000: £nil) has been included in prepayments and accrued income, representing the excess of the contributions made to the scheme over the income and expenditure charge. No pension provision is included within provisions for liabilities and charges at 31 December 2002 (2001: £0.7 million, 2000: £nil).

The Group also contributes to a defined contribution scheme. The amount charged for this in the year amounted to £130,000 (2001: £2,000, 2000: £nil).

Whilst the Group continues to account for pension costs in accordance with SSAP 24, under FRS 17 'Retirement Benefits' the following transitional disclosures relating to the scheme at 31 December 2002 are required. The Society and its subsidiaries are unable to identify their share of the scheme assets and liabilities on a reasonable and consistent basis. Therefore, as permitted by FRS 17, the scheme will be accounted for by the Society when the standard is fully adopted.

Scheme assets are stated at their market value at 31 December. The liabilities of the scheme under FRS 17 were calculated using the projected unit method and the following financial assumptions.

	2002	2001
	%	%
Rate of increase in salaries	3.50	3.50
Rate of increase in pensions in payment		
Pre 1 August 2000 service	5.00	5.00
Post 31 July 2000 service	2.50	2.50
Discount rate	6.10	6.25
Inflation assumption	2.50	2.50
Date of last update	31 December 2002	

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

The assets in the scheme, their expected rates of return and the net pension scheme liability at 31 December were:

	<i>Long-term rate of return expected 2002 %</i>	<i>Value 2002 £m</i>	<i>Long-term rate of return expected 2001 %</i>	<i>Value 2001 £m</i>
Equities	8.00	33.2	7.20	39.6
Bonds	4.50	33.5	4.95	29.8
Other		0.1		0.8
Total market value of assets		66.8		70.2
Present value of scheme liabilities		(92.2)		(81.6)
Deficit in the scheme at 31 December		(25.4)		(11.4)
Deferred tax asset		7.6		3.4
Net pension liability		(17.8)		(8.0)

The scheme's assets are not intended to be realised in the short term and their fair values may be subject to significant change before the assets are realised. The present values of the scheme's liabilities are derived from cash flow projections over long periods and thus are inherently uncertain. If the net pension liability had been recognised in the Accounts the Group's general reserves would, as a consequence, be reduced.

7 PENSION ARRANGEMENTS (continued)

	2002 £m
Movement in the deficit in the scheme during the year	
Deficit in the scheme at beginning of year	(11.4)
Current service cost	(2.9)
Contributions	5.9
Other finance income	(1.0)
Actuarial deficit	(16.0)
Deficit in the scheme at end of year	<u>(25.4)</u>

The full actuarial valuation at 31 December 2002 under FRS 17 showed an increase in the liability from £11.4 million to £25.4 million.

The following are disclosed in note form only, in accordance with the transitional rules of FRS 17.

The amount which would be charged to operating profit is analysed as follows:

Current service cost	2.9
Total operating charge	<u>2.9</u>

The amount which would be credited/(charged) to other finance income is analysed as follows:

Expected return on pension scheme assets	4.5
Interest on pension scheme liabilities	(5.5)
Net return	<u>(1.0)</u>

The amount which would be recognised in the Statement of Total Recognised Gains and Losses (STRGL) is analysed as follows:

Actual return less expected return on pension scheme assets	(11.8)
Experience gains and losses arising on the scheme liabilities	(0.1)
Changes in assumptions underlying the present value of the scheme's liabilities	(4.1)
Actuarial deficit recognised in STRGL	<u>(16.0)</u>

History of experience gains and losses

Difference between the expected and actual return on scheme assets	
Amount	£11.8m
Percentage of scheme assets	17.7%
Experience gains and losses on scheme liabilities	
Amount	£0.1m
Percentage of the present value of the scheme liabilities	0.1%
Total amount recognised in STRGL	
Amount	£16.0m
Percentage of the present value of the scheme liabilities	17.4%

8 LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	<i>Year ended 31 December</i>		
	2002	2001	2000
	£m	£m	£m
Loans and advances to credit institutions have remaining maturities as follows:			
Accrued interest	1.1	5.7	11.9
Repayable on demand	10.2	8.6	7.1
Other loans and advances by remaining maturity repayable			
In not more than three months	344.0	681.6	469.3
In more than three months but not more than one year	30.0	74.4	268.6
In more than one year but not more than five years	1.0	7.0	16.0
	386.3	777.3	772.9

Included within the Society's 'Loans and advances to credit institutions' in 2002 is £1,170.5 million (2001: £116.0 million) due from Sun Bank plc, a subsidiary undertaking.

9 DEBT SECURITIES

	<i>Year ended 31 December</i>		
	2002	2001	2000
	£m	£m	£m
Debt securities have remaining maturities as follows:			
Accrued interest	17.8	9.0	7.4
In not more than one year	1,012.0	623.0	215.0
In more than one year	546.2	480.9	501.6
	1,576.0	1,112.9	724.0
Analysis of transferable debt securities, excluding accrued interest			
Listed on a recognised investment exchange	605.7	547.7	456.6
Unlisted	952.5	556.2	260.0
	1,558.2	1,103.9	716.6
Market value of listed transferable debt securities	605.7	548.4	457.1
Included in debt securities are:			
Unamortised premiums	0.1	0.1	–
Unamortised discounts	(0.4)	(0.3)	(0.3)

The Directors of the Society consider that the primary purpose of holding securities is prudential. All transferable securities held as liquid assets are held with the intention of use on a continuing basis in the Society's activities and are classified as 'financial fixed assets'. No debt securities have been issued by public bodies.

Movements during the year of debt securities held as financial fixed assets are analysed as follows:
Adjusted cost and net book value:

At 1 January	1,103.9	716.6	508.8
Additions	2,941.8	1,900.0	1,085.3
Disposals	(2,487.7)	(1,512.8)	(877.7)
Amortisation gain during the year	0.2	0.1	0.2
At 31 December	1,558.2	1,103.9	716.6

10 PROVISIONS FOR BAD AND DOUBTFUL DEBTS

	<i>Loans fully secured on residential property</i>	<i>Loans fully secured on land</i>
	Total £m	£m
Group		
At 1 January 2002 – general provision	20.4	19.7
– specific provision	2.0	1.7
	22.4	21.4
Amounts written off to specific provision	(0.4)	(0.2)
Income and expenditure account		
– general provision	2.0	2.1
– specific provision	(0.1)	(0.1)
	1.9	2.0
Adjustments to specific provision resulting from recoveries	(0.3)	(0.2)
	1.6	1.8
At 31 December 2002 – general provision	22.4	21.8
– specific provision	1.2	1.2
	23.6	23.0

11 LOANS AND ADVANCES TO CUSTOMERS

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
Loans fully secured on residential property	7,933.8	6,477.5	4,848.5
Other loans			
Loans fully secured on land	303.4	474.1	391.8
Other loans	0.1	65.4	0.1
	8,237.3	7,017.0	5,240.4

Maturity analysis

The remaining maturity of loans and advances to customers from the date of the balance sheet is as follows:

Accrued interest	0.2	–	0.4
On call and at short notice	0.7	0.9	1.3
In not more than three months	42.6	43.1	24.2
In more than three months but not more than one year	118.1	99.8	57.6
In more than one year but not more than five years	700.5	578.1	394.3
In more than five years	7,407.6	6,328.9	4,781.6
	8,269.7	7,050.8	5,259.4
Less: provisions (note 10)	(23.6)	(22.4)	(19.0)
Less: deferred mortgage guarantee income	(8.8)	(11.4)	–
	8,237.3	7,017.0	5,240.4

12 LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO SECURITISATION ARRANGEMENTS

Sun Bank plc, a subsidiary of the Society, has advances secured on residential properties subject to non recourse finance and, as a result, has two quasi-subsiidiaries, as defined under FRS 5 'Reporting the Substance of Transactions', Maple Mortgage Holdings Limited (MHL) and Maple Mortgage Securities No.1 plc (MMS). MMS is registered in England and Wales. The holding company of MMS is MHL, which is a private company with limited liability. The entire share capital of MHL is held beneficially by a trustee for the benefit of the MHL creditors, or the holders of notes issued by any wholly owned subsidiary of MHL, and ultimately for charitable purposes.

During the year, the Group received income from the purchaser of the loans, which consisted of the income derived from the loans after deducting the funding costs and other expenses.

The securitisation provides that the Group may offer to sell further loans subject to their meeting certain criteria. No such sale has yet been made. Terms regarding the purchase of loans vary depending on the circumstances of each transaction. The Group generally has no obligation to repurchase loans other than in relation to any breach of warranty at the time of sale. All proceeds are payable to an appointed trustee and are held on trust for the beneficial owner of the loans, subject to the Group's right to receive certain entitlements. The securitisation offering documentation sets out the acknowledgement of the trustee to the providers of finance that they would seek repayment of the loans only to the extent that repayment is funded by proceeds generated by the loans and that they would not seek recourse in any other form. Other than as disclosed on the balance sheet, the Group is not obliged to support any losses in respect of public securitisations, nor does it intend to.

There are amounts due in respect of the securitised loans which comprise subordinated loans from the Group to the purchasers of the assets. These loans are held by the purchasers in order to meet any losses arising on the assets sold which may not be recovered out of income due to the Group. These amounts are repayable in accordance with the terms of the notes issued in connection with the securitisation to the extent that such amounts are not required to redress losses incurred on the securitised portfolio. As at 31 December 2002, subordinated loans from the Group to MMS amounted to £1.75 million and were included under 'Other assets'.

12 LOANS AND ADVANCES TO CUSTOMERS SUBJECT TO SECURITISATION ARRANGEMENTS (continued)

Under the provisions of FRS 5, the results of MHL have been included in the Group Accounts using the linked presentation method. Detailed below are the summarised unaudited consolidated financial statements of MHL for the year to 31 December 2002.

	2002 £m	2001 £m
Balance Sheet at 31 December		
Loans and advances to customers	33.8	43.7
Other assets	1.0	2.2
Creditors	(34.8)	(45.9)
Total net assets	-	-
Profit and Loss Account for the year ended 31 December		
Total income	4.6	7.7
Total expenses	(4.6)	(7.7)
Profit after tax	-	-
Amounts receivable in respect of a gross distribution from the securitised vehicle of £0.3 million (2001: £0.1 million, 2000: £nil) are included under 'Fees and commissions receivable'.		
Cash Flow Statement		
Net cash outflow before financing and decrease in cash	(1.1)	(1.5)

13 INTANGIBLE FIXED ASSETS

	2002 £m	2001 as restated £m	2001 £m
<i>Goodwill</i>			
Group			
Cost			
At 1 January	18.7	-	-
Prior year adjustment (note 17)	(3.2)	-	-
At 1 January as restated	15.5	-	-
Additions	-	15.5	18.7
At 31 December	15.5	15.5	18.7
Amortisation			
At 1 January	0.2	-	-
Charged in year	1.5	0.2	0.2
At 31 December	1.7	0.2	0.2
Net book value			
At 31 December	13.8	15.3	18.5

The goodwill arises following the acquisition of Sun Bank plc on 30 November 2001. The goodwill is being amortised on a straight line basis over 10 years.

14 TANGIBLE FIXED ASSETS

Group	Total	Land and buildings	Equipment, fixtures & fittings & vehicles
	£m	£m	£m
Cost			
At 1 January 2002	109.0	53.8	55.2
Additions	19.6	6.8	12.8
Disposals	(1.3)	(0.8)	(0.5)
At 31 December 2002	127.3	59.8	67.5
Depreciation			
At 1 January 2002	34.6	4.5	30.1
Charged in year	7.0	1.6	5.4
Disposals	(0.7)	(0.3)	(0.4)
At 31 December 2002	40.9	5.8	35.1
Net book value			
At 31 December 2002	86.4	54.0	32.4
At 31 December 2001	74.4	49.3	25.1
	<i>Year ended 31 December</i>		
	2002	2001	2000
	£m	£m	£m
The net book value of land and buildings comprises:			
Freehold	48.6	44.8	17.1
Long leasehold	0.2	0.2	0.6
Short leasehold	5.2	4.3	4.7
	54.0	49.3	22.4
Occupied by the Group/Society for its own activities	48.7	43.9	16.6
Non-depreciated properties have been subject to an impairment test in 2002.			

15 OTHER ASSETS

Included within the Society's 'Other assets' is £nil (2001: £0.1 million, 2000: £0.1 million) due from Group companies.

16 INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

SOCIETY	Subordinated debt	Shares	Loans	Total
	£m	£m	£m	£m
Cost and net book value				
At 1 January 2002	20.1	91.3	15.9	127.3
Additions	5.0	2.5	0.2	7.7
Repayments	(12.0)	–	(3.8)	(15.8)
At 31 December 2002	13.1	93.8	12.3	119.2

The Society holds the following interest in operating subsidiary undertakings:

	Country of registration or incorporation	Principal activity	Class of shares held	Interest of Society %
Sun Bank plc*	England	Banking services	Ordinary	100
Portman Channel Islands Ltd*	Guernsey	Offshore deposit taking	Ordinary	100
Ridgeway Mortgage Services Ltd	England	Mortgage lending	Ordinary	100
Confederation Mortgage Services Ltd	England	Mortgage lending	Ordinary	100
Exeter Trust Financial Services Ltd	England	Asset backed lending	Ordinary	100
Exeter Trust Ltd	England	Mortgage lending	Ordinary	100
Primett Property Management Ltd	England	Property management	Ordinary	100

*Indicates the names of the subsidiary undertakings, included in the consolidation, where that information is important for the purpose of assessing the assets and liabilities, financial position and profits and losses.

17 PREPAYMENTS AND ACCRUED INCOME

	Year ended 31 December			
	2002	2001	2001	2000
		as restated		
	£m	£m	£m	£m
Interest accrued on financial instruments	43.8	29.8	29.8	35.0
Deferred tax asset	8.0	9.7	0.7	2.1
Other	7.1	2.4	2.4	1.4
	58.9	41.9	32.9	38.5
Deferred tax asset				
At 1 January	9.7	7.4	2.1	1.3
Asset acquired with subsidiary undertaking	–	3.6	0.4	–
Movement in year	(1.7)	(1.3)	(1.8)	0.8
At 31 December	8.0	9.7	0.7	2.1
The amounts provided for deferred tax, are set out below:				
Excess/ (deficit) of depreciation over capital allowances	0.1	2.3	(0.6)	0.7
Other timing differences	7.9	7.4	1.3	1.4
	8.0	9.7	0.7	2.1

Change of accounting policy

The Society and Group have, during 2002, implemented the requirements of FRS 19 'Deferred Tax'. Under FRS 19, full provision is made for tax timing differences and, in particular, deferred tax assets can be recognised where it is more likely than not that there will be sufficient future taxable profits against which to recover them. Previously, they were recognised only where it was probable that they would be recovered without replacement in the foreseeable future.

The impact of the change is that, as at 31 December 2001, Group deferred tax assets have increased by £9.0 million, goodwill on acquisition of Sun Bank plc has reduced by £3.2 million and Group general reserves have increased by £5.8 million. Society deferred tax assets as at 31 December 2001 have increased by £5.7 million and Society general reserves have increased by the same amount. The effect on the results for the year ended 31 December 2001 was to increase Group and Society profit for the financial year by £0.5 million. Had the previous accounting policy been continued, profit for the financial year ended 31 December 2002 would have been £0.5 million higher for the Group and £0.2 million lower for the Society. Profit on ordinary activities before tax is unaffected by the change in accounting policy.

18 SHARES

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
Held by individuals	7,657.7	6,797.4	5,882.1
Other shares	2.4	2.0	2.2
	7,660.1	6,799.4	5,884.3
Repayable from the date of the balance sheet in the ordinary course of business as follows:			
Accrued interest	184.4	197.9	195.6
On demand	5,871.9	5,516.2	4,306.3
Other shares with remaining maturity repayable			
In not more than three months	211.2	262.5	376.8
In more than three months but not more than one year	690.9	681.5	709.2
In more than one year but not more than five years	701.7	141.3	296.4
	7,660.1	6,799.4	5,884.3

19 AMOUNTS OWED TO CREDIT INSTITUTIONS

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
Repayable from the date of the balance sheet in the ordinary course of business as follows:			
Accrued interest	1.1	0.5	0.2
On demand	20.4	2.9	6.3
Other amounts owed to credit institutions with remaining maturity repayable			
In not more than three months	157.7	13.9	10.0
In more than three months but not more than one year	10.0	13.8	–
In more than one year but not more than five years	–	–	25.0
In more than five years	0.5	0.5	0.5
	189.7	31.6	42.0

Included within the Society's 'Amounts owed to credit institutions' in 2002 is £315.5 million (2001: £136.7 million, 2000: £154.2 million) due to Portman Channel Islands Ltd.

20 AMOUNTS OWED TO OTHER CUSTOMERS

Repayable from the date of the balance sheet in the ordinary course of business as follows:			
Accrued interest	14.5	22.9	7.0
On demand	259.2	133.5	118.5
Other amounts owed to other customers with remaining maturity repayable			
In not more than three months	627.1	548.0	46.8
In more than three months but not more than one year	118.8	367.2	35.9
In more than one year but not more than five years	42.6	106.4	6.5
In more than five years	1.7	1.8	–
	1,063.9	1,179.8	214.7

21 DEBT SECURITIES IN ISSUE

Certificates of deposit	403.8	133.5	66.4
Fixed and floating rate notes	355.5	240.4	178.6
	759.3	373.9	245.0
Repayable from the date of the balance sheet in the ordinary course of business as follows:			
Accrued interest	4.0	4.4	1.4
Other debt securities with remaining maturity repayable			
In not more than one year	438.4	234.2	96.0
In more than one year	316.9	135.3	147.6
	759.3	373.9	245.0

22 OTHER LIABILITIES

Income tax	18.2	22.0	21.4
Corporation tax	10.1	11.2	11.1
Other creditors	4.0	5.6	1.7
	32.3	38.8	34.2

Included within the Society's 'Other creditors' is £1.0 million (2001: £1.3 million, 2000: £1.3 million) due to Group companies.

23 ACCRUALS AND DEFERRED INCOME

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
Interest accrued on financial instruments	9.4	9.3	0.5
Interest accrued on subordinated liabilities	1.6	1.7	0.4
Interest accrued on subscribed capital	0.3	0.3	–
Other	15.4	19.9	5.8
	<u>26.7</u>	<u>31.2</u>	<u>6.7</u>

24 PROVISIONS FOR LIABILITIES AND CHARGES

	2002	2001	2000
	£m	£m	£m
At 1 January	1.7	1.1	1.2
Provisions (release)/ charge	(1.0)	0.6	(0.1)
At 31 December	<u>0.7</u>	<u>1.7</u>	<u>1.1</u>

Provisions for liabilities and charges at 31 December 2002 represents provisions for onerous contracts relating to future rentals in respect of vacant leased properties. The provisions will reverse over the length of the lease or, if sooner, the period to the anticipated date of disposal. £0.3 million was released from provisions for onerous contracts during the year (2001: £0.1 million, 2000: £0.1 million). The balance at 1 January 2002 included a provision of £0.7 million in respect of pension costs, which was released during the year (2001: £0.7 million charge).

25 SUBORDINATED LIABILITIES

	Year ended 31 December		
	2002	2001	2000
	£m	£m	£m
Dated loan capital			
Subordinated loan 2009	25.0	25.0	25.0
Subordinated loan 2014	15.0	15.0	15.0
Subordinated notes 2016	75.0	75.0	–
Subordinated loan 2019	15.0	15.0	15.0
	<u>130.0</u>	<u>130.0</u>	<u>55.0</u>

All loans and notes are denominated in sterling. The loan maturing in 2009 has a variable interest rate, set at 0.7% above 3 month LIBOR. The loans and notes maturing in 2014, 2016 and 2019 are fixed at interest rates of 6.73%, 7.125% and 6.74% respectively.

The Society may, with the prior consent of the Financial Services Authority, exercise its option to repay the debt five years before each final maturity.

The rights of repayment of the holders of subordinated debt are subordinated to the claims of all depositors, all creditors and members holding shares (other than holders of deferred shares) in the Society, as regards the principal of their shares and interest due on them.

26 SUBSCRIBED CAPITAL

7.25% permanent interest bearing shares	<u>60.0</u>	<u>60.0</u>	–
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All permanent interest bearing shares (PIBS) are unsecured and denominated in sterling. Interest is payable half yearly on 5 June and 5 December.

The PIBS are repayable, at the option of the Society, in whole on 5 December 2021 and every fifth successive 5 December thereafter. Repaying the PIBS requires the prior consent of the Financial Services Authority. If the PIBS are not repaid on a call date, the interest rate is reset at a margin to the yield on the then prevailing 5 year benchmark gilt.

PIBS are deferred shares of the Society and rank behind the claims of all holders of subordinated debt, all depositors, all creditors and members holding shares in the Society.

27 RESERVES

	2002 £m
General reserves	
At 1 January	399.9
Prior year adjustment (note 17)	5.8
Balance as restated at 1 January	405.7
Profit for the financial year	44.2
At 31 December	449.9

28 MEMORANDUM ITEMS

	Year ended 31 December		
	2002 £m	2001 £m	2000 £m
Commitments			
Undrawn committed loan facilities	3.0	15.3	7.5

29 RELATED PARTY TRANSACTIONS

The Society has related party transactions, as defined under FRS 8 'Related Party Transactions', with Portman Financial Services Ltd (PFS), which is a wholly-owned subsidiary of Aviva plc. Robert Sharpe (Chief Executive) and Matthew Wyles (Group Development Director) are members of the Board of PFS. PFS provides financial planning advice to the Portman members, and the Society receives commission for any financial services products which are sold as a result of these introductions. During the year, the Society received commission amounting to £7.6 million (2001: £8.7 million, 2000: £7.8 million) and at the balance sheet date the amount owing from PFS to the Society amounted to £1.2 million (2001: £0.7 million, 2000: £0.6 million).

30 GUARANTEES AND OTHER FINANCIAL COMMITMENTS

Subsidiary undertakings

The Society has given a contractual undertaking to discharge the liabilities of its offshore subsidiary Portman Channel Islands Ltd in so far as that subsidiary is unable to discharge them out of its own assets. It is also the intention of the Board to support its other subsidiary undertakings.

Capital commitments at 31 December for which no provision has been made in the Accounts

	2002 £m	2001 £m	2000 £m
Contracted but not provided for	4.1	8.3	8.0

Commitments under operating leases

There are commitments to make payments during the forthcoming year under non-cancellable operating leases for land and buildings, which terminate as follows:

	2002 £m	2001 £m	2000 £m
Within one year	0.3	0.7	0.2
Within two to five years	0.9	2.1	0.6
After five years	2.8	2.4	2.2
	4.0	5.2	3.0

31 FINANCIAL INSTRUMENTS

The Society is a retailer of financial instruments in the form of mortgages, savings and insurance products. The Group uses wholesale financial instruments to invest in liquid assets, raise wholesale funding and to manage the risks arising from its operations. Derivative financial instruments (derivatives) are used by the Group to reduce the risk of loss arising from changes in interest rates or other factors which affect the business.

Derivatives are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices.

The Assets and Liabilities Committee (ALCO) is responsible for managing the financial risk of the Group and the minutes of each ALCO meeting are reviewed by the Board of Directors at its subsequent Board meeting. The ALCO is responsible for overseeing the use of derivatives.

31 FINANCIAL INSTRUMENTS (continued)

Types of derivatives

The principal derivatives used in balance sheet risk management are interest rate swaps (IRS), interest rate options and forward rate agreements (FRA), which are used to hedge Group balance sheet exposures arising from fixed rate mortgage lending and savings products, funding and investment activities.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. Alternatively, such risks may be managed using on balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the investment of reserves and other net non-interest bearing liabilities	Sensitivity to changes in interest rates	IRS; FRA
Fixed rate savings products and fixed rate funding	Sensitivity to falls in interest rates	IRS which receive fixed interest rates and pay variable interest rates; FRA
Fixed rate mortgage lending and other fixed rate asset investments	Sensitivity to increases in interest rates	IRS which pay fixed interest rates and receive variable interest rates; FRA

The accounting policies for derivatives are described in the Statement of Accounting Policies on page 32.

The table below analyses derivatives used by type of contract and maturity. Nominal principal amount indicates the volume of business outstanding at the balance sheet date and does not represent the amount at risk. The replacement cost represents the cost of replacing contracts with positive values, calculated at market rates current at the balance sheet date and reflecting the Group's exposure, should the counterparties default. The credit risk weighted amount, which is calculated according to rules specified by the Financial Services Authority, is based on the replacement cost, but also takes into account the extent of potential future exposures and the nature of the counterparty.

	<i>Nominal principal amount</i>	<i>Credit risk weighted amount</i>	<i>Replacement cost</i>	<i>Nominal principal amount</i>	<i>Credit risk weighted amount</i>	<i>Replacement cost</i>
	2002	2002	2002	2001	2001	2001
	£m	£m	£m	3m	£m	£m
Group						
Interest rate contracts						
Interest rate swaps	5,001.9	15.8	61.7	3,966.5	12.1	42.0
Forward rate agreements	–	–	–	260.0	–	–
	5,001.9	15.8	61.7	4,226.5	12.1	42.0
Under one year	2,512.6	6.1	30.3	1,496.9	4.7	23.1
Between one and five years	2,066.9	7.2	25.4	2,236.2	6.0	18.9
Over five years	422.4	2.5	6.0	493.4	1.4	–
	5,001.9	15.8	61.7	4,226.5	12.1	42.0

All of the Group's derivatives activity is contracted with OECD financial institutions.

In addition to credit risk, the financial risks faced by the Group include liquidity risk and interest rate risk.

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 by maintaining a prudent level of liquid assets and wholesale funding, and through managing the growth of the business.

Interest rate risk

The net interest income of all financial assets and liabilities and the market value of the Group's debt securities/financial instruments are exposed to movements in interest rates. This exposure is managed on a continuous basis within limits set by the Board using a combination of on and off balance sheet instruments.

31 FINANCIAL INSTRUMENTS (continued)

The interest rate sensitivity of the Group after taking into account the various derivatives entered into by the Group was:

	Not more than 3 months £m	More than 3 months but not more than 6 months £m	More than 6 months but not more than 1 year £m	More than 1 year but not more than 5 years £m	More than 5 years £m	Non- interest bearing £m	Total £m
At 31 December 2002							
ASSETS							
Liquid assets	1,463.2	310.1	147.4	12.0	–	38.0	1,970.7
Loans and advances to customers	4,700.8	369.2	605.6	2,323.2	270.9	(32.4)	8,237.3
Intangible fixed assets	–	–	–	–	–	13.8	13.8
Tangible fixed assets	–	–	–	–	–	86.4	86.4
Other assets	–	–	–	–	–	64.4	64.4
Total assets	6,164.0	679.3	753.0	2,335.2	270.9	170.2	10,372.6
LIABILITIES							
Shares	6,342.1	304.4	391.9	621.7	–	–	7,660.1
Other borrowings	1,714.8	170.6	52.3	75.2	–	–	2,012.9
Other liabilities	–	–	–	–	–	59.7	59.7
Subordinated liabilities	25.0	–	–	–	105.0	–	130.0
Subscribed capital	–	–	–	–	60.0	–	60.0
Reserves	–	–	–	–	–	449.9	449.9
Total liabilities	8,081.9	475.0	444.2	696.9	165.0	509.6	10,372.6
Off balance sheet items	1,457.1	(137.4)	(302.3)	(925.0)	(92.4)	–	–
Interest rate sensitivity gap	(460.8)	66.9	6.5	713.3	13.5	(339.4)	–
At 31 December 2001 (as restated)							
ASSETS							
Liquid assets	1,657.3	125.0	85.0	15.0	–	15.7	1,898.0
Loans and advances to customers	3,928.1	292.4	415.3	2,110.3	304.7	(33.8)	7,017.0
Intangible fixed assets	–	–	–	–	–	15.3	15.3
Tangible fixed assets	–	–	–	–	–	74.4	74.4
Other assets	–	–	–	–	–	47.4	47.4
Total assets	5,585.4	417.4	500.3	2,125.3	304.7	119.0	9,052.1
LIABILITIES							
Shares	6,117.7	357.4	300.2	24.1	–	–	6,799.4
Other borrowings	1,136.6	130.0	119.9	198.8	–	–	1,585.3
Other liabilities	–	–	–	–	–	71.7	71.7
Subordinated liabilities	25.0	–	–	–	105.0	–	130.0
Subscribed capital	–	–	–	–	60.0	–	60.0
Reserves	–	–	–	–	–	405.7	405.7
Total liabilities	7,279.3	487.4	420.1	222.9	165.0	477.4	9,052.1
Off balance sheet items	1,849.9	(200.5)	(34.6)	(1,431.3)	(183.5)	–	–
Interest rate sensitivity gap	156.0	(270.5)	45.6	471.1	(43.8)	(358.4)	–

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities. Other assets include other loans, other assets, prepayments and accrued income. Other borrowings represent owed to credit institutions and other customers and debt securities. Other liabilities include other liabilities, accruals and deferred income and provisions for liabilities and charges.

The Society manages its balance sheet risk using dynamic simulation. Stress testing is carried out under various interest rate scenarios and business strategies, and the risk to net interest receivable is determined.

31 FINANCIAL INSTRUMENTS (continued)

Gains and losses on hedges

Gains and losses on hedges are recognised on an equivalent basis to the assets, liabilities or positions that are being hedged.

Hedge accounting movements in the year were as follows:

	<i>Gains</i>	<i>Losses</i>	<i>Net gains/ (losses)</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Amounts deferred in the balance sheet at 1 January 2002	17.9	(54.0)	(36.1)
Amounts recognised during the year	(14.2)	23.2	9.0
Amounts not recognised during the year	3.7	(30.8)	(27.1)
Amounts arising but not recognised during the year	16.6	(41.3)	(24.7)
Amounts deferred in the balance sheet as at 31 December 2002	20.3	(72.1)	(51.8)
	<i>Gains</i>	<i>Losses</i>	<i>Net gains/ (losses)</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>
Amounts deferred in the balance sheet at 1 January 2001	13.2	(24.7)	(11.5)
Amounts recognised during the year	(7.1)	8.1	1.0
Amounts not recognised during the year	6.1	(16.6)	(10.5)
Amounts arising but not recognised during the year	11.8	(37.4)	(25.6)
Amounts deferred in the balance sheet as at 31 December 2001	17.9	(54.0)	(36.1)

The table below compares the book and fair values of some of the Group's financial instruments by category as at 31 December 2002 and 31 December 2001. Market values have been used to determine fair values where available and, where not, fair values have been calculated by discounting cash flows at the prevailing interest rate.

	<i>Book value 2002 £m</i>	<i>Fair value 2002 £m</i>	<i>Book value 2001 £m</i>	<i>Fair value 2001 £m</i>
Assets/(liabilities)				
On balance sheet instruments				
Liquid assets	1,951.8	1,952.1	1,883.3	1,884.0
Other borrowings	(1,993.3)	(1,993.3)	(1,557.5)	(1,557.5)
Subordinated liabilities	(130.0)	(133.8)	(130.0)	(130.4)
Subscribed capital	(60.0)	(63.0)	(60.0)	(63.9)
Off balance sheet and similar instruments	34.4	(17.4)	20.5	(18.2)

ANNUAL BUSINESS STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

1 STATUTORY PERCENTAGES

	2002	<i>Statutory limit</i>
	%	%
Proportion of business assets other than in the form of loans fully secured on residential property (the lending limit)	4.32	25.00
Proportion of shares and borrowings other than in the form of shares held by individuals (the funding limit)	20.83	50.00

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, the Building Societies Act 1986 and are based on the consolidated balance sheet.

Business assets are the total assets of the Society and its subsidiary undertakings as shown in the balance sheet plus provisions for bad and doubtful debts less liquid assets and tangible and intangible fixed assets.

Loans fully secured on residential property are the amount of principal and interest owing by borrowers. This is the amount shown in the balance sheet before deferred mortgage indemnity income and provisions for bad and doubtful debts plus suspended interest.

The statutory limits ensure that the principal purpose of the building society is that of making loans which are secured on residential property and are funded substantially by its members.

2 OTHER PERCENTAGES

	2002	<i>2001</i>
	%	<i>As restated</i>
	%	%
As a percentage of shares and borrowings		
Gross capital	6.62	7.10
Free capital	5.81	6.28
Liquid assets	20.37	22.64
As a percentage of mean total assets		
Profit after taxation	0.46	0.55
Management expenses	0.82	0.82

The above percentages have been calculated from the Group Accounts.

'Shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

'Gross capital' represents the aggregate of general reserves, subscribed capital and subordinated liabilities.

'Free capital' represents the aggregate of gross capital and general provision for bad and doubtful debts less intangible and tangible fixed assets.

'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

'Mean total assets' is the average of the total assets during the financial year.

'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

3 INFORMATION RELATING TO DIRECTORS AND OFFICERS

Directors as at 31 December 2002

<i>Name</i>	<i>Date of birth</i>	<i>Date of appointment</i>	<i>Occupation</i>
S C Ellen, BSc	15 Dec 1948	19 Nov 2001	Company Director
M P Nicholls, MA, MBA	5 May 1949	1 Dec 2002	Investment banker and lawyer
F A L Robinson	19 Sep 1937	1 Jul 1998	Company Director
D J S Roques, CA	14 Oct 1938	1 Jun 1995	Chartered Accountant & Company Director
* R Sharpe	14 Feb 1949	20 Sep 1994	Chief Executive
* G M Smith, MA, FCA	15 Sep 1952	1 Oct 1999	Group Finance Director
W Tudor John, MA	26 Apr 1944	1 Sep 2001	Lawyer and Managing Director
P M Vaz, OBE, MCIPS	9 Oct 1946	1 Jul 1998	Company Director
A H Westropp	22 Dec 1944	1 May 1989	Company Director
* M P V Wyles, ACII	25 Aug 1958	1 Oct 1999	Group Development Director

**Executive Directors*

Correspondence and other documents may be addressed to any of the Directors, care of KPMG Audit Plc, 1 The Embankment, Neville Street, Leeds, LS1 4DW.

3 INFORMATION RELATING TO DIRECTORS AND OFFICERS (continued)

Service contracts for Executive Directors

Robert Sharpe, Glyn Smith and Matthew Wyles are each employed on service contracts dated 1 October 1999 for a term expiring at the age of 60. The period of notice the Society is required to give in the event of termination is 12 months. The period of notice required from each Executive Director in the event of termination is 6 months.

Directorships as at 31 December 2002

<i>Name</i>	<i>Other directorships</i>
S C Ellen	S T Ellen Consultancy Ltd; West Middlesex University Hospital NHS Trust.
M P Nicholls	Bovis Homes Group plc; City of London Investments Ltd; CNW Nominees Ltd; MACA (The Mental After Care Association); MACA Trading Ltd; Natwest Finance Ltd; Natwest Ventures Investments Ltd; RBDC Administrator Ltd; RBDC General Partner Ltd; RBDC Investments Ltd; RBDC (Ireland) Ltd; RBDC Parallel Nominees Ltd; RBEF Ltd; RBS Investment Ltd; Royal Bank Development Capital Ltd; Royal Bank Development Ltd; Royal Bank Investments Ltd; Royal Bank Project Investments Ltd; Royal Bank Ventures Investments Ltd; Royal Bank Ventures Ltd; Save the Baby (Charity); The City of London European Trust Ltd; The City of London Finance Company Ltd; The City of London Investment Trust plc.
F A L Robinson	Marshall of Cambridge (Holdings) Ltd; New England Company (Charity); RMC Group Plc; St Nicholas' Hospice (Suffolk) (Charity).
D J S Roques	BBA Group Plc; Chubb plc; Premier Farnell Plc; The PPP Foundation.
R Sharpe	Marketing Matters Ltd; Portman Financial Services Ltd; Residential Property Reversions V Ltd; Ridgeway Mortgage Services Ltd; Ridgeway Rentals IV Ltd; Ridgeway Rentals VI Ltd; Sun Bank plc.
G M Smith	Portman Channel Islands Ltd; Residential Property Reversions V Ltd; Ridgeway Mortgage Services Ltd; Ridgeway Rentals IV Ltd; Ridgeway Rentals VI Ltd; Sun Bank plc.
W Tudor John	Lehman Brothers Europe Ltd; Lehman Brothers International (Europe); NFTS Foundation (Charity); Sun Bank plc; Wales In London Ltd.
P M Vaz	Roffey Park Institute Ltd; Tomorrow's People Ltd; UK Sports Institute.
A H Westropp	Abacus Group Plc; Agrivert Ltd; Baxall Ltd; Belvoir Fruit Farms Ltd; Bepton Farms Ltd; Bepton Investments Ltd; Bepton Organic Farms Ltd; Cherry Valley Farms Ltd; Midhurst Whites Ltd; Norbain Ltd; Norbain SD Ltd; The Nickerson Group Rothwell Ltd; Time and Data Systems International Ltd; Upperpoint Distribution Ltd; Upperpoint Manufacturing Ltd.
M P V Wyles	Portman Channel Islands Ltd; Portman Financial Services Ltd; Ridgeway Mortgage Services Ltd; Sun Bank plc.

Officers and their directorships as at 31 December 2002

<i>Name</i>	<i>Directorships</i>	<i>Occupation</i>
S A T Baker	None	Building Society Executive
A R James	None	Building Society Executive
A R Jones	None	Building Society Executive
S J Peters	None	Building Society Executive
J Westhoff	None	Building Society Executive

DIRECTORS' REPORT

The Directors have pleasure in presenting their Report, together with the Annual Accounts and Annual Business Statement of the Society and its subsidiaries (the "Group") for the year ended 31 December, 2002.

The following pages 51 to 54, with the exception of the sentences in italics, contain information which has been reproduced from the Society's 2002 Report & Accounts (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.

Business objective

The Society's business objective is to deliver the demonstrable benefits of mutuality and an excellent service to its members through cost-effective and profitable operations. This has been achieved by maintaining the commitment to remaining a profitable, independent building society and ensuring that the level of growth necessary to remain competitive in the long term is sustained.

Group results for the year

Profits and capital – Group pre-tax profit for the year was £64.1 million. The post-tax profit transferred to general reserves was £44.2 million. Gross capital totalled £640 million at the year end, made up of general reserves of £450 million, subscribed capital of £60 million and subordinated debt of £130 million. The gross capital ratio at 31 December 2002 was 6.6%, and the free capital ratio was 5.8%. The Group solvency ratio at the year end was 13.3%.

Assets – Group assets rose by 15% to £10.4 billion at the year end. Liquid assets amounted to £2.0 billion, representing 20.4% of shares and borrowings, ensuring that sufficient short-term funds are available for an organisation of this size. The funds are placed with a large number of highly rated institutions in order to minimise the credit risk. Liquid assets also include mortgage-backed securities which are held for investment purposes.

Funding – Net share receipts during the year amounted to £637 million (excluding interest credited) and retail investors' balances at 31 December 2002 totalled £7.7 billion, an increase of 13% on the previous year. The Group continued to be active in the wholesale money markets and deposits amounted to £2.0 billion at the year end.

Lending – Gross residential lending for the year was £2.9 billion and net residential lending was £1.5 billion.

Arrears – At the year end, there were 85 mortgages, with balances of £4.6 million, including properties in possession, where payments were twelve or more months in arrears. These arrears amounted to £0.8 million, 0.01% of mortgage balances.

Supplier payment policy

The Portman's policy for the payment of suppliers is as follows:

- At the start of the relationship with the supplier, payment terms will be agreed and will only be changed by agreement;
- Terms of payment are normally within 30 days of the date of the invoice; and
- Suppliers are advised without delay when an invoice is contested and disputes are settled as quickly as possible.

The Society had trade creditors outstanding at the year end representing 28 days of purchases.

Charitable and political donations

During the year, the Portman Group supported over 70 community and charitable events. As a result, £106,000 has been donated and direct support given to the raising of a further £67,000.

No political donations were made during 2002.

Directors

The following persons were Directors of the Society during the year:

D John S Roques, Chairman

Lord Stewartby, Vice-Chairman (retired 30.06.02)

F Alastair L Robinson, Vice-Chairman (from 1.07.02)

Rosemary S Barnes (retired 30.06.02)

Susan C Ellen

Mark P Nicholls (appointed 1.12.02)

Robert Sharpe

Glyn M Smith

William Tudor John

Patricia M Vaz

A Harry Westropp (retired 30.06.03)

Matthew P V Wyles

In accordance with the Society's Rules, John Roques, Robert Sharpe and Glyn Smith are retiring and, being eligible, seek re-election at the Annual General Meeting. Mark Nicholls was appointed during 2002 and will, therefore, stand for election.

None of the Directors or members of their families had any beneficial interest in, or rights to subscribe for, shares in, or debentures of, any connected undertaking of the Society at any time during the financial year.

Regulation

The Society's affairs are regulated by the Financial Services Authority.

Corporate governance

The Society complies with the principles of good governance as set out in the FSA's guidance contained in the Interim Prudential Sourcebook for Building Societies. The Society also has regard to the Combined Code, developed by the Committee on Corporate Governance. A version of the Combined Code, adapted for the particular circumstances of building societies, is contained in the Interim Prudential Sourcebook.

All Directors are Approved Persons and are required to meet the 'fit and proper' criteria laid down by the FSA and to comply with the FSA Principles for Approved Persons and its Code of Practice.

The Board has established Committees to consider certain specialist areas in more detail than would be possible at a Board meeting. Each Committee operates within defined terms of reference. Minutes of meetings are formally recorded and reported to the Board by the respective Committee Chairmen. The Committees and their summary terms of reference are set out below.

Board Committees

Remuneration and Nomination Committee – The Committee consists entirely of Non-Executive Directors. It reviews Board composition and considers nominations for new Board appointments. It also makes recommendations to the Board on remuneration packages and service contracts for Executive Directors and on Directors' fees.

A Report on Directors' Remuneration has been prepared by the Committee.

The Committee also makes decisions on matters of urgency concerning the Society, which would otherwise require a decision by the Board and which cannot, in the opinion of the Committee, await the next monthly meeting of the Board. All such decisions are reported to the Board and ratified at the next Board meeting.

Chairman John Roques
 Alastair Robinson, Vice-Chairman
 William Tudor John

Audit and Compliance Committee – The Committee consists entirely of Non-Executive Directors. It reviews the effectiveness of the Group's systems of internal control and monitors compliance with regulatory requirements and with relevant codes of practice. The Committee approves the annual Internal Audit Plan, which is based on a thorough risk assessment of the full scope of the Group's business activities, and monitors progress against that Plan. The Committee also reviews in detail the Society's Annual Report and Accounts, prior to formal approval by the Board.

Chairman Alastair Robinson, Chairman
 Sue Ellen
 William Tudor John

Assets and Liabilities Committee – The Committee determines treasury and balance sheet risk management strategies, capital requirements and the content of the Society's policy statements concerning liquidity, wholesale funding and structural risk management.

Chairman Robert Sharpe
 Glyn Smith
 Matthew Wyles
 David Stunell, Group Treasurer
 Andrew McQueen, Director of Marketing

Risk Committee – The Committee reviews the effectiveness of the Group's policies and procedures for the identification, assessment, monitoring, control and recording of risks.

Chairman Robert Sharpe
 Glyn Smith
 Matthew Wyles

People

The Portman is fully committed to the continuing development and well-being of its people. During the year, some 9,000 days of training took place, equivalent to 5 1/2 days per person. The Society recognises the importance of effective communication with its people. Such communication includes an active intranet site, in-house publications, conferences and a Chief Executive's Review published 10 times per year and through which all employees have an opportunity to ask about issues affecting them. In addition, the Portman Staff Association continues to be involved in consultative processes across a wide range of matters affecting employees.

The Portman believes fully in equal opportunities. All applicants for roles within the Group are treated solely on their ability to do the job. Should employees become disabled, the Group's policy is to make every effort to allow them either to continue with their current responsibilities or, if this is not possible, to retrain them to take on a role elsewhere within the Group.

Events since the year end

The Directors consider that no events have occurred since the year end to the date of this Report that are likely to have a material effect on the financial position of the Group as disclosed in the Accounts.

Director candidate

On 31 December 2002, a member, supported by more than the required number of qualifying members, put himself forward as a candidate for election as a Director. Members will have the opportunity to vote in the election at this year's Annual General Meeting.


Other resolutions

On 31 December 2002, the Society received three resolutions from members for consideration at the Society's Annual General Meeting. The Board has received independent advice from Leading Counsel that none of the resolutions would have any legal effect and that they should, therefore, be rejected. Members have the right to propose resolutions that would be legally effective, but not otherwise.

Auditors

The Auditors, KPMG Audit Plc, have expressed their willingness to continue in office and, in accordance with Section 77 of the Building Societies Act 1986, a Resolution for their reappointment as Auditors of the Society is to be proposed at the Annual General Meeting.

For and on behalf of the Board

A handwritten signature in black ink that reads "John Roques". The signature is written in a cursive, flowing style.

John Roques
Chairman
30 January 2003

STATEMENT OF DIRECTORS' RESPONSIBILITIES

In respect of the Annual Accounts

The following statement, which should be read in conjunction with the statement of the Auditors' responsibilities on page 56, is made by the Directors to explain their responsibilities in relation to the preparation of the Directors' Report, the Annual Accounts and the Annual Business Statement.

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 the Group as at the end of the financial year; and
- the income and expenditure of the Society and the Group for the financial year.

In preparing those Accounts, the Directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are responsible and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Accounts; and
- prepare the Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

In addition to the Accounts, the Act requires the Directors to prepare, for each financial year, a Directors' Report and an Annual Business Statement, each containing prescribed information relating to the business of the Society and its connected undertakings.

In respect of accounting records and internal control

The Directors are responsible for ensuring that the Group:

- keeps accounting records in accordance with the Act; and
- takes 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 Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Going concern

The Directors are satisfied that the Group 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.

AUDITORS' REPORT

The following is the text of the Auditors' Report to the members of Portman Building Society with references therein to page numbers amended to accord to the page numbering used in this document.

Independent Auditors' Report to the Members of Portman Building Society

We have audited the Annual Accounts on pages 28 to 48. 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 on pages 49 to 50 and pages 51 to 54 respectively.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Directors' Report, the Annual Business Statement and, as described on page 55, the Annual Accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the Annual Accounts give a true and fair view and are properly prepared in accordance with the Building Societies Act 1986 and regulations made under it. We also report to you our opinion as to whether certain information in the Annual Business Statement gives a true representation of the matters in respect of which it is given, whether the information in the Directors' Report is consistent with the accounting records and the Annual Accounts and whether the Annual Accounts, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

We also report to you if, in our opinion, the Annual Accounts are not in agreement with the accounting records or if we have not received all the information or explanations that we require for our audit.

We read the other information accompanying the Annual Accounts, the Annual Business Statement and the Directors' Report and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Annual Accounts, Annual Business Statement and Directors' Report.

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 and the Annual Business Statement. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Annual Accounts, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the Annual Accounts give a true and fair view of the state of affairs of the Society and of the Group as at 31 December 2002 and of the income and expenditure of the Society and of the Group for the year then ended;
- 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;
- the information given in the Directors' Report is consistent with the accounting records and the Annual Accounts; and
- the Annual Accounts, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of Part VIII of the Building Societies Act 1986 and regulations made under it.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds

30 January 2003

INTERIM RESULTS **for the six months ended 30 June 2003**

The following is the full text of the unaudited interim results for the six months ended 30 June 2003:

"Review

The first six months of 2003 have been very successful for the Society and its members:

- Total assets now exceed £11 billion, up 20% in the past year;
- Pre-tax profit up 6% to £33 million;
- Gross mortgage lending of £1.5 billion was 8% up on the record levels of first half 2002;
- Net residential mortgage lending and net retail inflows both substantially ahead of the Group's natural market share;
- Our market leading ISA range attracted £226 million of deposits from savers;
- Underlying profits from the Society's Sun Bank subsidiary increased by 18%, the benefits of which continue to flow to members primarily through highly competitive products, and;
- Despite further strong growth in lending, the arrears experience of the Group has shown no deterioration; indeed, balances in arrears have fallen by 9% since the year end.

In addition to these achievements, the Society's ongoing programme of member research and face-to-face communication ensures that we continue to listen to our members and improve our products and services better to meet their needs.

Business Volumes

Savings balances increased to almost £8 billion as further market leading products and member only offers proved very attractive to savers. The Members' Tracker Bond, exclusive to the Society's members, was extremely popular, attracting over £90 million of balances, whilst our market leading 30 Day Notice ISA generated balances in excess of £108 million. The new Bonus Extra Notice Account, launched on 19 June, has attracted over £46 million in just 12 days.

Portman Channel Islands, the Society's offshore subsidiary, also achieved an impressive performance in an intensely competitive environment, with deposits increasing by 20% in the first 6 months.

Ongoing coverage in best buy tables, clearly demonstrates the attractiveness of the Group's mortgage offering in the market. This is reflected by the Group's achievements in attracting new business, with gross new residential mortgage lending of £1.5 billion substantially ahead of the Group's natural market share. In a market where remortgaging has reached 50% of new lending activity, retaining existing borrowers is clearly a challenge. The fact that the Group has achieved a market share in net lending of some 50% above its natural level shows that borrowers are not leaving the Group in anything like the volumes experienced by many other lenders. This is further testimony to the Society's focus on delivering consistently good value over time.

Financial Performance

The Society continues to generate profit growth to support its capital ratios. Pre-tax profit increased by 6% to £33 million compared with the same period in 2002. The solvency ratio continues to be strong at 12.8%.

At the end of 2002, the Society announced its decision to transfer the business operations of Sun Bank from Stevenage to Bournemouth in order to achieve operational efficiencies in handling the levels of business growth being experienced. The first phase of this has been completed and this, combined with other investments in efficiency made during 2002, meant that the management expenses ratio reduced to 0.76%.

The outlook for the next six months

The second half of the year will present further challenges for both the Group and the industry as a whole. Clear evidence has emerged during the first half of the year that the predicted slowdown in the housing market has started. Encouragingly, this evidence does appear to show that it is a slowdown and not the type of hard landing that has followed high growth cycles in the past. However, there is a possibility that, should remortgage activity fall away, volumes of new lending in the sector as a whole may reduce.

The Society was very pleased to announce, on 24 June, a proposed merger with Staffordshire Building Society. Whilst it is not anticipated that the merger will be finalised until the year end, the Group will be very well positioned to take advantage of the enhanced distribution and some economies of scale which the enlarged group will offer.

Group Income and Expenditure Accounts

	<i>6 months ended 30 June 2003 £m</i>	<i>6 months ended 30 June 2002 £m</i>	<i>Year ended 31 December 2002 £m</i>
Net interest receivable	59.0	50.3	108.2
Other income and charges	16.4	18.7	36.7
Total income	75.4	69.0	144.9
Administrative expenses	(41.2)	(37.9)	(79.2)
Operating profit before provisions	34.2	31.1	65.7
Provisions for bad and doubtful debts	(1.2)	0.1	(1.6)
Profit before tax	33.0	31.2	64.1
Taxation	(10.2)	(9.9)	(19.9)
Profit after tax	22.8	21.3	44.2
 Financial ratios	 %	 %	 %
Profit after tax as % of mean total assets	0.42	0.47	0.46
Management expenses as % of mean total assets	0.76	0.83	0.82

Group Balance Sheets

	<i>As at 30 June 2003 £m</i>	<i>As at 30 June 2002 £m</i>	<i>As at 31 December 2002 £m</i>
Assets			
Liquid assets	2,175	1,818	1,971
Loans to customers – residential mortgages	8,665	7,133	7,934
– other	282	331	303
Fixed and other assets	143	142	165
Total assets	11,265	9,424	10,373
Liabilities and reserves			
Shares	7,935	7,118	7,660
Borrowings	2,620	1,636	2,013
Other liabilities	47	53	60
Subordinated debt	130	130	130
Subscribed capital	60	60	60
Reserves	473	427	450
Total liabilities and reserves	11,265	9,424	10,373
Movements			
Gross residential lending	1,486	1,375	2,913
Net increase in residential mortgages	731	656	1,456
Net increase in share balances	275	319	861
Financial ratios			
	%	%	%
Liquid assets	20.6	20.8	20.4
Gross capital	6.3	7.0	6.6
Solvency	12.8	14.0	13.3
Tier 1 capital	9.9	10.6	10.2

Consolidated Cash Flow Statements

	<i>6 months ended 30 June 2003 £m</i>	<i>6 months ended 30 June 2002 £m</i>	<i>Year ended 31 December 2002 £m</i>
Net cash inflow from operating activities	266.8	229.4	507.2
Returns on investments and servicing of finance	(3.8)	(3.9)	(12.9)
Taxation	(7.9)	(12.5)	(19.3)
Net financial investment	(248.2)	(199.3)	(454.1)
Net capital investment	(4.9)	(9.1)	(18.7)
Increase in cash	2.0	4.6	2.2

Notes to the Financial Information

- 1 The interim financial information, which has not been audited, was approved by the Board of Directors on 29 July 2003 and does not constitute accounts within the meaning of the Building Societies Act 1986.
- 2 The interim financial information has been prepared on the basis of the group accounting policies set out in the Annual Accounts to 31 December 2002.
- 3 Reconciliation of profit before tax to net cash inflow from operating activities:

	6 months ended 30 June 2003 £m	6 months ended 30 June 2002 £m	Year ended 31 December 2002 £m
Profit on ordinary activities before tax	33.0	31.2	64.1
Depreciation and amortisation	4.7	3.9	8.5
Net (increase)/decrease in:			
Loans and advances to customers	(711.2)	(444.1)	(1,221.3)
Loans and advances to credit institutions	38.5	284.4	388.0
Net increase in:			
Shares (excluding accrued interest)	340.8	413.5	874.2
Owed to credit institutions and other customers	472.1	60.5	50.0
Debt securities in issue	143.8	0.1	385.8
Other	(54.9)	(120.1)	(42.1)
Net cash inflow from operating activities	266.8	229.4	507.2
Analysis of cash balances included in the balance sheet:	30 June 2003 £m	Flows £m	31 December 2002 £m
Cash in hand and balances with Bank of England	9.4	1.0	8.4
Loans and advances to credit institutions repayable on demand	11.2	1.0	10.2
	20.6	2.0	18.6

- 4 The financial information for the year ended 31 December 2002 has been extracted from the Annual Accounts for that year, which have been filed with the Financial Services Authority and on which the auditors gave an unqualified opinion."

USE OF PROCEEDS

As described on page 21 of this document, the net proceeds of the issue of the PIBS (estimated to be approximately £123,235,000) will be used by the Society to strengthen its capital base. It is intended that the discounted proceeds of the PIBS (£124,797,500) will be treated for capital adequacy purposes as Tier 1 capital.

RECENT BUSINESS PERFORMANCE

Since 30 June 2003, the business of the Group has continued broadly in line with the performance for the six months ended 30 June 2003 as detailed in "Interim Results" on page 57.

The Directors are cautiously optimistic with respect to the financial and trading prospects of the Group for the remainder of the current financial year.

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.
- 2 Persons in the United Kingdom paying interest to or receiving interest on behalf of another person 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 then on making a payment of interest an amount will be withheld by the Society on account of United Kingdom tax at the lower rate (currently 20 per cent.) unless the Society reasonably believes that the person beneficially entitled to the interest is within the charge to United Kingdom corporation tax in respect of such interest and the Inland Revenue has not issued a direction that the payment be made subject to such withholding. Certain classes of taxpayer (such as tax exempt investors and individuals whose taxable income is below their personal allowance) may be able to reclaim all or part of any tax deducted. PIBS holders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted pursuant to the provisions of an applicable double taxation convention and may be able to make an individual claim to the relevant tax authorities for payment of interest gross.
- 4 Regardless of whether interest is received net of a lower rate income tax deduction or not, PIBS holders who are companies resident in the United Kingdom or who carry on a trade, in the United Kingdom through a United Kingdom branch or agency (in respect of accounting periods commencing prior to 1 January 2003) or through a permanent establishment (in respect of accounting periods commencing on or after 1 January 2003) with which the holding of the PIBS is connected may, depending on the circumstances, be liable to pay United Kingdom tax on the interest received.
- 5 The Society is required each year to supply to the Inland Revenue particulars of all interest paid or credited in relation to the PIBS.

Corporation Tax Payers

- 6 PIBS holders who are subject to United Kingdom corporation tax will be charged to tax on income arising on the PIBS under the "loan relationships" regime in the Finance Act 1996, broadly in accordance with their accounting treatment.
- 7 In respect of accounting periods commencing prior to 1 October 2002, the PIBS are not generally assets within the loan relationships regime (and are "qualifying corporate bonds" for the purposes of corporation tax) and therefore on any disposal of the PIBS by a holder subject to corporation tax, no taxable gain or allowable loss will be realised for the purposes of corporation tax on chargeable gains depending upon that holder's particular circumstances.
- 8 In respect of accounting periods commencing on or after 1 October 2002, PIBS are now generally treated as loan relationships for UK corporation tax purposes. Thus, PIBS holders within the charge to United Kingdom corporation tax will be subject to tax as income on all profits and gains arising from, and from fluctuations in the value of, the PIBS broadly in accordance with their statutory accounting treatment.

Stamp Duty

- 9 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.

Withholding Tax: European Union Directive on the Taxation of Savings Income

The European Union has adopted proposals for a new directive (the "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 1 January 2005 to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in that other Member State, subject to the right of certain Member States to opt instead for a withholding system for a transitional period in relation to such payments.

The Finance Act 2003 includes provisions to enable HM Treasury to make regulations for a scheme to collect information about overseas residents receiving savings income, which will enable the implementation of the Directive. The Inland Revenue is currently consulting upon the scope of any such regulations, including whether the regulations should apply in respect of interest paid on permanent interest bearing shares. The regulations are required to be in place by 1 January 2004 although the Directive will not be effective before 1 January 2005.

MARKETING ARRANGEMENTS

The Manager has, pursuant to a subscription agreement dated 17 October 2003 (the "Subscription Agreement"), agreed with the Society, subject to the satisfaction of certain conditions (including, without limitation, the admission of the PIBS to the Official List becoming effective by not later than 22 October 2003 or such later date as the Society and the Manager may agree), to subscribe for, or procure subscribers for, the PIBS at the issue price of 99.838 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 which amounts to £1,562,500 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 as widely as possible. 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 Manager will not directly market the PIBS to the public.

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 may not be offered or sold within the United States or to United States persons otherwise than in accordance with applicable United States securities laws and regulations. The Manager has agreed that it will not offer or sell a PIBS within the United States or to United States persons otherwise than in accordance with applicable United States securities laws and regulations.

In addition, until 40 days after the commencement of the offering, 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 that (1) it has not offered or sold and will not offer or sell any PIBS to persons in the United Kingdom prior to admission of the PIBS to listing in accordance with Part VI of FSMA 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) or FSMA, (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) 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.

Save for having obtained approval of this document by the UK Listing Authority pursuant to listing rules made under Part VI of FSMA and having delivered copies thereof to the Registrar of Companies in England and Wales, no action has been or will be taken by the Society or the Manager that would 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

Significant change

There has been no significant change in the financial or trading position of the Society or of the Group, save for the proposed merger with Staffordshire Building Society described on pages 21, 65 and 66 of this document since 30 June 2003, being the date to which the latest unaudited interim financial information of the Society has been prepared.

Litigation

Neither the Society nor any of its subsidiary undertakings is or has been involved in any legal or arbitration proceedings and the Society is not aware of any pending or threatened legal or arbitration proceedings which, in either case, may have, or have had during the past twelve months, a significant effect on the financial position of the Society and its subsidiary undertakings taken as a whole.

Auditors

The consolidated accounts of the Society for the three years ended 31 December 2002 have been audited in accordance with United Kingdom auditing standards by KPMG Audit Plc (Chartered Accountants) and have been reported upon without qualification. KPMG Audit Plc has given and has not withdrawn its written consent to the issue of this document with the inclusion herein of its audit report and the references to its name and report in the form and context in which they are included, having also authorised the contents of its report for the purposes of Regulation 6(1)(e) of the Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001.

Authorisation

The issue of the PIBS was authorised by resolutions of the assets and liabilities committee on 29 September 2003 and 30 September 2003 and, in respect of certain resolutions, by the Chairman's Committee of the Board on 23 September 2003 which committees were, by a resolution of the Board duly passed on 29 July 2003, empowered to deal with matters relating to the issue of the PIBS.

Expenses

The overall cost of the issue of the PIBS by the Society, including all commissions and expenses, is estimated to amount to approximately £1,750,000 (exclusive of VAT).

Material contracts

Members of the Group have entered into the following contracts (other than in the ordinary course of business) either within the two years immediately preceding the date of this document and which are material or at any earlier time and which contain any provision under which any member of the Group has any obligation or entitlement which is material to the Group at the date of this document:

- (i) An agreement dated 22 January 2002 between Sun Bank plc ("Sun Bank"), a wholly owned subsidiary of the Society, and ING Lease (UK) Twelve Limited ("ING"), pursuant to which ING agreed to purchase Sun Bank's asset finance portfolio for a cash consideration of £66.5 million, being a sum equal to the monies outstanding, including accrued interest, in respect of the credit agreements transferred pursuant to the agreement, plus a premium of £15,000. The agreement contains warranties and indemnities usual for a transaction of this type;
- (ii) A mortgage sale agreement dated 8 February 2002, between Sun Bank and First National Bank plc ("First National") pursuant to which Sun Bank sold, and procured that Exeter Trust Limited ("Exeter Trust") sold, to First National the mortgage portfolios of Sun Bank and Exeter Trust for a consideration of approximately £137 million being a sum equal to the par value of loans transferred pursuant to the agreement and an amount equal to a premium of 1.685% of such par value. The agreement contains warranties and indemnities usual for a transaction of this type;
- (iii) An instrument of transfer of engagements ("Instrument") between Staffordshire Building Society ("Staffordshire") and the Society dated 22 July 2003 pursuant to which Staffordshire has agreed to transfer its undertakings to the Society. The transfer is subject to the approval of the FSA. The

merger bonuses to be paid to qualifying shareholding and borrowing members of Staffordshire pursuant to the Instrument will not exceed £65 million, payable out of the reserves of Staffordshire;

- (iv) The Subscription Agreement dated 17 October 2003 between the Manager and the Society, and described under "Marketing Arrangements" on page 64 of this document; and
- (v) The Society will enter into a Receiving Bank Agreement to be dated on or about 22 October 2003 (pursuant to the terms of a Registrar's Agreement dated 4 December 2001) with Lloyds TSB Registrars (the "Registrar") pursuant to which the Registrar will be appointed as registrar for the issue. Under these agreements, the Registrar shall provide a securities registration service in respect of the issue. The Society will agree to indemnify the Registrar against certain liabilities in connection with the issue of the PIBS. These agreements will be terminable by either party giving at least six months written notice to the other.

Registrar

The Society has appointed Lloyds TSB Registrars at its specified office at The Causeway, Worthing, West Sussex, BN99 6DA to maintain the PIBS Register at such specified office. It is intended that the Registrar will act as agent of the Society for the purposes of maintaining the PIBS Register, accepting instructions for, and effecting, transfers of PIBS, issuing PIBS Certificates to new PIBS holders, receiving requests for the replacement of, and replacing, defaced, damaged, stolen, worn-out, lost or destroyed PIBS Certificates and making payments in respect of the PIBS as they fall due.

PIBS Certificates

No temporary documents of title shall be issued by the Society in respect of the PIBS. The Registrar will, from 22 October 2003, 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 ISIN for the PIBS is GB0033627968 and the SEDOL number is 3362796. PIBS will be held and transferred through the CREST System operated by CREST Co Limited.

Payment for the PIBS

Payment for the PIBS subscribed for by the Manager or by persons procured by the Manager will be made by telegraphic transfer (or other approved means) to the account nominated by the Society in accordance with the Subscription Agreement.

Subsidiary undertakings

Details of the subsidiary undertakings of the Society are set out on page 41 of this document. The registered office of each subsidiary undertaking is the same as the Society's Principal Office, save for Portman Channel Islands Ltd. whose registered office is at 2 Grange Place, The Grange, St Peter Port, Guernsey GY1 2PX and for Confederation Mortgage Services Limited, Exeter Trust Financial Services Limited, Exeter Trust Limited, Primett Property Management Limited and Sun Bank plc, the registered office is at The Icon, Lytton Way, Stevenage, Hertfordshire SG1 12G.

Changes in Capital

During the three years preceding the date of this document, the Society has made the following capital issues:

Date	Borrowing
9 October 2001	£75 million Subordinated Notes Capital due 2016
5 December 2001	£60 million Permanent Interest Bearing Shares

Documents for inspection

Copies of the following documents may be inspected at the offices of Addleshaw Goddard at 25 Cannon Street, London EC4M 5TB during normal business hours on any weekday (Saturdays and public holidays excepted) during the period of 14 days from the date of this document:

- (i) the Rules and the Memorandum;
- (ii) the published audited consolidated accounts of the Society for each of the years ended 31 December 2001 and 2002 and the unaudited consolidated interim accounts of the Society for the six months period ended 30 June 2003;
- (iii) a draft (subject to modification) of a PIBS Certificate (including the special conditions of issue of the PIBS);
- (iv) the Directors' service agreements referred to above;
- (v) the consent of KPMG Audit Plc referred to above;
- (vi) the material contracts referred to above; and
- (vii) the report by KPMG Audit Plc on the Annual Accounts of the Society and of the Group as at 31 December 2002.

PRINCIPAL OFFICE OF THE SOCIETY

Portman Building Society

Portman House
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REGISTRAR

Lloyds TSB Registrars

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PORTMAN