



1 December 2001

Compromise offer – Recommendation from your Board

Dear Policyholder,

Your heart must have sunk when you saw this huge envelope containing our final compromise scheme. We apologise for the documents' size and complexity but they are necessary to give you all of the relevant information to make this important decision. Rightly the Court and our regulators insist on nothing less.

Your Society is at a crossroads. If you and your fellow policyholders vote for the compromise scheme then we have a positive way forward. Without a compromise the future for all of us is very bleak. The decision is as stark as that. This is why your new Board is unanimous in recommending that you vote 'yes' to the compromise scheme.

With this letter you will find the following:

- A guide on completing your Form(s) of Proxy
- A booklet entitled 'Your questions answered'
- The full compromise scheme details, contained in the Scheme Circular
- Interim Accounts for the half-year ended 30 June 2001
- A white envelope containing:
 - An indicative statement of voting value
 - Form(s) of Proxy
 - A pre-paid reply envelope
 - Admission card(s) for the class meetings

The way forward

During the consultation period, over 40,000 policyholders gave us their views on the draft compromise proposals. They show strong support for them. Consequently we have not changed the uplift in policy values for GARs and non-GARs. However some technical changes have been made and are detailed in the Scheme Circular.

The compromise scheme has been reviewed by the Independent Actuary, Michael Arnold, for fairness to all categories of policyholders from an actuarial perspective. You will find a summary of his report in the Scheme Circular.

The scheme will tackle the Society's main sources of uncertainty: the uncertain cost of GARs in the future and the threat of a mass of individual GAR-related legal claims by policyholders. These competing legal claims – relating to GARs – could mean we would be in Court for years. No one can want that.

The importance of your vote

Your vote is vital. To achieve the compromise, in each class we need a majority of GARs and non-GARs to vote in favour of the compromise and those majorities must represent at least 75% by value. The responses from policyholders show a clear majority in favour of the compromise. But unless they vote then there is the very real risk that the 75% majority will not be achieved and the compromise will fail.

The Society's financial position

Interim Accounts for the half year ended 30 June are enclosed and are the first ever published by your Society. They provide you with financial information relevant to your voting decision. In the time available it has not been possible to produce third quarter interim accounts, but we should draw to your attention the financial impact on your Society during the third quarter of policyholder claims and the aftermath of September's terrorist attacks in America which saw interest rates and stock markets fall.

Your Society is and remains solvent. This has in part been achieved by reducing our investments in the stock market and increasing holdings in lower-risk investments. At 30 June, some 48% of the with-profits fund was invested in the stock market. At 30 September that had reduced to 35%.

Since 30 June we have experienced an increase in policyholder maturities and surrenders as a result of the painful but necessary reductions in policy values. In the three months to 30 September these claims were £1.7 billion, though the rate of new claims has fallen since then. At 30 September, the with-profits fund was estimated to stand at £20.1 billion as against £22.8 billion at 30 June 2001. This reduction was due to the claims and the decline in stock market values over the quarter exacerbated by the 11 September attacks.

At the end of September the Fund for Future Appropriations (which is available to pay bonuses) had fallen to an estimated £300m, but the total policy value for all with-profit policies compared to the value of the with-profits fund was within the 5% bounds set by the Appointed Actuary for the financial management of the Society.

The low level of free assets makes your Society financially unstable and vulnerable to market risks.

Your Board believes that adopting the compromise scheme is essential to make the Society more stable and place it on a stronger financial footing.

The benefits of compromise for policyholders

The adoption of the compromise scheme will see your current policy value increased in exchange for you giving up some of your rights. An indication of the uplifts are in your indicative statements of value, contained in your Voting Documents.

The successful completion of the compromise agreement by 1 March 2002 sees the Halifax £250 million used to uplift your policy funds. We believe that the compromise is still preferable to continuing as we are, even if this deadline is missed and uplifts are lower.

The compromise scheme will reduce uncertainty and worry for all policyholders and means we can invest the with-profits fund without the current abnormal constraints. The resulting improved financial position of the Society should ultimately lead to a less constrained bonus policy.

A successful compromise will not stop us from pursuing those who caused the Society's problems, if that is in policyholders' interest. However, any compensation is years away. We cannot wait – we must solve the Society's problems now.

The dangers of no compromise

We have examined all the alternatives to a compromise. Either they do not work or would greatly reduce the value of your policy.

Liquidation would be very bad. All non-guaranteed bonuses could be lost. There is a risk that guaranteed benefits could be scaled back. Annuity payments including GAR pensions would be suspended and the competing claims of GARs and non-GARs might well delay payments for years.

No compromise means we do not gain the Halifax £250 million.

Without a compromise the Society would have to maintain a very restrictive investment policy, investing much less in stocks and shares. Bonus policy would need to be very cautious; payments might not include any non-guaranteed bonuses. A bleak outlook for policyholders.

The Government is clear that there will be no lifeboat for us and compensation for policyholders, if any arises, is years away. We cannot afford to wait. We must sort out our own problems now.

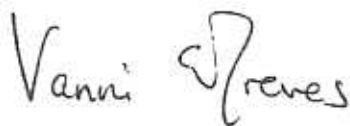
Finally, without a compromise the instability, uncertainty and worry will continue, and may well get worse for everyone, whatever their policy, whatever their age. We have listened to and read the views of many policyholders and know that this is rightly unacceptable to the vast majority.

How to vote

We have high voting hurdles to overcome, so it is very important that you vote. We enclose a guide to assist completion of the voting forms (called Forms of Proxy - you will find these in your voting pack). Your votes will be counted at the policyholder class meetings to be held on Friday 11 January. You do not need to attend as you can vote by proxy. You can vote at any time from now on but please make sure your Forms of Proxy are posted to arrive by the relevant time on Wednesday 9 January using the pre-paid envelope provided.

This has been a very difficult time for all policyholders. We appreciate your patience and loyalty. Now we all have the chance to move ahead. Your Board is unanimous in believing that the compromise scheme is the only fair, realistic and positive way forward for policyholders and the Society. We urge you to vote for it.

Yours sincerely,



Vanni Treves
Chairman



Charles Thomson
Chief Executive