



REGULATORY NEWS ANNOUNCEMENT

2 DECEMBER 2009

PROPOSED MERGER OF YORKSHIRE & CHELSEA BUILDING SOCIETIES: CAPITAL EXCHANGE

Background

The Boards of Yorkshire Building Society and Chelsea Building Society have announced today that they intend to merge, creating a major new force in the mutual sector. Details of the merger are covered in a separate RNS announcement.

Summary

A strengthening of Chelsea's capital position is required as part of the agreed merger process. Following discussions with Chelsea's subordinated debt holders, agreement has been reached to exchange the full outstanding principal amount of Chelsea's subordinated debt for new notes to be issued by the Yorkshire on completion of the merger (the "Capital Exchange").

Under the Capital Exchange, the notes to be issued by the Yorkshire form a new type of capital instrument for building societies called convertible notes (the "Convertible Notes").

The Convertible Notes will carry a fixed coupon and rank as subordinated interests in the Yorkshire, but would convert into profit participating deferred shares (the "PPDS"), which are equity equivalent instruments, should the Yorkshire's core tier 1 capital ratio fall below 5%.

The Yorkshire intends to apply for listing of the Convertible Notes on a recognised stock exchange as soon as reasonably practicable following the Capital Exchange but in any event prior to the first payment of interest on the Convertible Notes.

The Capital Exchange will have the effect of strengthening the enlarged Society's core tier 1 capital position on completion of the merger and will also provide it with additional core tier 1 capital should the trigger level for the conversion of the Convertible Notes be reached at any stage prior to their maturity date.

Terms

The details of the proposed Capital Exchange are summarised below:

- £200m of subordinated notes issued by Chelsea will be exchanged for £100m of Convertible Notes issued by the Yorkshire on completion of the merger (which is expected on 1 April 2010);

- Chelsea’s subordinated notes consist of two series of notes: £100m 6.25% notes maturing 2017 (the “2017 notes”) and £100m 5.875% notes maturing 2019 (the “2019 notes”);
- The Convertible Notes will be classified as lower tier 2 capital and rank *pari passu* with the Yorkshire’s existing subordinated debt;
- The Convertible Notes will pay a fixed interest coupon of 13.5% per annum (payable semi-annually in equal instalments) and have a fifteen year maturity;
- The Convertible Notes will convert in full into PPDS in the Yorkshire if the Yorkshire’s core tier 1 capital ratio falls below 5% (however, this would require a reduction in the core tier 1 capital ratio of the enlarged Society of more than 50% or post-tax losses of greater than £645m, in addition to fair value adjustments - see “Financial Impact” below); and
- In the event of conversion, the PPDS will (under current rules) qualify as core tier 1 capital of the Yorkshire and be eligible for a dividend payment based on a percentage of the Yorkshire’s annual post-tax profits, any such dividend to be distributed at the sole discretion of the Yorkshire’s board of directors.

The Capital Exchange is subject to the passing of certain resolutions at Chelsea noteholder meetings to be held as soon as practicable after the date of this announcement. Noteholders representing over 75% by value of both the 2017 notes and the 2019 notes have irrevocably undertaken to approve the Capital Exchange at these noteholder meetings, the Capital Exchange being subject to the condition that the merger closes on or before 1 June 2010. This level of approval is sufficient to effect the Capital Exchange in full.

Financial Impact

As at 31 October 2009, the Yorkshire and Chelsea had core tier 1 capital ratios of 12.3% and 9.1% respectively. On completion of the merger, the Yorkshire is required by accounting standards to make appropriate fair value adjustments to Chelsea’s balance sheet, in particular to reflect any future losses which may arise from Chelsea’s existing loans. These fair value adjustments are estimated at over £200m post-tax.

On a pro-forma basis and after taking account of the Capital Exchange and fair value adjustments, the enlarged Society’s core tier 1 capital ratio as at 31 October 2009 would be 10.2%.

The fair value adjustments made with respect to Chelsea’s mortgage book protect the future profitability of the enlarged Society from further losses on Chelsea’s mortgage book to the same degree. As such, while the enlarged Society’s capital position is initially reduced by the fair value adjustments, the capital position is robust and future earnings generation is improved.

At a core tier 1 capital ratio of 10.2%, the enlarged Society would have one of the strongest capital positions of any major UK bank or building society.

RBS Corporate Finance Limited acted as financial adviser to the Yorkshire in relation to the merger and Capital Exchange. Lexicon Partners acted as financial adviser to Chelsea in relation to the merger and Capital Exchange.

For more information contact:

Yorkshire Building Society:

Andy Caton

Tel: 07881 518703

RBS Corporate Finance Limited (financial adviser to the Yorkshire):

Ed Jennings, Guy Miller and
Cuneyt Ates

Tel: 020 7085 5000

Chelsea Building Society:

Vicki O'Connell

Tel: 01242 271466

Lexicon Partners (financial adviser to Chelsea):

Ollie Clayton, Matthew Lindsey-Clark and
Graham Copeland

Tel: 020 7653 6000

Notes:

A summary of the terms of the PPDS, if issued, is set out below:

- The PPDS would be deferred shares for the purposes of Section 119 of the Building Societies Act 1986, as amended;
- The PPDS would be perpetual instruments with no maturity date or right to repayment other than on a winding-up;
- In the event of a winding-up, the PPDS would rank *pari passu* with the claims in respect of the Yorkshire's existing Permanent Interest Bearing Shares ("PIBS");
- Save as described below, the holders of the PPDS would be entitled to receive a dividend, at the discretion of the Board of the Yorkshire, based upon the annual consolidated post-tax profits of the Yorkshire (calculated prior to payment of the PPDS dividend and subject to certain other adjustments);
- The maximum participation percentage of profits for which the PPDS holders would be eligible would be equivalent to the greater of (i) that proportion of the Yorkshire's core tier 1 capital which the PPDS represent immediately after conversion, and (ii) 10% (the "Participation Percentage");
- The PPDS would also absorb the Participation Percentage of any consolidated post-tax losses recorded by the Yorkshire, any such amount being debited to a reserve account maintained by the Yorkshire for the purpose of the PPDS (the "PPDS Reserve Account"). Any net profits which are eligible to be paid to holders of PPDS but are not so paid will be credited to the PPDS Reserve Account;
- No dividends may be paid on the PPDS in years where the Yorkshire incurs consolidated post-tax losses or where the PPDS Reserve Account is in deficit;
- Dividends on the PPDS are non-cumulative; and
- The PPDS would not be protected deposits for the purposes of the Financial Services Compensation Scheme.

This announcement, including information included or incorporated by reference in this announcement, may contain "forward-looking statements" concerning the Yorkshire or Chelsea. Generally, the words "will", "may", "should", "could", "would", "can", "continue", "opportunity", "believes", "expects", "intends", "anticipates", "estimates" or similar expressions identify forward-looking statements. The forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. Many of these risks and uncertainties relate to factors that are beyond the Yorkshire's or Chelsea's abilities to control or estimate precisely, such as future market conditions and the behaviours of other market participants, and therefore undue reliance should not be placed on such statements. The Yorkshire and Chelsea assume no obligation and do not intend to update these forward-looking statements, except as required pursuant to applicable law.

RBS Corporate Finance Limited, which is authorised and regulated in the United Kingdom by the Financial Services Authority, is acting exclusively for Yorkshire Building Society and no-one else in connection with the merger and Capital Exchange and will not be responsible to anyone other than Yorkshire Building Society for providing the protections afforded to customers of RBS Corporate Finance Limited or for providing advice in relation to the merger and Capital Exchange or in relation to the contents of this announcement or any transaction or arrangement referred to herein.

Lexicon Partners, which is authorised and regulated in the United Kingdom by the Financial Services Authority, is acting exclusively for Chelsea Building Society and no-one else in connection with the merger and Capital Exchange and will not be responsible to anyone other than Chelsea Building Society for providing the protections afforded to customers of Lexicon Partners or for providing advice in relation to the merger and Capital Exchange or in relation to the contents of this announcement or any transaction or arrangement referred to herein.

This announcement is only being distributed to and is only directed at (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order"); or (ii) to high net worth entities and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a) of the Order; or (iii) persons falling with Article 43(2) of the Order (all such persons in (i), (ii) and (iii) above together being referred to as "relevant persons"). Any investment or investment activity to which this announcement relates is available only to relevant persons and will be engaged in only with relevant persons. This announcement must not be acted on or relied on by persons who are not relevant persons.

This announcement is not for distribution, directly or indirectly, in or into the United States (including its territories and possessions, any state of the United States and the District of Columbia). This announcement does not constitute or form a part of any offer or solicitation to purchase or subscribe for securities in the United States. The capital exchange mentioned herein has not been, and will not be, registered under the U.S. Securities Act of 1933 (the "Securities Act").

The capital exchange may not be made in the United States or to, or for the account or benefit of, U.S persons (as such term is defined in Regulation S under the Securities Act) except pursuant to an exemption from the registration requirements of the Securities Act. There will be no public offer of securities in the United States.